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Horizons of Law in Business and Finance

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Petr Tomciak

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Petr Tomciak is a Ph.D. Candidate at the Department of Business and European Law, Faculty of International Relations, Prague University of Economics and Business (VŠE), Czech Republic. He obtained his master's degree at the Charles University Law School, Prague, Czech Republic. Moreover, he also graduated from master's programme in international business at Prague University of Economics and Business. Besides his academic activities, he experienced working in both private and public sector. He served as Ministerial Counsellor at Ministry of Finance of the Czech Republic during the Presidency of the Czech Republic in the Council of the EU. He works as the Economic and Financial Counsellor at the Permanent Delegation of the Czech Republic to the Organization of Economic Cooperation and Development (OECD) in Paris. He is a member of Czech European Law Society (ČESP). Petr Tomciak was selected in the academic excellency programme at the Faculty of International Relations, Prague University of Economics and Business in two consecutive years. He publishes in international peer-reviewed journals.

Publications
Despite his junior experience in academia Petr Tomciak has already published numerous research publications notably focused on the EU economic law, international economic law and financial markets regulation. His master thesis was awarded by a national price of talented students *(Cena Josefa a Marie Hlávkových*). Recently, he co-authored a chapter in a monograph Changes in private law in the time of Covid-19 *(*Škrabka J. et all.: *Proměny soukromého práva v době Covid-19*, C.H. Beck, Prague, 2023). He published a single-authored paper indexed in Web of Science (WoS) and two co-authored papers indexed in Scopus. He attended numerous international conferences and actively participate in papers peer-review. He participated in a research project for the Office of the Government of the Czech Republic (TAČR MT10).

Study visits
During his undergraduate and graduate studies, Petr Tomciak spent one semester at Erasmus+ programme at the Norwegian School of Economics (Norway), one exchange semester at Konkuk University (South Korea) and one-year Erasmus+ LL.M. programme at Tilburg Law School (Netherlands). As part of his graduate studies, he also participated in the Marten's Summer School of International law at University of Tartu (Estonia) and completed a traineeship at the European Parliament (Belgium). During his doctoral studies he participated in 10 months graduate traineeship programme at European Securities and Markets Authority (ESMA) in Paris (France). He obtained a scholarship to attend the Cologne Summer School of European Legal-Linguistics (Germany) and attended an international conference for comparative private law in Santiago de Compostela (Spain).

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 monograph on the *Precautionary principle in International Trade Law* (*Zásada předběžné opatrnosti v právu mezinárodního obchodu)*, Prague: C.H. Beck, 2022. In 2021 Nicole Grmelová co-authored 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 *Different regulatory approaches to enhanced water protection in selected European jurisdictions* (Water International [online]. 2023, Vol. 48 (2), pp. 188–201.

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.

Nicole Grmelová (ed.)
Petr Tomčiak (ed.)

Horizons of Law in Business and Finance

Conference proceedings
15th International Scientific Conference „Law in Business of Selected Member States of the European Union"
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Foreword

These conference proceedings constitute a selection of the best papers submitted to the 15th 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 from 25 to 27 October 2023 and welcomed speakers and participants from abroad (Belgium Latvia, Netherlands, Poland, Romania, Slovakia, Spain, Turkiye, United States) and the Czech Republic. The conference was held hybrid format. Although the on-site participation was encouraged, the conference was 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. The papers were submitted and presented in English. All the papers included in this volume passed a rigorous double-blind peer review successfully and were checked for their originality using the iThenticate software kindly provided by the University.

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

1. Section: ***Business and Corporate Law;***

2. Section: ***European and International Aspects of Doing Business;***

3. Section: ***Banking, Finance and Insurance Law*****.**

The conference has been supported by the Internal Grant Agency Project No. IG 43/2023 “Law in Business of Selected Member States of the European Union (15th annual conference)” of the Prague University of Economics and Business.

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

The conference organizers will be happy to welcome the readers at the conference to be held next year. The date of the conference is to be announced in due course.

For more information on the call for papers for the upcoming conference please check the conference webpage at https://lawinbusiness.vse.cz/.

Wishing you a nice read.

Nicole Grmelová
Chair of the Scientific Committee

Petr Tomčiak
Chair of the Organisational Committee

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Pavlína Hubková, Ph.D.
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SECTION I
BUSINESS AND CORPORATE LAW

The role and importance of effective compliance management systems in criminal law practice

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Abstract: *In April 2023, the Regional State Prosecutor's Office in Ústí nad Labem – Liberec, Czech Republic, decided to set aside the decision of the Czech Police, National Headquarters against Organized Crime. This resulted into termination of the criminal prosecution of one of the largest construction companies in the Czech Republic. The company, together with other legal entities, was accused of committing the crime of conspiracy to confer an advantage in the award of a public contract, a public tender and a public auction, as well as the crime of attempted damage to the financial interests of the European Union. The Supervising Prosecutor's Office assessed in detail the information and documents provided regarding the internal compliance management system of the accused companies and, in accordance with provisions of section 8(5) of the Act on Criminal Liability of Legal Entities, released them from their criminal liability. Since the practical impact of this decision is crucial, the author subjects it to a detailed analysis and subsequent comparison with the rules set out in relevant methodology of the Czech Supreme State Prosecutor's Office, which is a practical guide to the above-mentioned legislation. The result thus serves as a good inspiration for effective setting up and maintenance of compliance management systems in corporate practice (not only from the perspective of Czech law, as the presented conclusions are fully applicable internationally).*

Keywords*: compliance management system, criminal liability, exculpation, legal entity*

INTRODUCTION

On 19 April 2023, the Regional State Prosecutor's Office in Ústí nad Labem – Liberec, Czechia, decided in a criminal case brought by the Police of the Czech Republic, National Headquarters against Organised Crime of the Criminal Police and Investigation Service, on the complaints of the accused legal entities against the decision of the police authority[1], so that the order on initiation of criminal prosecution[2] is cancelled. The cancelled prosecution was to be brought in respect of the crime of conspiracy to confer an advantage in the award of a public

[1] Dated 22 September 2022, file no. NCOZ-2268-2254/Tč-2016-417404-H.
[2] For more details, see the provisions of section 160(1) of Act No. 141/1961 Coll., on Criminal Procedure (Criminal Procedure Code), as amended (hereinafter also referred to as the "Criminal Procedure Code").

contract, a public tender and a public auction[3] and the crime of attempted damage to the financial interests of the European Union[4] – in both cases in the form of assistance. In short, the accused legal entities (four entities in total) were attributed with the conduct of a specific natural person who was to participate in the conduct in connection with the award of a sub-limit public contract. All of the accused legal entities lodged complaints against the decision to initiate criminal proceedings, which they substantiated through their counsel by a joint submission of 14 December 2022 and subsequently supplemented by three further submissions. In the grounds of these complaints, a variety of detailed arguments and annexes appear. However, for the purpose of this text, the main relevance goes to the assertion that the conduct of the natural person concerned cannot be attributed to the accused legal entity due to the fulfilment of prerequisites in section 8(5) of the Act on Criminal Liability of Legal Entities (ACLLE).[5]

The institute referred to as exculpation from the criminal liability of legal entities within the meaning of section 8(5) of the ACLLE has been introduced to Czech laws in 2016. As of 1 December 2016, a legal person is released from criminal liability under section 8(1) to (4) of the ACLLE if it has made all efforts that could reasonably be required of it to prevent the commission of an unlawful act by the persons referred to in paragraph 1. As this was a completely new approach at that time, the Supreme State Prosecutor's Office of the Czech Republic issued the above-mentioned material entitled "*Application of Section 8(5) of the ACLLE*" (hereinafter also referred to as the "Methodology"), which is a document that constitutes a methodological guide or a kind of practical first aid for prosecutors to take into account all relevant circumstances when assessing the criminal liability of legal entities. The first edition of this Methodology was published in November 2016[6]; the second, considerably modified and revised edition was published in August 2018[7]. The current, *i.e.* the third edition of the Methodology is dated November 2020[8]; this edition builds on the previous ones, but elaborates the material in the direction of improving the procedures for evaluating the compliance management system (hereinafter also the "CMS"). One of the greatest benefits of the latest edition of the Methodology is therefore a list of practical recommendations for the procedure of law enforcement authorities – specifically, the Methodology offers questions that prosecutors can use in their review and decision-making practice when evaluating the CMS. The findings of the latest

[3] For more details, see the provisions of section 256(1) and 256(2)(a) and (c) of Act No. 40/2009 Coll., the Criminal Code, as amended (hereinafter also referred to as the "Criminal Code").
[4] For more details, see the provisions of section 256(1)(4)(a) and 256(5) of the Czech Criminal Code.
[5] Section 8(5) of the ACLLE: "A legal person shall be released from criminal liability under paragraphs 1 to 4 if it has made all efforts that could reasonably be required of it to prevent the commission of the unlawful act by the persons referred to in paragraph 1."
[6] File No. 1 SL 123/2016.
[7] File No. 1 SL 141/2017.
[8] File No. 1 SL 113/2020.

Czech case law and current international compliance standards are also applied. Although the Methodology is primarily addressed to prosecutors, it is also publicly available – with the aim of supporting the preventive effect of the implementation of internal CMS. Thus, the methodology can also serve as a very good inspiration for streamlining the compliance processes of Czech but also foreign business corporations.

1. FORMAL REVIEW OF COMPLAINTS OF THE ACCUSED LEGAL ENTITIES

The Regional State Prosecutor's Office first stated that the contested decision to initiate criminal proceedings complied with all formal requirements. First of all, the public prosecutor dealt with the objections that the conduct of the above-mentioned natural person was attributable to the relevant legal person. The bases for the criminal liability of legal entities are regulated in particular by provisions of section 7 and section 8 of the Criminal Code. Whilst section 7 of the Criminal Code contains a list of offences which cannot be attributed to legal entities, section 8 of the Criminal Code defines an offence committed by a legal person as an unlawful act committed in its interest or in the course of its activities. Considering the above, the prosecutor concluded that: (1) "*...(t)he conduct of the natural person concerned was related to the participation of the legal entity in question in the public procurement procedure, thus constituting conduct falling within the activities of that legal entity*"[9]; and further that: (2) "*...(s)ecuring the described advantage and benefit in the award of the public contract was in the interest of the legal person in question*".[10] It was further held that the conduct of the natural person in question was fully attributable to the accused legal person in accordance with section 8(1)(b) of the ACLLE, as the natural person held a managerial employment function within the concerned legal entity.

The author fully supports such conclusion, as it is clear from the applicable legal theory[11] that a legal person itself never commits a crime (as it is always imputed to it under certain conditions). Therefore, the law defines several natural persons whose unlawful acts may establish the criminal liability of a legal entity. The concept of imputability then consists of attributing to a legal person an unlawful act committed in its interest or in the course of its activities by one of the persons listed in the provisions of section 8(1)(a) to (d) of the ACLLE.[12] In order

[9] Resolution of the Regional State Prosecutor's Office in Ústí nad Labem - Liberec Branch, Czech Republic, dated 19 April 2023, file no. 2 KZV 14/2018 - 2263.
[10] Ibid.
[11] See, for example, ŠÁMAL, P. et al. Act on Criminal Liability of Legal Entities and Proceedings against them. Commentary. 2 ed. Prague: C. H. Beck, 2018, p. 186 et seq.; or FENYK, J., SMEJKAL, L., BÍLÁ, I. The Law on Criminal Liability of Legal Entities and Proceedings against Them. Commentary. 2 ed. Prague: Wolters Kluwer, 2018, p. 36 et seq.
[12] THE SUPREME STATE PROSECUTOR'S OFFICE OF THE CZECH REPUBLIC. Application

for a legal person to avoid criminal liability and to avoid the excesses of a subordinate person – an employee or a person in a similar position – it is required to take certain measures. These include the obligations of proper management and control, including the obligation to prevent the commission of criminal activities within the legal person.[13] Therefore, the aim of the law is not to punish well-managed legal entities, but to motivate them to make maximum possible efforts and take adequate measures to prevent or minimise the risk of committing an illegal act by persons referred to in the provisions of section 8(1) of the ACLLE.[14] The requirement to '*use all efforts that could reasonably be required of a legal person*' does not appear newly in section 8(5) of the ACLLE, since it is part of the obligation to exercise the functions of a member of an elected body of a legal entity with due care.[15] "*A proper manager is supposed to know what is happening in the legal entity they manage and to take the necessary measures to prevent damage to the legal entity they manage and represent. The duty of care of a good manager includes the duty to carry out legal acts with necessary care and knowledge[16] and the standard of care that would be exercised by another person in a similar position in a similar situation is always examined (provisions of Section 52(1) of the Business Corporations Act)*."[17] Generally speaking, the possibility of releasing a legal entity from its criminal liability in cases where it has properly set up its internal measures so that they are capable of preventing or minimising unlawful conduct is a concept that has been introduced into the Czech legal system from abroad[18] (and which has undergone a truly dynamic development throughout its existence).

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of Section 8(5) of the Act on Criminal Liability of Legal Entities and Proceedings Against Them – a guide to the legal regulation for public prosecutors. Third revised edition, 2020, p. 6.

[13] For more information see *e.g.* FOREJT, P., HABARTA, P., TREŠLOVÁ, L. *The Act on Criminal Liability of Legal Entities and Proceedings against them with a Commentary.* Prague: Linde Praha, 2012, p. 81 ff.; and also, ŠÁMAL, P., *op.cit*., p. 217 et seq.

[14] See *supra* note 12, p. 10.

[15] For more information see *e.g.* ANDREISOVÁ, L. *Duty of care of members of statutory bodies of capital companies and its relation to internal compliance programs*. Dissertation. Prague University of Economics and Business, 2017. p. 231 et seq.; or ANDREISOVÁ, L., KLOUDA, J. Practical guide to duty of care in times of pandemic. *Obchodní právo*. 2020. vol. 29, no. 5, pp. 2-18; or KLOUDA, J. The Extent of the Duty to Exercise the Office of an Elected Member of a Legal Entity with Necessary Knowledge and Diligence. *Obchodní právo*. 2021, volume 30, no. 6, pp. 30-40. ISSN 1210-8278.

[16] For more details, see the provisions of Section 159 of Act No. 89/2012 Coll., the Civil Code, as amended (hereinafter also referred to as the "New Civil Code") in conjunction with the provisions of Section 51 et seq. of Act No. 90/2012 Coll., on Business Companies and Cooperatives, the "Business Corporations Act", as amended (hereinafter also referred to as the "Business Corporations Act").

[17] See *supra* note 12, p. 10.

[18] KLOUDA, J. The Extent of the Duty to Exercise the Office of an Elected Member of a Legal Entity with Necessary Knowledge and Diligence. In: ŠKRABKA, Jan (ed.). *Law in Business of Selected Member States of the European Union. Proceedings of the 13th International Scientific Conference*. Prague: TROAS, s.r.o, 2021, pp. 76-84.

2. ASSESSMENT OF FORMAL ASPECTS OF CMS

As stated above, one of the central arguments of the complaint of the accused legal entities was that their criminal liability could not be inferred in view of the fulfilment of the conditions of section 8(5) of the ACLLE. This argument was supported by extensive annexed documentation containing internal regulations[19], documents related to the implementation of their CMS, documents on staff training and documents related to the practical functioning of the CMS in question. It should be stressed out that, according to the findings of the competent prosecutor, the police authority did not have these evidentiary materials at its disposal when making its decision. The complaint of the accused legal entities was thus based on new facts and evidence[20].

In the first step, the prosecutor's office reviewed the submitted compliance measures from a so-called functional point of view, *i.e.* it examined "*whether these measures were set up after a proper risk analysis; whether the system is aimed at preventing violations of the law; and whether it is set up to effectively detect and respond to criminal activity*."[21] Furthermore, the prosecutor examined "*whether the measures set up by the legal entity in question are actually implemented and whether its CMS specifically addresses the risks associated with the public procurement process*".[22] Last but not least, the competent prosecutor also examined the question "*whether the position of the natural person whose conduct is attributed to the accused legal person excludes the application of the exculpatory ground under the provisions of Section 8(5) of ACLLE*".[23] It should be recalled that the legal definition of the term "*making every effort that could reasonably be required of a legal entity*"[24] does not exist. Nothing can be found in the wording of the relevant legal norm that would help its addressees to clarify when the clause in section 8(5) of ACLLE is permissible and when it is excluded. However, the opinion of the Supreme State Prosecutor's Office of the Czech Republic might help in this respect: "*The concept of making all efforts that could be fairly required of a legal person may be understood as the creation, application and enforcement of effective measures aimed at managing existing and future risks causing, facilitating or supporting the commission of criminal offences that may be attributed to the legal person (criminal risk), and thereby preventing the commission of a criminal offence.*"[25]

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[19] This was a complex of compliance measures consisting mainly of a binding compliance methodology for all companies, an annexed compliance manual, annexed basic rules for compliance, a charter of ethics and conduct and an employee code.

[20] Which is in line with the provisions of section 145(2) of the Criminal Procedure Code.

[21] Resolution of the Regional State Prosecutor's Office in Ústí nad Labem - Liberec Branch, Czech Republic, dated 19 April 2023, file no. 2 KZV 14/2018 - 2263.

[22] Ibid.

[23] Ibid.

[24] See the provisions of section 8(5) of the ACLLE.

[25] See *supra* note 12, p. 11.

The review findings show that the above-cited binding compliance methodology was introduced to the legal entity in question with effect from 1 October 2016, *i.e.* it was already in force in the period when the imputed conduct was supposed to have occurred. According to the prosecutor's findings, the personal scope of this methodology aims at all employees of the Group in Czechia and Slovakia. In addition to the above, the compliance methodology contains a definition of basic terms (*e.g.* compliance officer, where the prosecutor emphasises that in this case it refers to an external person – a lawyer registered with the Czech Bar Association), and also explains that one of its basic missions is to link the annexed compliance manual with the existing compliance rules.

The compliance manual itself is divided into three parts[26]:

- The first part defines its subject and purpose and also contains a list of elements that constitute a CMS in the whole Group, including, for example, systemic employee training, regular spot checks, documentation, evaluation of the functioning of the CMS, implementation of measures and the introduction of a compliance reporting (whistleblowing) line. The compliance manual obliges the statutory bodies and their members, senior employees and "in the rest" also all other employees of the Group.
- The second part of this manual, according to the outcome of the review[27], is to describe the processes for compliance. For the purposes of reporting and addressing incidents and suspicious activities, the manual highlights the ability of any employee to report any violation or even suspected violation of the law or other rules. The above-mentioned incidents are classified into three levels, with the aforementioned compliance officer participating in all of them. The third, *i.e.* the most serious level of incidents is dealt with by the compliance officer directly in cooperation with the board of directors and, where necessary, followed by a police investigation. This area, *i.e.* the area of early detection of violations of CMS rules, is very important when compared with the recommendations resulting from the Methodology[28] – it should include a system for reporting suspicions, headed by an independent and trusted person (*e.g.* a compliance officer), a functional process for internal investigations (where the principle of "zero tolerance" clearly applies[29]), with particular emphasis on a clear division of roles and responsibilities, as well as on how relevant findings will be handled. The second part of the compliance manual also sets out the basic rules on employee training, control of the functioning of the entire CMS and record keeping. Three consequences for violation of the rules of the manual are

[26] Resolution of the Regional State Prosecutor's Office in Ústí nad Labem - Liberec Branch, Czech Republic, dated 19 April 2023, file no. 2 KZV 14/2018 - 2263.
[27] For more details, see the resolution of the Regional State Prosecutor's Office in Ústí nad Labem - Liberec Branch, Czech Republic, dated 19 April 2023, file no. 2 KZV 14/2018 - 2263.
[28] See *supra* note 12, p. 28 et seq.
[29] WALKER, R. International Corporate Compliance Programmes. *International Journal of Disclosure and Governance*. 2006, vol. 3 (issue 1), pp. 70-81.

introduced: (1) warning, (2) written warning, and (3) termination of employment.

- The third part of the compliance manual contains a list of functions of the above-mentioned compliance officer, which, in the author's opinion, is a reaction to one of the fundamental assumptions of the functioning of the CMS according to the Methodology: "*In practice, it is possible to encounter a model of contracting the compliance agenda through an external expert advisor, especially for smaller legal entities. In all cases, sufficient financial and personal background, expertise, knowledge of the environment of the legal entity, clearly defined competences and independence of persons with appropriate responsibility for CMS are prerequisites for functionality*."[30] Obviously, without being able to consult the attached internal regulations of the accused legal entities, this point cannot be evaluated in a bigger detail, however, from this part of the reasoning of the analysed resolution, in conjunction with other statements of the relevant prosecutor, it can be expected that the above assumption has been duly verified.

The reasoning of the analysed resolution further shows that the above-mentioned compliance manual, which is an annex to the binding compliance methodology, contains another annex – namely, basic rules in the area of compliance, which is supposed to be a document that further specifies the rules for individual areas, for example, the rules for the area of competition, according to which employees are to avoid actions concerning the intention that would determine the outcome of a tender or other similar procedure. In such cases, staff are obliged to stop the conduct in question immediately and to inform the compliance officer without delay. Furthermore, the prosecutor highlights the criminal rules, which oblige the Group's employees to avoid any conduct that may be contrary to the law. According to the analysed resolution, this rule is followed by a further document, the so-called company's employee charter[31], which obliges employees to act in such a way as to avoid favouring the Group within the meaning of Section 256 of the Criminal Code and harming the financial interests of the European Union within the meaning of the same provision of the Criminal Code.

The competent prosecutor evaluated all the documents in question and concluded that "...(t)hey contain rules that impose on all employees of the legal entity both general obligations to comply with the law and specific obligations, compliance with which would not lead to the conduct attributed to the legal entity in the contested order initiating the prosecution."[32] The prosecutor further stated that "...(t)he compliance system in place applies to all persons, including employees holding senior positions, with the most serious incidents falling under the review of the external compliance officer and the company's board of directors."[33]

[30] See *supra* note 12, p. 26.
[31] This seems to be the aforementioned charter of ethics and conduct.
[32] Resolution of the Regional State Prosecutor's Office in Ústí nad Labem - Liberec Branch, Czech Republic, dated 19 April 2023, file no. 2 KZV 14/2018 - 2263.
[33] Ibid.

The conclusion to be drawn from the first part of the quoted resolution is therefore that the legal person in question had, from a formal point of view, a system of compliance measures in place which in itself made it possible to prevent the commission of criminal offences by its employees.

At this point, it is again worth pointing out at the Methodology, which emphasizes that in corporate practice, even the best efforts of a legal entity to minimize the occurrence of crime cannot be expected to guarantee a 100 % result. Thus, even if adequate and effective measures[34] are in place, a breach of an individual's duty may result in the commission of a criminal offence. In this case, the offence should not be attributed to the legal person if the offender has acted arbitrarily, in the form of an excess.[35] The Methodology then lists comprehensive measures in Chapter 5 in the form of an exemplary compliance management system based on internationally recognised practice. In this respect, a reference can also be made to the decision-making practice of Czech courts, in particular the Regional Court in Hradec Králové: "*(...) any possible measures to prevent criminal activity by legal entities of their employees will always be insufficient to certain extent and it is always possible to find a way to overcome these measures. It is not possible to require a legal person to have another person for each of its employees to control the employee and prevent them from committing criminal activities*."[36]

3. ASSESSMENT OF MATERIAL ASPECTS OF CMS

In the second step, and probably also with regards to the above recommendations, the competent prosecutor dealt with the question whether the compliance management system was properly implemented, *i.e.* whether it actually worked. This is fully in line with one of the central rules of the Methodology, which states that: "*In assessing the criminal liability of a legal person, it is necessary to deal with the functioning of the CMS in material terms, i.e. the conduct of the legal person according to the measures adopted in real practice*."[37] The emphasis on the material aspect of the functioning and practice of the CMS is also derived from applicable court decision practice.[38]

For this “secondary-review”, the accused legal entities submitted documents that attempted to prove the functionality of the entire CMS. It was thus

[34] For more details, see, for example, ANDREISOVÁ, L. Building and Maintaining an Effective Compliance Program. *International Journal of Organizational Leadership*. 2016, vol. 5 (issue 1), pp. 24–39.
[35] See *supra* note 12, p. 12.
[36] Decision of the Regional Court in Hradec Králové of 21 January 2019, Case No. 7 T 11/2015.
[37] See *supra* note 12, p. 23.
[38] See, for example, the resolution of the High Court in Prague of 9 March 2017, Case No. 6To 7/2017.

established that the natural person concerned, in their capacity as a senior employee of the accused legal entity, was trained on the rules set out in the ethics and conduct charter on 19 October 2010, which they even confirmed by their signature. On 12 December 2012, they also signed a declaration, the content of which is a commitment to comply with the charter of ethics and conduct and the Group's employee code. Furthermore, the certificate of attendance showed that they had completed an anti-corruption course back in 2018. The prosecutor also received print-screens of the intranet of the accused legal entity, which served to document the fact that this is the channel through which internal regulations and other documents are made available to employees. The prosecutor's findings further show that the documents of the CMS in question were available under the link "Ethics", as well as contact details of the relevant compliance officer. The compliance training conducted by the accused legal entities was documented through attendance sheets. The resolution shows that the training was carried out at least once a year and the prosecutor verified that the individual concerned (a senior employee of the accused legal entity) had always attended these training sessions. The presentations of the individual training sessions were also submitted, *i.e.* the prosecutor had the opportunity to see their content.

The above summaries are fully in line with the recommendations resulting from the Methodology. It states that: "The basic principles of CMS, and hence the corporate culture, will usually be set out in a code of ethics. This is the basic document of CMS, which should be concise, clear and understandable. To enforce the rules, it is not enough to put the code of conduct on a website or attach it to an employment contract. Repeated familiarisation with its content and the purpose of its adoption (internal PR) is necessary."[39] However, what the author completely misses in the conclusions summarised above is the verification of the level of understanding of the given obligations (towards the natural person, i.e. the concerned employee). It is clear that the natural person in question had been trained, and that they had signed the declaration, but there is no mention of verification of the level of understanding of the compliance rules. This is one of the most important assumptions of the Methodology, not only in the context of investigating possible CMS failures, but in general, in the context of proper compliance communication.[40]

In addition to the above, the prosecutor's office was provided with other evidentiary materials, in particular (a) reports of inspections conducted by the compliance officer; (b) compliance officer's annual reports containing overview of compliance incidents and consultations, which documented how individual compliance incidents were handled. In the reasoning part of the concerned resolution, the prosecutor states that for each incident a description of the incident,

[39] See *supra* note 12, p. 27.
[40] For more details see *supra* note 12, pp. 35 and 37.

the outcome of the investigation and the (probably remedial) action taken are recorded. The submitted material also shows that the relevant compliance officer conducted an internal investigation on account of the initiation of the prosecution under discussion, but concluded that "*the allegations are not supported by evidence"*.[41] This last reference is very important for a proper assessment of the CMS in question, as the Methodology states that: "*The prosecutor makes an individualized assessment based primarily on the consideration of what the legal entity did in general to prevent the commission of the offence and in particular the offence in question, and consequently to minimize its consequences, and how it subsequently reacted to it.*"[42]

According to the prosecutor's office, it is clear from the submitted reports on the activities of the supervisory board of the accused legal entity and from the minutes of its meetings between 2016-2019 that the supervisory board dealt with setting up of the CMS back in 2016. Prior to the adoption of relevant CMS, the identification and assessment of risks by an external law firm should have been carried out, which is also fully in line with the assumptions of the Methodology.[43] The Supervisory Board then discussed the functioning of the CMS at its meetings. Similarly, the steering committee and the extended (Group's) steering committee were to address this area.[44]

A cross-reference to the Methodology should be conducted here again, as it explicitly states that in each individual case it is necessary to consider the degree of effort devoted to measures to prevent the commission of the offence in question and the possibilities of its detection, and what those measures consisted of in particular. According to the Supreme State Prosecutor's Office of the Czech Republic, it is also necessary to consider the efforts of the legal person to take adequate remedial measures in response to the offence committed, even if the conditions for exculpation under section 8(5) of the ACLLE are not met; even in these cases, it is appropriate to assess whether and how the legal person has learned from the relevant misconduct.[45]

4. FINAL EVALUATION OF THE CONCERNED CMS

On the basis of the documents and information provided, the prosecutor concluded that: "…(t)he measures set up to prevent criminal activity were func-

[41] Resolution of the Regional State Prosecutor's Office in Ústí nad Labem - Liberec Branch, Czech Republic, dated 19 April 2023, file no. 2 KZV 14/2018 - 2263.
[42] See *supra* note 12, 2020, p. 31.
[43] *Ibid*, p. 26.
[44] For more details, see the Resolution of the Regional State Prosecutor's Office in Ústí nad Labem - Liberec Branch, Czech Republic, dated 19 April 2023, file no. 2 KZV 14/2018 - 2263.
[45] See *supra* note 12, p. 12.

tional in the legal entity in question and they can be considered sufficient to prevent the commission of criminal activity."[46]

To illustrate the whole picture, it is worth mentioning that in order to assess the CMS in question, the accused legal entities submitted an expert independent assessment dated 16 April 2023. This document was submitted as an expert opinion.[47] The reasoning of the analysed resolution shows that the author of this assessment carried out "*an assessment of the compliance program in relation to the standards set out in particular in the Methodology of the Supreme State Prosecutor's Office File No. 1 SL 113/2020 of 9 November 2020 and the international standards ISO 31001:2016 and ISO 37301:2021, taking into account the Methodology of the US Department of Justice.*"[48] Specifically, a detailed analysis of various elements of the accused corporation's CMS was prepared, accompanied by 41 sub-assessments and a concluding summary that the accused corporation has, since at least 2010, made every effort that can fairly be required in order to prevent the crime attributed to it.

In the conclusion of the resolution in question, the public prosecutor, on the basis of all his findings and partial conclusions, states that: "*The objection that the accused legal entity cannot be held liable for the conduct for which the natural person concerned is prosecuted in their capacity as a senior employee, because the conditions set out in section 8(5) of the ACLLE are met, is well founded.*"[49] Thus, it was decided to cancel the decision of the Police of the Czech Republic dated 22 September 2022.[50] The public prosecutor then logically did not deal with other objections. Pursuant to the second sentence of Article 141(2) of the Criminal Procedure Code, no further complaint(s) may be lodged against the above resolution.

5. CRITICAL EVALUATION OF THE REVIEW AND DECISION OF THE PUBLIC PROSECUTOR

In the author's opinion, what can be partially criticized in the review and decision-making practice of the competent Regional Prosecutor's Office is the assessment of *'all efforts that can be fairly required of a legal person*' in the perspective of so-called overall context of the accused legal person. The Methodology states in detail[51] that any CMS must be proportionate to the size, complexity of regulatory requirements, internationality, nature of the business, risk profile, market environment and *de lege artis* practices of the organisation in question

[46] Resolution of the Regional State Prosecutor's Office in Ústí nad Labem - Liberec Branch, Czech Republic, dated 19 April 2023, file no. 2 KZV 14/2018 - 2263.
[47] In accordance with the provisions of section 105(1) of the Criminal Procedure Code.
[48] See *supra* note 46.
[49] Ibid.
[50] In accordance with the provisions of section 149(1) of the Criminal Procedure Code.
[51] See *supra* note 12, p. 22.

(the CMS proportionality principle) and that it will address those risks to which a particular legal entity is or could be exposed. In this light, the interests and expectations of all stakeholders should be considered; the legal entity should have an interest in enhancing its value and building its brand and, for example, selecting collaborating third parties (business partners, consultants *etc*.) responsibly. Although it can be assumed that this consideration was duly carried out and that it was also reflected in the above conclusions, the author points out at the fact that the prosecutor did not explicitly deal with this requirement.

Similarly, in listing certain "deficiencies" in the rationale of the analysed resolution, a reference can be made towards one of the other key rules of CMS operation, namely that: "*A properly set up CMS is a closed and functional system of prevention, detection, and response measures that is continuously monitored and improved.*"[52] Based on the above analysis and in the author's opinion, there is no doubt that the prosecution paid sufficient attention to various elements of prevention, detection and response, but the issue of continuous improvement of the CMS in question is not mentioned in the reasoning at all. If this absence means that the prosecutor did not address this issue, it could be a rather significant error, since regular internal evaluation of the functionality of the CMS and, in particular, its subsequent adjustment and improvement, including, for example, regular reassessment of applicable risks, is one of the key prerequisites for a good internal management and control system.

Internal or external audits can also be used to regularly evaluate and improve the relevant CMS. According to the recommendations of the Methodology, these should take place every two to three years.[53] However, it does not emerge from the reasoning of the resolution in question whether, apart from the aforementioned expert independent (external) assessment of the CMS of the accused legal entity dated 16 April 2023, such audits have generally taken place.

In the author's opinion, other alleged shortcomings of the resolution in question, or rather its reasoning, include the fact that there appears to have been insufficient evaluation of so-called tone from the top, *i.e.* the support of CMS by the top management of the accused legal entity. The conclusion of the prosecutor's review[54] showed that the supervisory board of the accused entity and the steering committee, as well as the extended steering committee were involved in setting up and discussing the functioning of the CMS in question. However, this format is not sufficient[55]. The Methodology itself states that: "*Management must*

[52] *Ibid*, p. 25.
[53] For more details, see *Ibid*, p. 30.
[54] For more details, see the Resolution of the Regional State Prosecutor's Office in Ústí nad Labem - Liberec Branch, Czech Republic, dated 19 April 2023, file no. 2 KZV 14/2018 - 2263.
[55] BELL, E. BRYMAN, A. The Ethics of Management Research: An Exploratory Content Analysis. *British Journal of Management*. 2007, vol. 18 (issue 1), p. 63-77.

clearly and credibly set, communicate and enforce a compliance culture, including not tolerating violations of it throughout the corporation."[56] It even emphasizes that this is "*absolutely crucial to the success of any CMS*".[57] However, the reasoning of the relevant prosecutor does not really show how the functioning of the whole CMS was communicated internally by the Group's top management, whether, for example, members of the Group's management were personally involved in respective training sessions, how they otherwise highlighted the importance of CMS in their business practice, whether/how they personally dealt with the most serious compliance incidents, how they responded to regular annual and other reports of the compliance officer *etc*. CMS is only workable where the compliance (corporate) culture matches it[58]. This is generally set by the management of the company – hence the term above, where the management of the company (*i.e.* the statutory body and often also senior delegated management[59]) literally set the tone from the top.

Last but not least, it should be noted that the prosecutor does not explicitly mention the review of so-called long-term approach of the accused legal entity to the fulfilment of legal obligations and other commitments[60]. If such an assessment was not carried out when deciding on the case, it could represent more than just a formal procedural error, especially in case of construction companies with profits in hundreds of millions Czech crowns and thousands of employees[61]. It must be stressed out that the absence of the above-mentioned references does not mean that the prosecutor did not actually carry out these evaluations – in the author's opinion, it is clear from the text of the resolution in question, and especially from its reasoning, that a really thorough and high-quality investigation was carried out, as well as subsequent processing of all conclusions.

[56] See *supra* note 12, p. 25.
[57] Ibid.
[58] For more details see, for example, VALENCIA, J. C. N., VALLE, E. S., JIMÉNEZ, D. J. Organizational culture as determinant of product innovation. *European Journal of Innovation Management*. 2010, vol. 14 (issue 4), p. 466–480. ISSN: 1460-1060.
[59] The responsibility for the level of compliance of a legal entity with all legal and other obligations sits *e.g.* according to the judgment of the Supreme Court of the Czech Republic of 11 September 2019, Case No. 31 Cdo 1993/2019 with the statutory body; the statutory body may delegate the performance of this agenda to a person outside or inside the legal entity, but this does not relieve it of this responsibility.
[60] For more details, see *supra* note 51, pp. 31 and 33.
[61] For more information see BLAŽEK, V., NOHL, R. *The public prosecutor cancelled prosecution of Eurovia for contracts in Liberec*. Seznam Zprávy, 2023. Available online: <https://www.seznamzpravy.cz/clanek/domaci-kauzy-zalobce-zrusil-stihani-eurovie-za-zakazky-v-liberci-231987>.

CONCLUSION

In the final chapter of the Methodology, there is a list of the most common indicators of non-functional CMS.[62]

Taking into account the above list, the author hereby concludes that the competent prosecutor has indeed carried out a thorough and high-quality verification of the existence and functionality of the CMS of the accused legal entity, or the entire Group, but would herself question the level of compliance with some of the above points – in particular, the structure and complexity of the above-mentioned internal regulations; the commitment of top management towards the importance of compliance within the legal entity (tone from the top); the above-mentioned regularly recurring CMS audits (instead of a mere external *ad-hoc* assessment) and related continuous improvement; the approach of the accused legal entity to the fulfilment of legal obligations and other commitments, including, for example, responsible selection of business and other partners *etc*.

Nevertheless, the analysed resolution on the cancellation of the criminal prosecution of one of the largest construction companies in the Czech Republic represents a very valuable contribution and high-quality inspiration for practical interpretations and assessment of domestic and also foreign CMS of business corporations.

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[2] Decision of the Police of the Czech Republic, National Headquarters against Organised Crime of the Criminal Police and Investigation Service, Czech Republic of 22 September 2022, Case No. NCOZ-2268-2254/Tč-2016-417404-H.
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Belatedly, but still - will the 2022 amendment to the Czech Copyright Act improve copyright protection against illegal online sharing of content to the public from repositories?

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Abstract: *At the end of 2022, the Czech Parliament adopted an amendment to the Copyright Act, implementing, inter alia, the EU Directive on copyright and related rights in the digital single market - the SDM Directive. The aim of this paper is to assess the possible improvement of copyright enforcement under this amendment in private law disputes between copyright holders and repositories that allow their users to communicate illegal content to the public. The paper compares the results of a micro-research of selected court decisions before and after the amendment. The question of establishing a special "blocking" authority that could effectively and quickly make illegal content in online platforms inaccessible, as it works in some EU countries, will also be considered. Other aspects of the amendment will not be discussed in the paper due to the necessary limitation of its scope. The author will rely on the method of qualitative analysis of the new legislation, case law and legal scholarship. The method of legal micro-comparison will be used for comparison with the existing practice.*

Keywords: *amendment to the Copyright Act, "blocking authority", copyright, copyright enforceability related rights, court decisions, EU SDM Directive, online content sharing service, online storage.*

INTRODUCTION

At the end of 2022, the Czech Parliament finally adopted an amendment to the Copyright Act,[1] implementing the EU Directive on copyright and related rights in the digital single market - hereinafter referred to as the "SDM Directive" - as well as the EU Directive on online broadcasting by broadcasting organisations and on retransmissions of television and radio programmes.[2] The aim of this

[1] Act No. 429/2022 Coll., amending Act No. 121/2000 Coll., on Copyright, on Rights Related to Copyright and on Amendments to Certain Acts (Copyright Act), as amended.

[2] Directive (EU) 2019/790 of the European Parliament and of the Council of 17 April 2019 on copyright and related rights in the digital single market and amending Directives 96/9/EC and 2001/29/EC and Directive (EU) 2019/789 of the European Parliament and of the Council of 17 April 2019 laying down rules for the exercise of copyright and related rights applicable to certain online broadcasts by broadcasting organisations and retransmissions of television and radio programmes and amending Council Directive 93/83/EEC).

paper is to assess the new regulation of online content sharing services as well as the possible improvement of the conditions created by the amendment for the enforceability of copyright in the digital environment against copyright-protected intangible objects unlawfully stored in so-called platforms and made available to the public online. The possibilities of enforceability of the right in private law disputes after the amendment will be assessed in the context of previous cases of relatively difficult procedure of right holders in Czech judicial practice. The question of establishing a special "shutdown" or "blocking" authority that could effectively and quickly secure the rights of authors and make illegal content in the platform inaccessible, as it works in some EU countries, will also be considered. The other aspects of the amendment cannot be the focus of this article due to the required limitation of scope.[3,4] The author used the method of qualitative analysis of the new legislation, case law and legal scholarship. The legal micro-comparison method will be used for comparison with the current practice.[5]

1. SOURCES AND PROCEDURE FOR ADOPTING THE AMENDMENT TO THE COPYRIGHT ACT

The above-mentioned amendment to the Czech Copyright Act mainly implements into Czech law the two EU Directives referred to in the Introduction and further clarifies some provisions of the Copyright Act. In particular, the SDM Directive has been in preparation for some time as part of the implementation of the EU Digital Single Market Strategy.[6] Its implementation is also the related new regulation of digital content, digital content services and goods with digital characteristics, implemented in the Czech private law in the Civil Code and responded to by the Czech legal scholarship.[7]

[3] The author discussed another part of the amendment in more detail in a paper at this conference in 2020 for an amendment to the Copyright Act under the SDM Directive on digital learning, which was then adopted in the 2022 amendment. BOHÁČEK, Martin. *Digital learning according to Copyright Law of the Czech Republic and in the EU Digital Single Market*. In: ŠKRABKA, Jan and VACUŠKA, Lukáš (ed.). Law in Business of Selected Member States of the European Union. Proceedings of the XII. International Scientific Conference. Prague: TROAS, 2020, pp. 202-213, ISBN: 978-80-88055-10-5.

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[7] Directive (EU) 2019/770 of the European Parliament and of the Council of 20 May 2019 on certain aspects of contracts for the provision of digital content and digital services; Directive (EU) 2019/771 of the European Parliament and of the Council of 20 May 2019 on certain aspects of contracts for the sale of goods, amending Regulation (EU) 2017/2394 and Directive 2009/22/EC and repealing

Already at the time of drafting, the SDM Directive was hotly debated, especially its Article 17 on the service of sharing online content to the public, which is sometimes abused in practice to store and share copyright infringing content without any effort to prevent it by the provider of this service (the operator of the digital repository or online platform), often with its support of this illegal activity. Critics' concerns were primarily directed against regulating this type of business at all - which would, of course, mean that copyright law would not have proper legal protection against illegal storage and access. There were also concerns that the court's intervention could affect the rights of people who have legally stored content on an online sharing platform. Other objections from some authors were against the rather complicated and unclear rules for the platform operator's and the authors' actions, which the Directive prescribes to prevent copyright infringement. According to them, this could also lead to abuse of the new protection to damage the rights of third parties - regular users of the platform.[8] Similar criticisms of the modification of Article 17 of the Directive were also contained in informative articles by Czech authors from before the adoption of the amendment.[9]

Directive 1999/44/EC; the implementation of these Directives is contained in particular in Sections 2158-2174a and Sections 2389a - 2389u of the Civil Code - Act No. 89/2012 Coll., as amended; see also HRÁDEK, J. Změny spotřebitelského práva ve vztahu k poskytování digitálního obsahu a digitálních služeb. *Jurisprudence* - Wolters Kluwer, 1/2023, 16 March 2023, pp. 11-20, ISSN 1802-3843; also LIMBERGOVÁ, Zuzana. Směrnice o digitálním obsahu a jejich implementace v právním řádu ČR. *Revue pro právo a technologie.* 2022, vol.13 (25), pp. 227-305, ISSN 1804-5383.

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The fate of the adoption of the amendment in the Czech Republic was not easy. Under Article 29(1) of Directive 2019/790, its transposition in the EU Member States should have been completed by 7 June 2021. The Ministry of Culture of the Czech Republic started drafting the implementation almost immediately after the adoption of the Directive by discussing with more than 130 concerned institutions and persons (about 70 organisations were involved in the public debate) in order to submit a draft amendment to the government already in autumn 2020, but the government at that time mainly dealt with the covid-19 crises and submitted the draft amendment to the Parliament only in June 2021 (Parliamentary Print 1246). The Chamber of Deputies did not have time to discuss it at all by the end of its term. The Czech Republic was thus late in transposing the Directive, but this was the case in most EU Member States and the European Commission therefore initiated infringement proceedings against them (including the Czech Republic).

After the elections, the newly elected Chamber of Deputies refused to discuss the bill of the previous government, so the newly formed government submitted a new draft amendment immediately after the elections at the end of 2021, although with virtually no substantive changes, including the Explanatory Report (Chamber print 31, Senate print 1). The discussion of the proposal in the Parliament took place during 2022 and it was adopted at the end of 2022. The European Commission then stopped the infringement against the Czech Republic. The content of the amendment was pre-determined by the two directives it implements, but during the course of the negotiations there were other minor modifications, which were highlighted in the interpretation of the amendment by Czech legal scholarship.[10]

2. REGULATION OF ONLINE CONTENT SHARING SERVICES IN THE AMENDMENT TO THE COPYRIGHT ACT

The analysed amendment to the Czech Copyright Act regulates the use of a work by a content sharing service provider in new provisions of Sections 46-52 according to Article 17 of the mentioned SDM Directive. First, it defines a provider of an online content sharing service as a provider of an information society service whose main purpose or one of its main purposes is to store and communicate to the public a large number of works uploaded by the user of such service and which competes or may compete with other online services making copyright works available to the same target group, whereby the provider of such service arranges and promotes such works for profit. In practice, these services

[10] FALADOVÁ, Adéla. Velká novela autorského zákona. *Duševní vlastnictví* 2/2023, pp. 3-12, ISSN 2788-2551. ŠAUROVÁ, Veronika. Novela autorského zákona. *Účetnictví neziskového sektoru* (Wolters Kluwer), Part 1 4/2023 of 20/04/2023, p. 15 and Part 2 5/2023 of 20/04/2023, p. 35, ISSN 2533-4484.

are usually referred to as repositories or platforms. At the same time, Section 18(2) of the Copyright Act has been added, which provides that communication to the public includes making available a work where anyone can access the work at a place and time of their choice, called "making available". The amendment adds that it also includes the making available to the public of a work by a provider of an online content sharing service, i.e. the operator of a repository, where the work has been uploaded by a user of that service.[11] A decision by the Court of Justice of the EU (CJEU) is also relevant to the nature of communication from an online platform as communication to the public under Article 18(2).[12]

Legal disclosure is usually obtained by users through licensing agreements with copyright and related rights holders. Providers of a non-profit online encyclopaedia, such as Wikipedia, a non-profit educational and scientific online repository, an open source software development and sharing platform, an electronic communications service, an online marketplace, and a business-to-business cloud service and a cloud service that allows users to upload content for their own use are not considered content sharing service providers under the amended law. For the definition of the term "information society service", the amendement refers to Act No. 480/2004 Coll., on certain information society services,[13] where this term is defined in Section 2(a) as "any service provided by electronic means at the individual request of the user made by electronic means, usually provided for a fee; a service is provided by electronic means if it is sent via an electronic communications network and retrieved by the user from an electronic data storage device". The provider may be any natural or legal person providing such a service, e.g. Netflix or Spotify.

The primary liability for illegal sharing of online content is borne by the user of the service who uploads the content to the repository without the permission of the rights holder, unless such use of the work falls within one of the statutory exceptions or limitations to the author's rights. However, the operator of the repository - the provider of the service as defined above - is also liable. However, the provider is not obliged to actively monitor their repository site and is only liable under Section 47 of the Copyright Act if the author or other rights holder has provided them with relevant and necessary information about the infringement of their right. In this provision, the amendment sets out the conditions under

[11] The nature of this newly defined right in relation to the general "making available" right under section 18(2), first sentence is debated - whether it constitutes a *lex specialis* or a right *sui generis* to it - HUSOVEC, Martin, QUINTAIS, J. P. How to license Article 17? Exploring the Implementation Options for the New EU Rules on Content-Sharing Platforms. [online] p. 14 [cit. 2023-7-11]. Accessible from: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3463011.

[12] Decision of the Court (Grand Chamber) of 22 June 2021. Frank Peterson v. Google LLC and others and Elsevier Inc. v. Cyando AG. Joined cases C-682/18 and C-683/18. The decision in the case "YouTube/Uploaded"). (OJ C 82, 4.3.2019).

[13] The Act implements Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on certain aspects of information society services, in particular electronic commerce, in the Internal Market.

which a service provider is not liable for illegal communication of works to the public - where the service provider has made their best efforts to obtain a licence from the copyright holders (in accordance with high industry standards of professional care) and, if the service provider fails to obtain one, immediately after notifying the author has disabled access to the work or removed it from its website. Crucially, however, the service provider must also use its best endeavours to prevent its re-upload, as infringers - users of the platform - will usually re-upload deleted works to it. In order to assess whether it has complied with these obligations, the type and scope of the service, the target audience, the type of work, the availability of appropriate means and the cost thereof are taken into account - in accordance with the principle of proportionality. It will thus turn to rights holders or their representatives and collective administrators known and easily accessible. They cannot invoke the limitation of liability under the Act on Certain Information Society Services, as was usually the case so far.[14]

Only an entrepreneur with large profits and large-scale storage of copyright works on the platform has to meet these demanding conditions. For smaller entrepreneurs, especially start-ups, this obligation is relaxed in Section 48 of the Copyright Act - the provider only has to make its best efforts to obtain a license and to make the work inaccessible or remove it immediately after notifying the author; it does not have to prevent illegal storage beforehand or re-save after deleting the file from the repository. The provider is a provider whose service has been provided on the market in the Czech Republic or in an EU or an EEA Member State for less than 3 years and whose annual turnover is less than EUR 10 000 000. However, if the average monthly number of unique visitors to the service, calculated on the basis of the previous calendar year, exceeds 5 000 000, they are also obliged to prevent the illegal re-saving of the work.

In line with the critical objections to the new regulation, safeguards against the misuse of this procedure to excessively block or remove legal content uploaded to the repository, in particular the conclusion of agreements between the platform and rights holders to do so, have been incorporated into Section 49. Section 50 sets out the service provider's information obligations to its users and rights holders, and Section 51 requires platforms to establish an effective and prompt mechanism for handling complaints and seeking redress.

During the discussion in the Chamber of Deputies, the amendment, based on the SDM Directive, was supplemented by proposals of the Czech Pirate Party to increase the protection of consumers - users of storage facilities and their operators. Paragraph 3 defining the rules for the use of so-called automatic filters and paragraph 4 explicitly stating the prohibition of so-called general surveillance of content uploaded by storage users were added to Article 47. The principle that complaints must be handled free of charge has been added to Article 51(1). In

[14] Act No. 480/2004 Coll., on certain information society services, as amended - cited above

addition, a new Section 51a has been added to the Act, also providing for protection against the so-called overblocking (excessive blocking or removal of content). It allows a legal person entitled to defend the interests of competitors or customers to seek an injunction against the operation of such a repository where it repeatedly and unlawfully prevents the uploading of a work, prevents access to a work or removes it. This provision is not explicitly supported by the Directive, and serious concerns were raised during the Parliamentary debate about the potential abuse of such amendments, e.g. in the context of competition.[15]

3. INTERPRETATION OF THE LEGAL REGULATION OF ONLINE CONTENT SHARING SERVICES IN THE AMENDMENT TO THE COPYRIGHT ACT

The new regulation is quite complicated and is being received controversially, as we have said. Therefore, its correct interpretation is very important. For this purpose, the interpretive sources - in particular the CJEU decisions, in particular in Poland v. European Parliament and Council, the European Commission Guidelines on Article 17 of the SDM Directive and the Explanatory Memorandum of the Czech Government on the draft amendment - are useful.

Poland brought an action against the European Parliament and the Council for annulment of Article 17 of the SDM Directive, which contains the preamble to the amendment, on the grounds that the service provider's obligations are contrary to the principle of protection of freedom of expression and information enshrined in the EU Charter of Fundamental Rights. The CJEU ruled that the obligation of service providers to check in advance the content that users of the service intend to upload to the platform, before making it available to the public, is complemented by appropriate safeguards to ensure that the regulation complies with freedom of expression and information. According to the CJEU, depending on the number of files uploaded and the type of subject-matter concerned, the service providers must use automatic content recognition and automatic filtering tools, which constitute a restriction on the exercise of the right to freedom of expression and information of the users of these services.

However, according to the Court, the regulation in question complies with the principle of proportionality - in view of the legitimate aim pursued by Article 17 of the SDM Directive, which is to protect intellectual property rights and provides a clear and precise framework for the use of automated recognition and filtering tools for uploaded content - by excluding measures that would filter and block legal content during uploading. Failure to sufficiently distinguish between illegal and legal content and the blocking of legal content would be incompatible with the right to freedom of expression and information and would not

[15] FALADOVÁ, Adéla. Velká novela autorského zákona. *Duševní vlastnictví*, 2/2023, pp. 3-12, ISSN 2788-2551.

respect the fair balance between this right and intellectual property rights.[16]

The European Commission's Guidance on Article 17 of the SDM Directive is also an important source for the correct interpretation of the new regulation in the amendment.[17] The Commission's Guidelines are not legally binding, they are soft law, but they serve as an inspiration of the CJEU and national courts or for the legislator. An important requirement of the Commission's Guidelines is that the mechanism of exceptions to provider liability should not explicitly apply in Member States' legislation to service providers "whose main purpose is to engage in or facilitate piracy." The assessment is to be made on a case-by-case basis.[18]

Another source of interpretation of the terms used in the amendment and in the SDM Directive is the Explanatory Memorandum from the Government to the draft amendment.[19] It can also be the legislation and case law on Article 17 in EU Member States, as can be seen from the example of France - see below point 5.

4. ENFORCEMENT OF COPYRIGHT PROTECTION AGAINST ILLEGAL ONLINE COMMUNICATION OF PROTECTED CONTENT TO THE PUBLIC BEFORE THE ADOPTION OF THE COPYRIGHT AMENDMENT ACT 2022

Enforcement of copyright in private law is generally regulated in Sections 40-42 of the Copyright Act, in line with the EU Directive on the enforcement of intellectual property rights.[20] The Directive has been implemented differently in Czech law in the Copyright Act for copyright and in a separate Act for industrial property and trade secrets.[21]

This Directive and the Copyright Act set out as tools for the injured copyright owner - in brief summary - the determination of authorship, information on the manner and extent of the unauthorised use, prohibition of unauthorised use and threat to protected rights, removal of the consequences of the infringement

[16] Judgment of the CJEU of 26 April 2022 in Case C-401/19 - Poland v. European Parliament and Council of the EU to annul Article 17 of the SDM Directive *(OJ C 270, 12.8.2019, p. 21).*

[17] Communication from the Commission to the European Parliament and the Council COM(2021) 288 final of 4 June 2021 - Guidance on Article 17 of Directive 2019/790 on copyright in the digital single market [cited 2023-7-11]. Available from: https://eur-lex.europa.eu/.

[18] SLIWKA, Rostislav. European Commission Guidelines on Article 17 - critical reflections on the application in practice. *Review of Law and Technology*, vol. 12, no. 24, (2021), pp. 77-124, eISSN: 1805-2797. https://doi.org/10.5817/RPT2021-2-3.

[19] See Parliamentary Print No. 31, footnote 15.

[20] Directive 2004/48/EC of the European Parliament and of the Council of 29 April 2004 on the enforcement of intellectual property rights, to which Commission Declaration No 2005/295/EC concerning Article 2 of that Directive is related (OJ L 94, 13.4.2005, p. 37).

[21] The cited provisions of Sections 40-42 of the Copyright Act and Act No. 221/2006 Coll., as amended, on the enforcement of industrial property rights and protection of trade secrets.

of protected rights, publication of the judgment at the infringer's expense and, in terms of property claims, the right to compensation for damages (property damage), reasonable compensation (non-property damage) and the payment of unjust enrichment. In addition, copyright, like other intellectual property rights, can be enforced by public law instruments - administrative and criminal.

In private law practice in the Czech Republic, there are relatively few cases in which copyright holders enforce their rights against repository operators who allow their users to communicate copyright and related content online without the permission of the copyright holders.

An example of the difficulty of enforcing copyright against repositories before the adoption of the amendment to the Copyright Act in Czech court practice was a dispute between the collective administrator DILIA theatre, literary, audiovisual agency, z.s. and the operators of the Ulož.to cloud a.s. repository, successively before the Municipal Court in Prague, the High Court in Prague as an appellate court and the Supreme Court as the second appellate court.

In this case, the Municipal Court in Prague dismissed at first instance an action by which the plaintiff sought to require the defendant to generally make digital files containing six specified films inaccessible to the public and to refrain from making such access in the future. On the other hand, it ordered the defendant to refrain from limiting the number of queries made from the applicant's specified internet protocol address to a server accessible via specified domain names and ordered the defendant to refrain from making publicly available digital files with specified extensions containing the six specified audio-visual works, in so far as members of the public can search for those files by entering the title of the work in a search engine provided by the defendant for that purpose. The defendant defended itself by arguing that the content on its server was not uploaded by it but was uploaded either by users of the service it provides or by its business partners and that it therefore provides its service in accordance with Sections 5 and 6 of Act No 480/2004 Coll. on certain information society services.[22]

On appeal by both parties, the High Court in Prague upheld the dismissal part of the judgment of the Municipal Court and changed the remaining part (granting the claim) so that the defendant is obliged only for the duration of the proprietary copyright and related rights and only for the works specified by the plaintiff to the defendant. The defendant cannot generally be ordered to make illegally uploaded works inaccessible to users and to refrain from doing so in the future without the defendant entering and inspecting the content of those files, since in each individually determined case it is necessary to examine whether the operator of an electronic communications service has exceeded the limits of the so-called safe harbour within the meaning of sections 5 and 6 of the Act on Certain Information Society Services and, therefore, whether liability for the content passes to it rather than to the user of the service. Restrictions can be imposed on

[22] Judgment of the Municipal Court in Prague of 22 February 2019, No. 34 C 6/2017-360.

the defendant only in respect of specific works which have been shown to be repeatedly and unlawfully present on its service and offered for download to the public.[23]

The plaintiff appealed against the judgment of the High Court and raised the question whether the defendant, as a provider of an information society service which has been notified of the unlawful appearance of specifically specified works, can be required to prevent any access to such works to the public (through a search engine which it itself provides) within the meaning of section 18(2) of the Copyright Act or only for the purposes of downloading. In the applicant's submission, the Court of Appeal narrowed the obligation originally imposed on the defendant by the Court of First Instance to refrain from making the digital files in question available to the public in general terms to refraining from making them available for downloading, thereby leaving the defendant free to communicate the defective files by streaming, which the defendant duly uses. The defendant also appealed. The Supreme Court dismissed the plaintiff's appeal on the grounds that it sought a decision on the basis of new findings of fact, which was inadmissible on appeal, and that it extended the claims to prohibit streaming, which it had not pleaded in its application. They dismissed the defendant's appeal.[24]

Even if in the given case the courts partially accepted the claim of the rights holders, the difficulty of enforcing copyright protection before the amendment of the Copyright Act is evident from the reasoning of the courts. During the proceedings, for example, the courts required a certificate of the fact that the works, the illegal communication of which the plaintiff objects to the online public, are actually uploaded on the given platform of the defendant, by notarization on the day of the judgment, although it would perhaps be sufficient if the judges themselves looked into the repository and convinced themselves that the objected works are actually stored here.

Similarly, criminal offenders of copyright and related rights were prosecuted under Section 270 of the Criminal Code, but those cases related to the activities of natural persons who themselves offered to download works that they had illegally uploaded on their websites. Even here, the punishment was not easy, especially due to the difficulty of identifying the offender, if more persons had access to the computer from which the illegal content was offered for download.[25]

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[23] Judgment of the High Court in Prague of 20 January 2021, No. 3 Co 58/2019-409.

[24] Resolution of the Supreme Court of 8 June 2022 Case No. 23 Cdo 1840/2021.

[25] E.g. Resolution of the Supreme Court of 27 January 2010 No. 5 Tdo 31/2010 in a case where the courts also addressed the question of whether the perpetrator of the crime of illegal recording and communication of a large number of content to public from the computer in the given apartment is the user or partner living there together and established an expert to determine the professional competence of the offender to work with computer more professionally; also Resolution of the Supreme Court of 2 July 2021 No. 5 Tdo 636/2021 confirmed the punishment of the offender who published links to films and series illegally placed on so-called file hosting servers - a discussion forum under a pseudonym; similarly Resolution of Supreme Court No. 5 Tdo 164_2011-41 of

5. ENFORCEMENT OF COPYRIGHT PROTECTION AGAINST ILLEGAL ONLINE COMMUNICATION OF CONTENT TO THE PUBLIC IN LITIGATION AFTER THE 2022 AMENDMENT OF THE COPYRIGHT ACT

The SDM Directive does not deal with enforcement issues, much less in its section on online content sharing services against repositories providing illegal content to the public. On the issue of copyright enforcement, the Commission only issued a Recommendation in 2023, and only for live events – live music, sports events, etc.[26] Therefore, the enforcement of rights against the illegal sharing of content online from internet repositories does not have any special new regulation.

Even though the period of validity of the amendment is very short and so far, there could not have been more court cases on this issue, a shift towards higher protection and an easier procedure against violations of their storage rights is still visible in practice. This was reflected in the new activity and procedure of some repositories as well as in the approach and decision-making of Czech courts. Already in February 2023, the Municipal Court in Prague ruled in the dispute between the Prima TV and Petacloud, a.s. which operates the Uloz.to cloud platform, that the defendant must not allow the public to download the ZOO series from its repository. Furthermore, the defendant operator must provide the plaintiff with information, in particular the IP addresses and other data of persons who illegally uploaded parts of the ZOO series to its platform. In the decision, the court stated that the defendant is committing unfair competition and infringement of the plaintiff's copyright for this series according to the amendment to the Copyright Act. Uloz.to allows the public to download content illegally uploaded there, either for free slowly, or quickly for a fee - and makes huge profits from the fees. However, the defendant appealed against the judgment, stating that the plaintiff's rights do not apply to them as a mere intermediary.

On the contrary, Prima has filed a similar lawsuit against the operator Uloz.to regarding the illegal access to the series Sunny (Slunečná) and intends to demand unjustified enrichment from the defendant and from the people who uploaded these series there. Similarly, after Uloz.to, CinemArt is demanding millions in unjustified enrichment for illegally offering the movie Charlatan (Šarlatán), awarded with the Czech Lions film awards, for free download from its repository. Nova TV also filed a lawsuit against Uloz.to regarding its series Street (Ulice) and Surgery in the rose garden (Ordinace v růžové zahradě) - the Municipal Court in Prague complied with this and imposed a preliminary injunction against Petacloud, which the defendant ignored and therefore was fined by the

23.2.2011; also Resolution of Supreme Court of 18 March 2020 No. 5 Tdo 211/2020.

[26] Recommendation of the European Commission on the fight against online piracy of sports and other live events of 4/5/2023 under No. C (2023) 2853. OJ C 136, 24 May 2023, p. 83.

court bailiff. There are also other repositories with illegal recordings in the Czech Republic, much smaller, but they are also changing their practice - the Hellspy or Hellshare repositories concluded an agreement with Prima, Nova and Óčko televisions to deploy automatic filters to prevent pirated recording and sharing of films and other recordings, but has now announced that it is ending operations due to an amendment to the copyright law.[27]

On the contrary, there was no reaction similar to the situation in France, where the SDM directive was implemented as in the first EU Member State, and where Google tried to circumvent the new regulation by threatening them instead of agreeing with the rights holders to legalize the online communication of content to the public in the license conditions. that if they don't give to Google free licenses to the protected content it distributes, it will delete them from the search results. In doing so, it abused its dominant position of providing search services on the Internet, which led to the intervention of the French cartel authority with the threat of a heavy fine and a ban on such a practice. The authority imposed a preliminary measure on Google to agree on a fair price with the rights holders.[28]

6. PROPOSAL FOR THE ESTABLISHMENT OF A "BLOCKING AUTHORITY" FOR THE PROTECTION OF COPYRIGHTS

In addition to private law, where the prohibition of illegal communication of protected works to the public, or an injunction to prevent their re-upload imposed by the repository can be enforced by rights holders in protracted legal disputes. Criminal punishment is, in accordance with the principle of subsidiarity of criminal repression ultima ratio, difficult to achieve. Therefore, even with the positive experiences from the changed judicial practice to date following the amendment of the Copyright Act, proposals for the establishment of a new office that could quickly and effectively achieve correction of copyright infringements are legitimate.

It could be an office for the protection of copyrights, the so-called "blocking" or "switching off", public in nature, which already operates similarly in some EU countries. According to a survey conducted by Luciá Kociánová, there are 3 types of such authorities:

1) Authorities that operate as an independent state institution or are part of another state institution and themselves block or propose blocking of illegal files or domains communicated to the public on websites, especially repositories including illegally disseminated live broadcasts of sports or cultural events (Greece, Italy, Lithuania, Spain).

[27] POKORNÝ, Marek. Televize začínají porážet Ulož.to. *Hospodářské noviny*, 3 April 2023, ISSN 0862-9587.
[28] DRTINA, Martin. Chystá se revoluce autorského práva. *Právní rádce,* 7/2020, p. 7. ISSN 1210-6410.

2) State authorities that do not block illegal content themselves, but have other specific competences that enable them to take an active role in the fight against illegal online dissemination - a lawsuit for a blocking order is filed by the rights holder against the operator - ISP, verifies the evidence sent by the rights holder and the identity of the infringer, gives the first and second warning to the intruder (France, from 2022 also regarding mirror sites).

3) A non-state independent self-regulatory body established on the basis of a multilateral agreement according to a common code of ethics, the review commission will recommend the blocking of the site to the Federal Agency for Networks, for Electricity, Gas, Telecommunications, Posts and Railways, which will confirm in writing the legality of the blocking, and then the site will be blocked by the connection provider, the legality of the procedure also confirmed by the CJEU in UPC Telekabel C-314/12, para. 43 (Germany).

These authorities operate (in some countries already since 2011) not exclusively but only as an alternative to judicial interventions, their purpose is to quickly block or delete illegal content, in some cases also to prevent re-uploading as a precaution, the rights holder must claim damages against the infringers in court. An order from an authority must still be quickly approved by a court (Lithuania, until 2019 Spain). A proposal for blocking is usually submitted by the owner of the infringed copyright with evidence of infringement, with payment of a fee (free in some countries), an appeal to the court or a complaint without suspensive effects is possible against the decision of the authority, the authority compensates the injured persons for any damage caused by unauthorized blocking (Lithuania) or the holder of rights requesting blocking, in case of delay in complying with the blocking order, the office will issue a fine to the violator or order the bank to suspend the violator's access to the account. The source of funding is fees from blocking applicants or contributions from companies operating in communications, partly from the state budget. The mentioned authorities really work in practice, the number of blocking decisions is in the order of hundreds to thousands.[29]

These experiences, in particular, the Greek regulation in Act 2121/1995, led the Association of Commercial Televisions to the initiative to establish an Office for the Protection of Copyright and Related Rights on the Internet ("blocking" office) in the Czech Republic as well. It should be an independent administrative office or attached to the Ministry of Culture or the Czech Telecommunications Authority. Proceedings would be initiated at the proposal of the rights holder for an administrative fee, the violator - the intermediary service provider, the repository, would first be invited by the authority to rectify the illegal situation

[29]KOCIÁNOVÁ, Lucie. *Představení systému fungování blokovacích úřadů v zahraničí.* Lecture at the ALAI Czech Republic seminar and the Cultural and Creative Industry Section of the Czech Chamber of Commerce as part of a series of lectures on illegal content sharing online, Prague, Jazz Dock, 15/03/2023.

voluntarily, and if it did not do so, the authority would obligate him to do so.

In the debate on the establishment of a new office, opinions denying the appropriateness of such drastic protection were also discussed, when disabling illegally stored content at the domain level can "block" even legally stored data there. Therefore, its task will always be to assess the given situation individually and to protect and not block the legally uploaded content on the platform. The experience of already existing "blocking" authorities attests to this practice. On the whole, it is possible to welcome the proposal and only state that it supports the objectives of the SDM Directive as well as the amendments under discussion.

CONCLUSION

From the aforementioned discussion it is clear that the amendment to the copyright law in the part relating to the online content communication service has a significant impact in practice in favour of copyright protection against illegal repositories. And not only the right to a court injunction against further violations of the law and the removal of negative consequences from repositories, or prevention against re-uploading, but also information obligations and unjustified enrichment as copyright enforcement tools. These results in practice fulfil the objective of the SDM Directive. Hence, the SDM Directive is sufficiently effective from the point of view of its implementation in the Czech Republic. There is a clear difference in the possibilities of copyright enforcement, but it turns out that in court practice it is also possible to use enforcement on the grounds of unfair competition to support them.

The establishment of a special "blocking" authority with similar status and functions to the authorities listed in point 6, especially the Greek one, can be considered a legitimate instrument of public law significantly supporting the objectives of the SDM Directive in the protection of copyright and related rights.

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[2] Decision of the CJEU (Grand Chamber) of 22 June 2021. Frank Peterson v. Google LLC and others and Elsevier Inc. v. Cyando AG. Joined cases C-682/18 and C-683/18 (the decision in case “YouTube/Uploaded"). (OJ C 82, 4.3.2019).

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[3] Communication from the European Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions - A strategy for a Digital Single Market in Europe, COM/2015/ 0192 final [online]. In EUR-Lex. Available from: http://eur-lex.europa.eu/.

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[3] Resolution of the Supreme Court, Czech Republic, Brno of 21.07.2021 No. 5 Tdo 636/2021 [cited 2023-7-11]. Available from: https://www.aspi.cz/.

[4] Resolution of Supreme Court, Czech Republic, Brno No. 5 Tdo 164_2011-41 of 23.2.2011 [cited 2023-7-11]. Available from: https://www.aspi.cz/.

[5] Resolution of Supreme Court, Czech Republic, Brno of 18.03.2020 No. 5 Tdo 211/2020 [cited 2023-7-11]. Available from: https://www.aspi.cz/.

[6] Judgment of the High Court in Prague, Czech Republic of 20 January 2021, No. 3 Co 58/2019-409 [cited 2023-7-11]. Available from: https://www.aspi.cz/.

[7] Judgment of the Municipal Court in Prague, Czech Republic of 22 February 2019, No. 34 C 6/2017-360 [cited 2023-7-11]. Available from: https://www.aspi.cz/.

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[2] CZECH REPUBLIC Civil Code - Act No. 89/2012 Coll., amended by Act No. 374/2022 Coll. [občanský zákoník, zákon č. 89/2012 Sb., změněný zákonem č. 374/2022 Sb.].
[3] CZECH REPUBLIC Act No. 480/2004 Coll., on certain information society services, as amended [zákon č. 480/2004 Sb., v platném znění, o některých službách informační společnosti].
[4] CZECH REPUBLIC Act No. 221/2006 Coll., as amended, on the enforcement of industrial property rights and protection of trade secrets [zákon č. 221/2006 Sb., v platném znění, o vymáhání práv průmyslového vlastnictví a o ochraně obchodního tajemství].
[5] Directive (EU) 2019/790 of the European Parliament and of the Council of 17 April 2019 on copyright and related rights in the digital single market and amending Directives 96/9/EC and 2001/29/EC. (OJ L130, 17.5.2019, p. 92).
[6] Directive (EU) 2019/789 of the European Parliament and of the Council of 17 April 2019 laying down rules for the exercise of copyright and related rights applicable to certain online broadcasts by broadcasting organisations and retransmissions of television and radio programmes and amending Council Directive 93/83/EEC. (OJ L130, 17.5.2019, p. 82).
[7] Directive (EU) 2019/770 of the European Parliament and of the Council of 20 May 2019 on certain aspects of contracts for the provision of digital content and digital services. (OJ L136, 22.5.2019, p. 1).
[8] Directive (EU) 2019/771 of the European Parliament and of the Council of 20 May 2019 on certain aspects of contracts for the sale of goods, amending Regulation (EU) 2017/2394 and Directive 2009/22/EC and repealing Directive 1999/44/EC. (OJ L136, 22.5.2019, p. 28).
[9] Directive (EU) 2000/31 of the European Parliament and of the Council of 8. 6. 2000 on certain aspects of information society services, in particular electronic commerce, in the Internal Market. (OJ L178, 17.7.2020, p. 1).
[10] Directive (EU) 2004/48 of the European Parliament and of the Council of 29 April 2004 on the enforcement of intellectual property rights, to which Commission Declaration No 2005/295/EC concerning Article 2 of that Directive is related (OJ L 94, 13.4.2005, p. 37).

Shares and non-monetary payment of interest of profit and of other resources of a joint stock company to shareholders

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Abstract: *This paper deals with the non-monetary share of profit and other own resources and the shares associated with them. This topic has not received much attention in legal scholarship so far. The Act No. 90/2012 Coll., on commercial companies and cooperatives (Act on Commercial Corporations) allows the payment of interest of profit and other own resources in non-monetary form to shareholders, however, the experience of the author of this paper is that in reality this possibility is not used very often. It is therefore necessary to ask whether it is justified for the professional public to overlook this issue. The possibility of paying an interest of the profit and of other own resources through non-monetary payment is not purely theoretical and may have some practical significance. In principle, the legal regulation allows two options how to proceed to use shares generating profit in kind. Both options will be discussed and evaluated. The paper aims at answering pending questions regarding the non-monetary payment of interest of profit and of other own resources. With respect to the methods used for drafting this paper, the author has mainly relied on analysis, synthesis and comparison.*

Keywords: *business share, general meeting, joint-stock company, other own resources, shares*

1. INTRODUCTION TO SHARES AND NON-MONETARY SHARES IN PROFIT AND OTHER OWN RESOURCES

This paper deals with non-monetary payment of interest of profit and other equity distributions to shareholders namely non-monetary payment of profit interest and of interest in other own resources and shares associated with them. The paper shall not address issues related to accounting and tax law. Generally speaking, it is not only a theoretical topic, but above all a practical one. An interest in profit and in other own resources paid to shareholders is undoubtedly the most important economic right associated with shares. The conditions for the distribution of profits and other own resources, the methods of distribution, the conditions for payment, the form of payment, and its maturity form an integral part of this right. In this paper, the author examines cases where a joint stock company has more than one shareholder, because in the case of a joint stock company with a single shareholder, the whole situation is disproportionately simpler.

The previous legal framework enshrined in Act No. 513/1991 Coll., the

Commercial Code (hereinafter also referred to as the "Commercial Code"), did not explicitly prohibit the payment of interest in profits and in other own resources to shareholders in a non-monetary form. However, it was clear from the wording of the regulation that non-monetary interest in profit was not envisaged. As an example, we can cite the provisions of Section 178(6) of the Commercial Code, which read as follows "The amount to be paid as an interest of the company's profit...". It is evident that economic practice did not lack the payment of interest in profit and other own resources in a non-monetary form, and thus throughout the entire period of the Commercial Code's effectiveness, economic practice did not need to force a change in legislation.

The legal framework enshrined in Act No. 90/2012 Coll., the Act on Commercial Companies and Co-operatives (hereinafter also referred to as the "Act on Commercial Corporations")[1], allows the payment of interest in profit and in other equity to shareholders also in a non-monetary form. However, the legislator did not consider this option of paying an interest in profits and in other own resources in a non-monetary form significant enough to explicitly mention this change in the explanatory memorandum to the Act on Commercial Corporations[2]. Nor did the legislator indicate which foreign legal order inspired this regulatory framework. However, it can reasonably be assumed that the stated inspiration was the German Act on Joint-Stock Companies, which in section 58(5) of the Act on Joint-Stock Companies allows the payment of interest in profit and other resources in kind in essentially similar words[3]. On the other hand, in Austria, there is no specific provision about the possibility of paying an interest in profit and other resources in kind, but legal scholarship believes this option is viable.[4]

As far as the Czech legal scholarship is concerned, some authors do not mention the possibility of payment in kind at all[5], others deal with this issue, albeit somewhat briefly. For example, Lasák[6] states that "The articles of association may also admit and regulate a dividend in kind (which may be tons of coal or the

[1] See Section 348(2) of the Act on Commercial Corporations.

[2] Důvodová zpráva k zákonu o obchodních korporacích, Sněmovní tisk Parlamentu ČR č. 363, VI. volební období, 2011, pp. 234-235. Available from https://www.psp.cz/sqw/text/orig2.sqw?id d=71126&pdf=1.

[3] Section 58(5) of the Act on Joint Stock Companies (AktG) states: "Where the by-laws so provide, the general meeting may also resolve to make a distribution [of profit] in kind."

[4] See REICH-ROHRWIG, Johannes. *Grundsatzfragen der Kapitalerhaltung bei der AG, GmbH sowie GmbH & Co KG*. Wien: MANZ Verlag. 2004, p. 104; KALSS Susanne in KALSS, Susanne, NOWOTNY, Christian, SCHAUER, Martin. Wien: MANZ Verlag. *Handbuch Österreichisches Gesellschaftsrecht,* 2017. Rz. 3/884.

[5] E.g. KOTÁSEK, Josef, PIHERA, Vladimír, POKORNÁ, Jarmila, VÍTEK, Jindřich. *Právo cenných papírů.* Praha: C.H. Beck. 2014, p. 65, ČECH, Petr, ŠUK, Petr. *Právo obchodních společností.* Praha: BOVA POLYGON. 2016. p. 360-362, ROZEHNAL, Aleš in ROZEHNAL, Aleš et al. *Obchodní právo.* Plzeň: Vydavatelství a nakladatelství Aleš Čeněk, s.r.o. 2014. p. 454.

[6] LASÁK, Jan in POKORNÁ, Jarmila, HOLEJŠOVSKÝ, Josef, LASÁK, Jan, PEKÁREK, Milan et al. *Obchodní společnosti a družstva.* Praha: C.H. Beck. 1st edition 2014, p. 277.

company's own shares, etc.)". Štenglová[7] notes, and I quote: "Interest in profit may be paid - if the articles of association so determine - in another form than cash (e.g. in securities, etc.)". Similarly, Dvořák[8] comments on the possibility of paying out non-monetary payment of interest in profit and in other own resources: 'Interests in profit are paid out in money, unless the articles of association specify otherwise. Although such an approach is not very common in practice, it is not impossible for a food company to pay of interest of profit in the form of, for example, six fresh eggs for each share, etc." Hampel[9] also briefly comments on the possibility of paying out of interest in profit and in other own resources. He says: "Monetary payment is traditional, but nevertheless dispositive, as the articles of association may specify otherwise, for example in the form of an in-kind equivalent (agricultural products, etc.). However, such a modification of the articles of association requires the approval of a qualified majority of the shareholders." Dědič and Lasák[10], whose views are confronted by the author below, are most concerned with the issue. As stated in the abstract, the author considers there are two situations that can in principle result in the payment of interest in profit and in other equity to shareholders. The first situation is that the joint stock company issues a special kind of shares to which the right to payment of interest in profit and other own resources in non-monetary form will be attached. The second situation, that may arise, is the payment of interest in profits in a non-monetary form without issuing a special type of shares. The paper will first focus on the possibility of issuing a special type of shares associated with a non-monetary payment of interest in profit and other equity interests, and then it will examine the simple payment of interest in profit and other equity interests in non-monetary form without incorporating this right into shares.

2. SHARES WITH NON-MONETARY INTEREST IN PROFIT AND OTHER OWN RESOURCES

The law does not expressly exclude issuing a special type of shares that would carry the right to receive an interest in profit and in other own resources in a non-monetary form. Above all, however, this right must be incorporated into this type of share equally for all shareholders, since a joint stock company must

[7] ŠTENGLOVÁ, Ivana and ŠTENGLOVÁ, Ivana., HAVEL, Bohumil, CILEČEK, Filip, KUHN, Petr, ŠUK, Petr. *Zákon o obchodních společnostech.* Komentář. Praha: C.H. Beck. 3rd edition. 2020, p. 695.

[8] DVOŘÁK, Tomáš. *Akciová společnost.* Praha: Wolters Kluwer ČR. 1st edition. 2016, p. 721.

[9] HAMPEL, Petr in BĚLOHLÁVEK, Alexander et al. *Komentář k zákonu o obchodních korporacích.* Plzeň: Vydavatelství a nakladatelství Aleš Čeněk, s.r.o. II. vol. 2013, p. 1490.

[10] DĚDIČ, Jan and LASÁK, Jan in LASÁK, Jan, DĚDIČ, Jan, POKORNÁ, Jarmila, ČÁP, Zdeněk et al. *Zákon o obchodních korporacích. Komentář.* Praha: Wolters Kluwer, a.s. 2nd edition. 2021, p. 1521-1522.

treat all shareholders equally under Section 244 of the Act on Commercial Corporations. In practice, however, this would also mean that the non-monetary consideration would have to be fungible; i.e. it would have to be a fungible good. The author believes it is not sufficient that the right to receive an interest in the profit and in other own resources in kind only in general terms is associated with this type of shares. It would then be up to the will of the general meeting to decide specifically, even against the will of the shareholders holding shares with a non-monetary interest in profit and other own resources, to pay them a non-monetary benefit in which they would have no interest and which would, in fact, negate the purpose of the interest in profits and in other own resources - the shareholders' effective share in the profit and loss.

The second argument for a more precise definition of the object of a non-monetary interest in profit is that a general definition of interest in profit and in other own resources as only "non-monetary" would be too vague and therefore illusory within the meaning of Section 553(1) of Act No. 89/2012 Coll., the Civil Code (hereinafter referred to as the "Civil Code"). Such a generally formulated right to a non-monetary payment of interest in profits and in other own resources would then be disregarded and the shares would not be associated with this special right. The Civil Code does allow for additional clarification of the expression of intent in Section 553(2); in that case, this defect in the articles of association of a public limited company would not be taken into account, but this possibility would be difficult to consider in this case. How could the subject matter of the non-monetary payment of profit and of other own resources be clarified otherwise than by amending the articles of association? Dědič and Lasák reach a similar conclusion - but only in relation to the payment of a non-monetary interest in profit and in other own resources[11] -, when they state that the general wording on the possibility to pay a non-monetary interest in profit and in other own resources would not be sufficient, as such a wording of the articles of association "... would render the decision on the method of performance arbitrary, and a simple majority of shareholders present at the general meeting could approve performance completely unacceptable to the other shareholders without them having been able to count on it in advance." At the same time, Dědič and Lasák offer a possible solution, which the author agrees with. They suggest that the articles of association could "...provide for the possibility of paying non-monetary consideration without material limitation where the shareholder would always have the right to elect to be paid in money instead of the specified non-monetary consideration." The author believes this alternative could only be applicable in practice in relation to a non-monetary consideration if the non-monetary consideration is economically attractive to the shareholder, e.g. because it is a scarce or otherwise exceptional

[11] DĚDIČ, Jan and LASÁK, Jan in LASÁK, Jan, DĚDIČ, Jan, POKORNÁ, Jarmila, ČÁP, Zdeněk et al. *Zákon o obchodních korporacích. Komentář.* Praha: Wolters Kluwer, a.s. 2nd edition. 2021, p. 1521.

good. There may be certain theoretical and practical problems associated with the inclusion of the right to a non-monetary interest in profit and other own resources by defining a specific fungible good in the articles of association. The first problem determines at what level of certainty the non-monetary benefit should be defined. Would it be sufficient to specify that the non-monetary benefit in question would be defined in kind, e.g. by specifying an agricultural product or another commodity? Or should the non-monetary benefit be specified at the level of the precise transaction in the form of the brand of the good and its technical parameters or the quality of the agricultural commodity?

The author believes it would be sufficient to define the non-monetary consideration by articles of association at the level of the specified commodity. A more detailed specification of the goods in the articles of association only at the level of the precise specification of the thing could cause the obligation to pay an interest in the profits and in other own resources to be extinguished because of the consequent impossibility of performance within the meaning of Section 2006 of the Civil Code if the non-monetary consideration defined in the articles of association no longer exists. This would, however, mean that the articles of association would have to be amended to change the definition of the non-monetary consideration in response to the situation. This means, however, that the type of shares would probably also change or, depending on the specific situation, the right attached to the shares would change, as the shareholder would be entitled to a different non-monetary consideration. A change in the type of shares or a change in the rights attached to the type of shares requires the consent of a two-thirds majority of the votes of the shareholders present pursuant to Section 416(1) of the Act on Commercial Corporations, since it is a change in the articles of association, and at the same time a three-quarters majority of the votes of the shareholders present who own the shares within the meaning of Section 417(2) of the Act on Commercial Corporations. The same majority would logically be required even if, during the existence of the joint stock company, another type of shares was changed to shares with a non-monetary interest in profit or other own resources, and it was not an "adjustment" or "refinement" of the non-monetary consideration.

A change in the type of shares or a substantial change in the rights attached to the shares by a decision of the General Meeting means, pursuant to the provisions of Section 335 of the Act on Commercial Corporations, that the joint-stock company is obliged to make a public proposal for a contract for the purchase of these shares. The company must comply with the obligation to make a public proposal for a share purchase agreement within 30 days of the effective date of such amendment to the articles of association, i.e. at the time of adoption of this resolution. In this case, Act No. 33/2020 Coll., which amended, inter alia, Section 431 of the Act on Commercial Corporations, reassessed the effects of an amendment to the articles of association concerning the type of shares in favour of declaratory effects. The corresponding section in the explanatory memorandum to

Act No 33/2020 Coll.[12] reads as follows: "In the case of a decision to split shares, merge shares, change the form or type of shares, it is proposed to abandon the constitutive effect of the entry of these facts in the Commercial Register. In these cases, the change is not of such fundamental importance that it is necessary to link its effectiveness to its entry in the Commercial Register." After a public proposal contract has been made for the purchase of the shares by a public limited liability company, the shareholders who voted in favour of the change in the type of shares or of a substantial change in the rights attached to the shares must, within three months of the date on which the company purchased them, purchase the shares from the company, according to the proportion of the nominal value of their shares or the number of shares held by them, and at the price paid for them by the company, plus interest at the rate customary at the time when the company made the public proposal.

The situation would be considerably simpler if the non-monetary consideration were either securities issued directly by the company or other securities which conferred a right to other consideration. If the non-monetary consideration paid out as an interest in profit and other own resources were the company's own shares, this would mean that the joint stock company would have to acquire its own shares subject to the rules set out in Sections 301 to 305 of the Act on Commercial Corporations and Sections 307 to 309 of the Act on Commercial Corporations, i.e. in particular with the approval of the General Meeting, the acquisition of treasury shares would not be allowed to reduce the shareholders' equity below the subscribed share capital increased by funds that cannot be distributed to shareholders under the Act on Commercial Corporations or the articles of association, and the company would have to have resources to create a special reserve fund for treasury shares. The limit to the possibility of acquiring treasury shares used for the payment of non-monetary interest in profit and other own resources is, of course, the fact that some shares of the company are available on the open market and can be easily acquired. As already indicated, in addition to treasury shares, the non-monetary consideration could consist of issuing other securities representing a different consideration. An example of such a security for another consideration could be a voucher for the goods of a public limited company or a voucher for the purchase of goods of a public limited company for the value stated on the voucher.

3. PAYMENT OF A NON-MONETARY INTEREST IN PROFITS AND IN OTHER OWN RESOURCES

As mentioned above, the Act on Commercial Corporations provides for

[12] Důvodová zpráva k zákonu o obchodních korporacích. Sněmovní tisk Parlamentu ČR č. 207, VIII. volební období, 2020, p. 213. Available from https://www.psp.cz/sqw/text/orig2.sqw?idd=135881.

the possibility of a non-monetary interest in profit and in other own resources in the provisions of Section 348(2) of the Act on Commercial Corporations. The condition for non-monetary consideration is that this possibility is determined by the articles of association of the joint stock company. Therefore, an amendment of the articles of association is required to allow this option, pursuant to section 416(1) of the Act on Commercial Corporations, by a qualified two-thirds majority of the votes of the shareholders present. The provisions of Section 348(2) of the Act on Commercial Corporations show at first sight that the non-monetary consideration is linked only to the payment of interest in profit and in other own resources and not that the resolution on the distribution of interest in profit and in other own resources itself contains the determination of the non-monetary consideration. It follows, therefore, that this is not a special kind of share, since this right, unlike the possibility of issuing a special kind of share, is linked to a non-monetary interest in profits and in other own resources, but a method of payment of interest in profit and in other own resources.

If the law requires that the articles of association admit the possibility of paying out an interest in profit and in other own resources in kind, the question logically arises - similarly to the case of combining a non-monetary interest in profit and in other special resources with shares and the creation of this special type of shares - what level of certainty the articles of association should contain in order to fulfil this possibility? Is it sufficient for the articles of association to specify that the interest in profits and in other special resources may also be granted in kind? The author agrees with the opinion of Dědič and Lasák[13] presented above that a general formulation would not be sufficient. These authors argue that a simple majority of the shareholders present could approve a non-monetary consideration that would be completely unacceptable to the other shareholders who could not count on this consideration in advance. The shareholders would only learn from the invitation to the general meeting which specific non-monetary consideration they can count on, which would undoubtedly affect their legal certainty, and moreover, the economic benefit of such consideration could be problematic for the shareholders, e.g. also because the payment of such a non-monetary consideration would require significant additional costs for the shareholder (e.g. in the case of a generally worded provisions of the articles of association allowing for non-monetary consideration, one can also agree with the opinion of Dědič and Lasák[14] that the articles of association should not only allow for non-monetary consideration but should alternatively allow for cash consideration).

However, contrary to the authors above, the author does not think that

[13] DĚDIČ, Jan and LASÁK, Jan in LASÁK, Jan, DĚDIČ, Jan, POKORNÁ, Jarmila, ČÁP, Zdeněk *et al*. *Zákon o obchodních korporacích. Komentář.* Praha: Wolters Kluwer, a.s. 2nd edition. 2021, p. 1521.
[14] Ibid.

the exclusive possibility of non-monetary performance of interest in profit and other own resources lacks support in the wording of the Act on Commercial Corporations, since the law does not imply the conditionality of granting non-monetary performance at the same time as cash performance. If the legislator had wanted to condition the payment of a non-monetary interest in profit and other own resources on the existence of a monetary alternative, it would undoubtedly have done so explicitly. However, the legislator has formulated the provisions of Section 348(2) of the Act on Commercial Corporations so broadly that it has given the company the scope to adjust this method of payment by allowing only non-monetary consideration. The author makes completely different arguments for excluding the wording of the articles of association allowing generally non-monetary consideration. The first argument for excluding the general formulation of "non-monetary consideration" has already been set out above. The author believes it is a vague provision of the articles of association which would be apparent within the meaning of section 553(1) of the Civil Code. The consequence of the apparent nature of such an arrangement would then be a situation in which such a provision of the articles would be disregarded, which would mean that the payment of interest in profit and other own resources would only be possible in money. The second argument is that the payment of a non-monetary consideration so generally formulated in the articles of association could be contrary to good morals pursuant to Article 2(1) of the Civil Code or contrary to the principle of fair dealing within the meaning of Article 6 of the Civil Code, in particular where the non-monetary consideration would be inappropriate or unforeseeable for certain shareholders.

In the author´s opinion, a different situation would arise if the articles of association significantly define the scope of non-monetary consideration, e.g. by stating that the subject of non-monetary consideration may be the production range of a joint stock company. In this case, in my opinion, on the basis of such a wording of the articles of association, the company could pay an interest in profit and in other own resources exclusively as a non-monetary consideration, as the shareholders could count on such consideration in advance.

In the event that the articles of association incorporate a provision on the possibility of paying out an interest in profit and in other own resources in kind, it cannot be excluded that, as in the case of shares with an incorporated non-monetary interest in profits and in other own resources, this would at the same time constitute a substantial change in the rights attached to the shares. This would again mean that the company would make a public proposal for a contract for the purchase of these shares within the meaning of Section 335(1) of the Act on Commercial Corporations. This would then be followed by the purchase of the shares acquired by the company by the shareholders who, by the weight of their votes at the general meeting, passed the resolution representing a substantial change in the rights attached to the shares, pursuant to Section 341 of the Act on Commercial Corporations.

One may ask which body of a joint stock company will decide on the non-monetary payment of interest in profit and other own resources to shareholders. The law does not contain an explicit provision on which body will decide on the payment of non-monetary consideration. Given that, according to Section 34(3) of the Act on Commercial Corporations, the statutory body decides on the payment of interest in profit and in other own resources, it would seem obvious that the Board of Directors in a dualistic model of the company's internal structure or the Management Board in a monistic model would decide on the payment in kind. However, the author believes that the legislator does not mean by the wording "shall be paid out" only the technical implementation of the resolution of the general meeting on the distribution of interest in profit and in other own resources to shareholders, but above all the decision on whether the interest in profit will be paid out in money or in kind; in the case of the decision to pay it out in kind, what kind of non-monetary consideration will be involved.

As regards the technical implementation of the payment of the non-monetary consideration, the author clearly considers that it is carried out by the Board of Directors or the Management Board, as in the case of a monetary consideration. The author believes the actual decision-making process as to whether a non-monetary consideration is to be paid (if the articles of association allow alternatively for both monetary and non-monetary consideration) and what it will be specifically is within the competence of the general meeting. The general meeting of a joint stock company decides on the distribution of profits within the meaning of Section 421(1)(h) of the Act on Commercial Corporations. The author is convinced that the decision on the distribution of profits includes not only the decision on what amount is to be distributed to the shareholders, but also on when this share is payable and, in the case of a non-monetary consideration, what its object is. Otherwise, the Board of Directors, or the Management Board, would decide whether and what non-monetary consideration is to be provided to the shareholders. However, this would mean that this fundamental economic right would not be decided by the shareholders themselves, but often only by professional management without a deeper connection to the shareholders. Thus, the company's Board of Directors (or the Management Board) could effectively exclude the payment of interest in profit and other own resources by selecting an inappropriate non-monetary item for the shareholders. A similar conclusion is reached by Dědič and Lasák[15], when they state that the right to an interest in profit and in other own resources is such a key right of shareholders that they cannot be subjected to the arbitrariness of the statutory body in determining whether the consideration will take the form of money or in kind, and they entrust this power to the General Meeting. However, they also allow for the solution that the General

[15] DĚDIČ, Jan and LASÁK, Jan in LASÁK, Jan, DĚDIČ, Jan, POKORNÁ, Jarmila, ČÁP, Zdeněk et al. *Zákon o obchodních korporacích. Komentář.* Praha: Wolters Kluwer, a.s. 2nd edition. 2021, p. 1521.

Meeting would approve the non-monetary form of the interest in profit and in other own resources contribution conditionally, i.e. on the condition that the statutory body approves the payment of the interest in profit and in other own resources in non-monetary form with the provision that otherwise the profit and other own resources contribution will be paid in monetary form. This solution outlined by both authors can also be accepted.

Another question arises as to how the value of such a non-monetary consideration should be determined and which body of the joint stock company decides on it. The author considers that the determination of the value of the consideration in kind is not within the competence of the General Meeting, since it is not the body empowered to make such a decision. The determination of the value of the consideration in kind is a professional decision, depending on a professional assessment of the matter. The same conclusion is expressed by Dědič and Lasák[16], who further emphasise the obligation to act with due care when determining the value of the non-monetary object of the transaction. At the same time, they express the opinion that the object of the non-monetary consideration should be assessed at fair value, referring to the application of this concept in relation to the settlement share pursuant to Section 36(3) of the Act on Commercial Corporations and the exceptions to the obligation to have the non-monetary consideration valued by an expert when increasing the share capital pursuant to Section 469 of the Act on Commercial Companies. The author is convinced that this is the only reasonable approach, as it is difficult to accept the conclusion that the subject of a non-monetary contribution should be assessed at book values. The author believes the interest in profit should reflect the market value of the transaction, i.e. its fair value at the time. This is because a situation could arise in which some of the shareholders to whom a monetary payment of interest in profit and other own resources would be paid would be prejudiced by the fact that the book value of the non-monetary consideration would be lower than the fair value, and the value of the non-monetary consideration would be determined according to its book value. The joint stock company would then be in violation of the principle set out in Section 244 of the Act on Commercial Corporations, i.e. that a joint stock company should treat all shareholders on equal terms.

4. CONCLUSION

In conclusion, it can be stated that an interest in profit and other own resources in non-monetary form has its aforementioned pitfalls and objective limits. However, this method of payment of interest in profit and other own resources cannot be completely dismissed as unnecessary and useless. In fact, situations may arise during the economic activity of a joint-stock company when a non-

[16] *Ibid*, p. 1522.

monetary payment to the shareholders as an interest in profit and other own resources will be their only realistic possibility to participate in the distributed economic result of the company. This may arise in a situation where the company lacks the financial resources to pay out interest in profit and other own resources but it has quite a lot of options to pay in kind e.g. using its own range of goods it produces.

The challenges outlined above related to this issue and possible solutions suggest the necessity to anticipate these open questions and, if legally possible, to adjust in advance the rules for the payment of non-monetary benefits to shareholders in the articles of association in an appropriate form in order to avoid possible adverse effects of unresolved issues for both the company and its shareholders.

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Debt discharge for insolvent Czech entrepreneurs under the EU Directive 2019/1023

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Abstract: *The Directive (EU) 2019/1023 requires Member States to ensure that insolvent entrepreneurs have access to at least one procedure that can lead to a full discharge of debts in a period no longer than three years. The deadline for transposition of the Directive 2019/1023 expired on 17 July 2021. The payment schedule according to the Czech Insolvency Act generally lasts five years. It is shortened to three years for some vulnerable groups of debtors, such as disabled or elderly people, and also for those who repaid 60% of debts within the first three years. This paper shall examine the consequences of not meeting the deadline for transposition, and whether Directive 2019/1023 could have a direct effect, based on the judgments of the Court of Justice of the EU (CJEU). The approach taken by the government's proposal for an amendment to the Insolvency Act which is currently pending in the legislative process shall also be addressed in this paper.*

Keywords: *creditor satisfaction, direct effect, discharge of debts.*

INTRODUCTION

Entrepreneurs are allowed to successfully file for debt discharge according to the Czech Insolvency Act[1], either in a way of realization of assets or by a general five-year payment schedule in combination with the realization of assets. The Directive 2019/1023[2] requires the EU Member States to ensure that insolvent entrepreneurs have access to at least one procedure that can lead to a full discharge of debt in a period no longer than three years. The period for transposition expired on 17 July 2021, while according to the Czech Insolvency Act, the debtors can benefit from the full discharge of debts within a three-year payment schedule only if 60% of verified debts are repayed, the debtor receives the state disability or retirement pension, or 2/3 of the debts originated before the debtor reached 18 years.

The question arises whether entrepreneurs who have started the debt discharge procedure after 17 July 2021 could benefit from the direct effect of Directive 2019/1023.

[1] CZECH REPUBLIC Act No. 182/2006 Coll., the Insolvency Act [zákon č. 182/2006 Sb., insolvenční zákon].
[2] DIRECTIVE (EU) 2019/1023 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 20 June 2019.

Literature as well as court decisions on the direct effect of directives in its both vertical and horizontal form have been researched in order to answer this question.

1. DISCHARGE OF DEBTS ACCORDING TO CZECH INSOLVENCY ACT

Full debt discharge was introduced to Czech law in 2008 as one of the forms of insolvency proceedings regulated by the Insolvency Act. Initially, it allowed relief solely from personal debts, and entrepreneur debts were excluded. Thus, the Czech legislator originally aimed to solve social problems related to over-indebtedness rather than to promotion of entrepreneurship, which is the narrative driving EU insolvency reforms.[3]

Through legislative changes, debts stemming from business were included and the debt discharge was gradually opened to entrepreneurs. The current conditions for debt discharge of entrepreneurs and other natural persons are now equal, except for practical regulation of calculation and payment of installments which differ for employees and self-employed insolvent debtors.

The original minimal level of creditors' satisfaction had been strictly set at 30 % of the verified unsecured debts, either through liquidation of assets or a payment schedule lasting invariably five years. By an amendment to the Insolvency Act[4] the 30 % threshold has been considered a rebuttable presumption of meeting the requirement for debt relief for debt discharge procedures where the insolvency petition was filed after 1 June 2019. The only threshold for creditor satisfaction has been set at the same amount as payments to the insolvency administrator. Thus, the conditions for debt discharge became rather vague, relying on the judgment of the court to determine, whether the debtor has made every effort to secure the maximum possible income eligible to make repayments to creditors during the debt discharge procedure.

The 2019 amendment to the Insolvency Act also shortened the payment schedule to 3 years for some vulnerable groups of debtors and also for those who repaid 60 % of debts within the first three years.

The economic fresh start is generally granted without drastic sorting out of the debtors by the court as the gatekeeper investigating the reasons behind the indebtedness.[5]

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[3] VANDENBOSSCHE, Gauthier. Natural person ltd.: Towards a unified discharge regime for entrepreneurs and consumers. International Insolvency Review. 2023, 32(1), 122–155. ISSN 1099-1107.

[4] CZECH REPUBLIC Act No. 31/2019 Coll.

[5] LINNA, Tuula. Consumer Insolvency: The Linkage Between the Fresh Start, Collective Proceedings, and the Access to Debt Adjustment. *Journal of Consumer Policy*. 2015, 38(3), 357–374. ISSN 1573-0700.

2. DIRECT EFFECT OF THE DIRECTIVE?

The Directive (EU) 2019/1023 requires Member States to ensure that insolvent entrepreneurs have access to at least one procedure that can lead to a full discharge of debt in a period no longer than three years.

Directives are legal acts adopted by the EU institutions addressed to the EU Member States and must be transposed into national law. However, in certain cases, the Court recognizes the direct effect of directives in order to protect the rights of individuals. A directive has a direct effect when its provisions are unconditional, sufficiently clear, and precise, and when the Member State has not transposed the directive by the deadline. Member States are obliged to implement directives but directives may not be cited by a Member State against an individual. Vertical direct effect is of consequence in relations between individuals and the state. This means that individuals can invoke a provision of EU law in relation to the state. Horizontal direct effect is of consequence in relations between individuals. This means that an individual can invoke a provision of EU law in relation to another individual.[6] The deadline for transposition of the Directive 2019/1023 expired on 17 July 2021. Article 21[7] of the Directive 2019/1023 is unconditional, sufficiently clear and precise. However, we cannot easily conclude that the requirement towards the EU Member States to allow discharge procedure for entrepreneurs in the period of no more than three years is directly effective. Such effect would not only establish the right to an insolvent entrepreneur to be relieved from their debts sooner than they can be discharged from debts according to the Insolvency Act. It also changes the legal position of the creditors, because shortening the debt relief procedure means fewer monthly payments, and without changing the way of calculating such payments it inevitably leads to lower creditors´ satisfaction.

It must be borne in mind that the Directive 2019/1023 does not apply to natural persons who are not entrepreneurs. To answer whether a person is eligible to apply for the discharge procedure under Directive 2019/1023, they should be able to prove that their debts in essence derive from entrepreneurial activities which are unrelated to the provision of goods and services outside the professional activities (consumer activities).[8]

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[6] EUR-Lex - l14547 - EN - EUR-Lex. EUR-Lex — Access to European Union law — choose your language [online]. [no date] [viewed 3 October 2023]. Available from: https://eur-lex.europa.eu/EN/legal-content/summary/the-direct-effect-of-european-union-law.html.

[7] Member States shall ensure that the period after which insolvent entrepreneurs are able to be fully discharged from their debts is no longer than three years starting at the latest from the date of either: (a) in the case of a procedure which includes a repayment plan, the decision by a judicial or administrative authority to confirm the plan or the start of the implementation of the plan; or (b) in the case of any other procedure, the decision by the judicial or administrative authority to open the procedure, or the establishment of the entrepreneur's insolvency estate.

[8] Remgijus Jokubauskas, 'Discharge of Debts of Insolvent Entrepreneurs Under the Restructuring and Insolvency Directive' (2023) 38(1) Utrecht Journal of International and European Law pp. 64–

Vertical direct effect was established by CJEU (formerly referred to as the "European Court of Justice") in van Gend & Loos case[9] and further elaborated on in numerous following cases. The vertical direct effect has been approved in various fields of law, even in criminal proceedings. As the CJEU put in Ratti case *„ ...a member state which has not adopted the implementing measures required by the Directive in the prescribed periods may not rely, as against individuals, on its own failure to perform the obligations which the Directive entails. "*[10]

Where the creditor is the state, the vertical direct effect of the Directive 2019/1023 seems to be available to the insolvent entrepreneur debtors and a claim to be relieved from such debts in three years according to the current provisions of the Insolvency Act (i.e. with no percentual threshold of the debts' repayment) seems to have good grounds based on the "estoppel argument". A Member State which failed to implement a directive cannot use this failure as a defence against an individual who is invoking the directive. If the Member State had implemented the directive correctly in time, it would have had the choice as to how far it wants to go and with what means. However, because it failed to do so, it forfeited the original choice[11]. The Czech legislator for example could have re-introduced a certain percentual threshold of debts repayment as a debt discharge condition or could have introduced some other stricter conditions for a debt discharge, but it did not.

It must be emphasized that it is not only the unpaid tax that could be considered as a debt towards the state, because CJEU uses a broader definition of the state. "*Unconditional and sufficiently precise provisions of a directive could be relied on against organizations or bodies which were subject to the authority or control of the State or had special powers beyond those which result from the normal rules applicable to relations between individuals. "*[12] Such institutions include local or regional authorities, authorities responsible for the maintenance of public order and safety, and public authorities providing public health services.

An insolvent entrepreneur does not usually have only public debts, but

75. DOI: https://doi.org/10.5334/ujiel.606.

[9] Judgment of the Court of 5 February 1963. NV Algemene Transport- en Expeditie Onderneming van Gend & Loos v Netherlands Inland Revenue Administration. Case 26/62. [online]. In EUR-Lex. [accessed on 2023-10-05]. Available from https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A61962CJ0026.

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[12] Judgment of the Court of 12 July 1990 A. Foster and others v. British Gas plc. Case C-188/89. [online]. In EUR-Lex. [accessed on 2023-10-03]. Available from https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:61989CJ0188.

also debts stemming from individual contracts, where the creditors are private creditors, no matter whether companies or individuals, entrepreneurs or not. Granting a benefit of a three-year full debt discharge for entrepreneurs based on the direct effect of Directive 2019/1023 in such cases would require application of the limits of the horizontal direct effect. This is a more limited form of direct effect and applies when the directive is not only clear, precise, and unconditional but also contains provisions that are intended to confer rights on individuals. The horizontal direct effect is not as commonly recognized as a vertical direct effect. It aims to provide individuals with a tool to protect their EU-derived rights in interactions with private parties[13].

In Marshall case[14] the CJEU pointed out that "With regard to the argument that a directive may not be relied upon against an individual, it must be emphasized that, according to Article 189 of the EEC Treaty, the binding nature of a directive, which constitutes the basis for the possibility of relying on the directive before a national court, exists only in relation to 'each Member State to which it is addressed.' It follows that a directive may not of itself impose obligations on an individual and that a provision of a directive may not be relied upon as such against such a person". Thus, the CJEU rejected the horizontal direct effect of directives in general. The main reason for such an approach was that the individuals are not addressees of directives and it would make the legal system less certain and predictable. However, this has been gradually undermined by numerous exceptions to this rule. Some authors even suggest, that after the lapse of the transposition period, it is prudent to treat every provision of an EU directive as having a horizontal direct effect.[15]

The horizontal direct effect has been admitted by CJEU in employment cases where a plaintiff claimed to be discriminated by their employer. The CJEU concluded that non-discrimination as a general principle of law is applicable in horizontal relationships.[16] In other cases where discrimination was not an issue, the horizontal direct effect was rejected.

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[13] Tichý, L. Evropské právo. Prague: C.H.Beck 2014. ISBN 978-80-7400-546-6.

[14] Judgment of the Court of 26 February 1986. M. H. Marshall v. Southampton and South-West Hampshire Area Health Authority (Teaching). Case 152/84. [online]. In EUR-Lex. [accessed on 2023-10-03]. Available from https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX %3A6 1984CJ0152.

[15] BOBEK, Michal. Why Is It Better to Treat Every Provision of EU Directives as Having Horizontal Direct Effect? International Journal of Comparative Labour Law and Industrial Relations. 2023, 39(Issue 2), 211–220. ISSN 0952-617X.

[16] Judgment of the Court of 12 July 1990 A. Foster and others v British Gas plc. Case C-188/89. [online]. In EUR-Lex. [accessed on 2023-10-03]. Available from https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:61989CJ0188; Judgment of the Court (Grand Chamber) of 19 January 2010 Seda Kücükdeveci v Swedex GmbH & Co. KG. Case C-188/89. [online]. In EUR-Lex. [accessed on 2023-10-03]. Available from https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A62007CJ0555.

The author of this paper believes that the three-year debt discharge procedure may be available for debts owed towards public institutions based on vertical direct effect, but not for debts with private parties. Would this mean that the insolvency administrator should alter the distribution scheme between creditors so that the public creditors are excluded, and their portion of the monthly repayment is equally redistributed between private creditors in the fourth and fifth year of the repayment schedule?

A practical solution might be to keep the payments for public creditors retained on a special account until a binding instruction is given by the insolvency court according to Article 11 of the Czech Insolvency Act.

3. DAMAGE SUFFERED

From the debtor's point of view, it makes little difference how their installments are distributed between creditors, with some exceptional cases with only public creditors, where the full debt discharge could be granted after three years based on the vertical direct effect of the Directive 2019/1023. The actual length of the debt discharge procedure is the center of interest of insolvent debtors and directly affects their economic position. They might see the payments made towards creditors "in excess" of the maximum period allowed by the Directive 2019/1023 (i.e. three years) as unjustified and seek redress towards the Czech Republic for such payments. In the Faccini Dori case[17] the CJEU stated that "*If the result prescribed by the directive cannot be achieved by way of interpretation, it should also be borne in mind that, in terms of the judgment in Joined Cases C-6/90 and C-9/90 Francovich and Others v. Italy [1991] ECR I-5357, paragraph 39, Community law requires the Member States to make good damage caused to individuals through failure to transpose a directive, provided that three conditions are fulfilled. First, the purpose of the directive must be to grant rights to individuals. Second, it must be possible to identify the content of those rights on the basis of the provisions of the directive. Finally, there must be a causal link between the breach of the State's obligation and the damage suffered*." The damages payable by the state were granted to a distant consumer and in the above referred Francovich case, the damages for unpaid salary were apportioned to an employee.

The Francovich case[18] established the principle that individuals could seek compensation from the state for damages suffered as a result of the state's

[17] Judgment of the Court of 14 July 1994. Faccini Dori v. Recreb Srl. Case 91/92. [online]. In EUR-Lex. [accessed on 2023-10-03]. Available from https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:61992CJ0091.

[18] Judgment of the Court of 19 November 1991. Andrea Francovich and Danila Bonifaci and others v. Italian Republic. Joined cases C-6/90 and C-9/90. [online]. In EUR-Lex. [accessed on 2023-10-03]. Available from https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A61990CJ0006.

failure to implement an EU directive correctly.

The existence of state liability for a breach of European Union law is evident from the established case law of the Court of Justice, and the Czech Supreme Court has had 'no doubt about its application, even in a situation where there is no corresponding regulation at the national level.' All three conditions under which state liability for a breach of Union law gives rise to the right of an individual to compensation for damages (violation of a Union legal provision granting rights to individuals, a sufficiently serious breach, a causal link between the breach of the legal provision and the damage) must be fulfilled cumulatively and apply to any form of breach of Union law.[19]

A claim for the sum of the installment payments made by the insolvency debtor three years after approving the repayment plan by the Court seems to be available to the debtor. It would be very interesting to see and argue whether payments of justified debts between private individuals (and professionals, because the Directive 2019/1023 grants a shorter period just for entrepreneurs) could be seen as "damages suffered" and such insolvency debtors would be granted redress against the Czech Republic.

4. PROPOSAL FOR AN AMENDMENT TO THE INSOLVENCY ACT

The government's proposal for an amendment to the Insolvency Act which is currently pending in the legislative process[20] (hereinafter referred to as „The Proposal") follows the Directive 2019/1023 and shortens the payment schedule with the liquidation of assets to three years with no difference to the status of the debtor.

The Proposal also introduces a presumption of meeting the conditions for debt discharge if the debtor has achieved the anticipated level of satisfaction of unsecured creditors' claims as determined by the insolvency court in the decision approving the debt discharge procedure ("rozhodnutí o schválení oddlužení"). This is in line with Article 20 (1) of Directive 2019/1023, which reads "*Member States in which a full discharge of debt is conditional on a partial repayment of debt by the entrepreneur shall ensure that the related repayment obligation is based on the individual situation of the entrepreneur and, in particular, is proportionate to the entrepreneur's seizable or disposable income and assets during the discharge period, and takes into account the equitable interest of creditors*." The Proposal does not have a clear answer as to whether the anticipated level of

[19] Judgment of the Supreme Court of the Czech Republic of 20 August 2012, No. 28 Cdo 2927/2010. In Nejvyšší soud [online]. [accessed on 2023-10-23]. Available from https://www.nsoud.cz/Judikatura/ns_web.nsf/web/Decisions~2012_8_20___28_Cdo_2927_2010__Production_Refunds_for_ Sugar~?openDocument&lng=EN.

[20] CHAMBER OF DEPUTIES. PARLIAMENT OF THE CZECH REPUBLIC [online]. [viewed 3 October 2023]. Available from: www.https://www.psp.cz/sqw/text/tiskt.sqw?O=9&CT=491&CT1=0.

satisfaction creates an unbreachable threshold. Arguably, the decision could be changed by the court if the conditions change outside the control of the debtor (e.g. not by their decision to change the job or work fewer hours).

The way Czech courts determine the anticipated level of satisfaction will become crucial. While in the case of employed debtors, the calculation based on salary usual for their profession and competence could be a justifiable solution, the assessment of possible outcomes of the debtor's business will largely depend on the suggestion in the report of the insolvency administrator. It is also not clear if and how the justified interest of the creditors should be taken into account.

The Proposal also introduces some measures to avoid misuse of the debt discharge procedure, namely the automatic prolongation to five years if the debtor has been discharged from the debts in 20 years preceding the petition for debt relief. The court may also prolong the procedure by up to twelve months if the debtor does not meet their obligations.

The continuing decline in the overall number of petitions for debt relief, despite the COVID-19 economic impacts, might indicate that the debtors are postponing their petitions until a three-year procedure becomes generally available. The practice of the courts with necessary support from the insolvency administrators, especially for setting the anticipated level of satisfaction as well as identifying the debtors' dishonest intentions, could show that the new legislation does not necessarily have to be more favorable to the debtors and detrimental to the creditors.

The Directive 2019/1023 does not aim at personal debts. It also leaves upon the Member States how to treat the personal debts of insolvent entrepreneurs, it only requests a single procedure for personal debts which cannot be reasonably separated from professional debts,[21] while explicitly allowing a separate coordinated procedure for personal debts.[22] It seems that the Czech legislator does not wish to take this approach and intends to grant the possibility of a three-year full debt relief for everybody. The Proposal does not distinguish between the private, consumer, and business-related debts of the entrepreneurs, mainly because their distinction would create an extra burden on the insolvency administrators and courts. The Proposal also makes no difference between entrepreneurs and other natural persons, to prevent the massive creation of fictitious businesses. Proving of such intention would again create an extra burden on insolvency administration.

[21] Article 24 (1) reads as follows: "Member States shall ensure that, where insolvent entrepreneurs have professional debts incurred in the course of their trade, business, craft or profession as well as personal debts incurred outside those activities, which cannot be reasonably separated, such debts, if dischargeable, shall be treated in a single procedure for the purposes of obtaining a full discharge of debt."

[22] Article 24 (2) reads as follows: "Member States may provide that, where professional debts and personal debts can be separated, those debts are to be treated, for the purposes of obtaining a full discharge of debt, either in separate but coordinated procedures or in the same procedure."

In recitals 77-82 the Directive 2019/1023 provides options for Member States and offers tools to establish a balance between the legitimate interests of the insolvent debtor and their creditors. The dishonest intent as the most important reason for not granting a debt discharge is described by its most common demonstration such as: the nature and extent of the debt; the time when the debt was incurred; the efforts of the entrepreneur to pay the debt and comply with legal obligations, including public licensing requirements and the need for proper bookkeeping; actions on the entrepreneur's part to frustrate recourse by creditors, etc. The Directive 2019/1023 also allows to shift the burden of proof concerning their honesty and good faith to the debtors, with a request that it should not make it unnecessarily difficult or onerous for them to enter the procedure. The Czech Insolvency Act denies access to debt discharge to debtors with dishonest intention, the meaning of which has been left upon judicial practice. The legislator does not seem to take the chance to incorporate further guidance into the law or to shift the burden of proof to the insolvent debtor.

The Directive 2019/1023 explicitly makes it possible to introduce specific derogations where it is necessary to guarantee the balance between the rights of the debtor and the rights of one or more creditors, such as where the creditor is a natural person who needs more protection than the debtor[23]. Such a possibility is reasonable and justifiable, however, neither the current wording of the Insolvency Act nor the Proposal took the chance to promote the balance between the rights of the debtor and the creditors. However, strong voices within the expert community [24] are against enabling debt relief to the general public in a three-year period, which goes above the requirements of Directive 2019/1023. They state that it is a political decision that will bring an unjustifiable disbalance to the legitimate interests of the debtors and creditors. Moreover, the inevitably lower recovery rate of receivables will bring pressure to increase the risk mark-up of the creditors and will create possible distortion to the free market. This would make more expensive not only interests on loans but possibly also rents and other services, which would give rise to receivables hypothetically subject to debt discharge.

To predict the economic outcome of the Proposal, as it is pending in the legislative process, exceeds the scope of this paper. Such a task would require serious statistical research, where certain important drivers of insolvency rate in the economy would have to be identified and their influence taken into account when assessing the legislative changes. Moravec[25] tested the influence of GDP, indebtedness of companies, inflation, and interest rates on the number of declared

[23] Recital 79 of the Directive 2019/1023.

[24] Insolcentrum s.r.o. Vláda schválila plošné zkrácení doby oddlužení - Insolcentrum s.r.o. [online]. [viewed 3 October 2023]. Available from: https://www.insolcentrum.cz/vlada-schvalila-plosne-zkraceni-doby-oddluzeni/.

[25] Moravec, T. The bancrupcy in the Czech Republic – influence of macroecomic variables. Acta academica karviniensia 2013, 13(3): 136-145.

bankruptcies on the time series for the period from 1993 to 2012. A similar approach could be taken to the debt discharge of entrepreneurs as well as other natural persons. Also, the impact of changes in debt discharge legislation on the loan market deserves to be tested as a correlation between the recovery rate of loan receivables and the risk mark-up of the interest on those receivables.

CONCLUSION

While the implementation of Directive 2019/1023 into the Czech legal system is still pending at the time of submission of this paper, we cannot exclude the possibility that entrepreneurs could benefit from relatively lenient conditions for debt discharge designed for a five-year repayment schedule and based on the direct effect reach for a three-year debt discharge procedure. This effect seems to be more likely for debts to the state and public institutions. In respect of debts owed to the private parties the application of the horizontal direct effect is generally less likely to be admitted. However, should the court assess the sum of payments to the creditors made after the third year of the debt discharge procedure as damage suffered by the creditor directly attributable to the fact that the Directive 2019/1023 has not been transposed in time, such damage could theoretically be claimed by the debtor against the state.

The current wording of the Czech Insolvency Act does include the duty of the debtor to render all possible effort to maximize the outcome to the creditors during the debt discharge procedure. The fulfillment of this duty is constantly controlled by the insolvency administrator and the court, under the possible sanction of not rendering the debt discharge at the end of the procedure. Such cases are in practice limited to an evident lack of effort on the side of the debtor.

In my opinion, introducing a rebuttable presumption of dishonest intents for certain types of activities of the debtor would help to restore the balance between the justified interests of the creditors and the insolvent debtors. Also, proper guidance for determining the anticipated level of satisfaction at the beginning of the debt discharge procedure would serve as a driver of motivation for the debtor and bring back the desired element of legitimate expectations to the parties involved.

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Limitations for the application of the hardship clause in the Czech Republic

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Abstract: *Since 2020, partially triggered by the pressure of the Covid-19 pandemic, the Czech courts were presented with several dozens of cases concerning possible termination or adjustment of contracts due to changed circumstances under the hardship clause. Given the relative novelty of the general hardship clause in the Czech law, the first bundle of case law presents an opportunity to see how the courts handle the application of the concept in practice. This paper focuses on the analysis of the Czech case law between 2020 and 2023, targeting the first two considerations under the hardship. Firstly, it is the question of what constitutes a change of circumstances. The point was chosen as a starting point mostly because it is the only one addressed by the Czech Supreme Court in more detail. One of the conclusions here is that the courts tend to list specific (extreme) circumstances but omit development of more universal characteristics which would help support the rule. In its second part, the article debates the effects of the change, a gross disproportion created within the contract. In this regard the courts (and also the claimants) misinterpret what should be the subject of examination, focusing on the economic struggle of the claimants unrelated to the contracts instead of looking within the contract on its damaged equilibrium. The aim of the paper is to name these general shortcomings, showing how they manifest in individual cases.*

Keywords: *change of circumstances, hardship, gross disproportion.*

INTRODUCTION

The Czech *rebus sic stantibus* rule, Section 1765 of the civil Code of Act No. 89/2012[2] (hereinafter referred to as the "**hardship clause**"), was inspired by the international standard[3] and is in principle comparable with hardship rules adopted by other European jurisdictions[4]. To summarize, the hardship clause sets-

[1] The article was supported by the Charles University, project GA UK No. 342 222.
[2] CZECH REPUBLIC Act No. 89/2012 Coll., the Civil Code [zákon č. 89/2012 Sb., občanský zákoník].
[3] The Czech lawmaker used as inspiration Articles 6.2.1 to 6.2.3 of the UNIDROIT Principles on International Commercial Contracts 2010 [online]. International Institute for the Unification of Private Law (UNIDROIT). Available from: http://www.unidroit.org/instruments/commercial-contra cts/unidroit-principles-2010.
[4] PENADÉS, Javier Plaza, and Luz M. Martínez VELENCOSO. European Perspectives on Common European Sales Law. Springer International Publishing AG, 2014, p. 157. ISBN 9783319 104966.

out a list of cumulative requirements for its application: (i) qualified change, (ii) gross imbalance, (iii) causality and (iv) absence of assumption of risk. [5]. If the conditions are met, the disadvantaged party may ultimately request a court action in a form of termination or adaptation of the contract.[6]

The wording of the rule is general enough to cover any contract type and its correct operation demands a court action which is why the appropriate limits to the rule could only be set by the case law. While there has been very little guidance from the Supreme Court of the Czech Republic (the "**Supreme Court**"), the clause is not unused. The lower courts have during the last three years[7] produced at least 50 judgments considering the application of the hardship clause, offering an interesting study of how the Czech judges approach the subject. Since the position of courts is crucial, this paper studies these first results of court application. The dataset under examination was created by targeted search in public database of lower court decision, using reference to the hardship clause as the decisive key word. This resulted in approximately 70 search results[8] forming a good basis for further research.

This paper will focus on two aspects of the court's consideration. Firstly, using the Supreme Court case as a guide, the article will consider what constitutes a change of circumstances, what type of circumstances is the court looking for when ruling what the parties should or should not have expected. Secondly, while the law states that the hardship clause is a measure to address gross disproportion in a contract position, it seems that both claimants and courts tend to consider the effect of the changed circumstances much more broadly than necessary. The shortcomings of such application will be addressed in the second part of this paper.

1. THE CHANGE OF CIRCUMSTANCES

The basic requirement for the hardship clause is a presence of a change of circumstances which was not "reasonably foreseeable" for the parties. To apply hardship more liberally would lead down the rabbit hole of considering the overall fairness of the contract and potentially undermine the freedom to contract.[9]

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[5] ŠILHÁN, Josef. *Právní následky porušení smlouvy v novém občanském zákoníku*. Praha: C. H. Beck, 2015, pp. 200–201. ISBN 9788074005442.

[6] PILÍK, Václav. In: PILÍK, Václav et al. *Změna okolností ve smluvním právu*, Praha: Wolters Kluwer, 2022, p. 40. ISBN 9788076761797.

[7] Based on the Ministry of Justice database, decisions published between December 2020 and May 2023.

[8] This is a total number of cases referencing the hardship clause, however, almost 20 cases included made the reference without any analysis beyond a simple (and irrelevant) mention of the hardship clause and were thus disregarded in further analysis.

[9] SCHWENZER, Ingeborg, and Edgardo MUÑOZ. Duty to renegotiate and contract adaptation in case of hardship. Uniform Law Review [online]. 2019, 24(1), 149–174 [viewed 8 October 2023]. ISSN 2050-9065. Available from: doi:10.1093/ulr/unz009. pp. 155.

The threshold is thus high and similar to *vis major* situations[10] which may seem to overlap with hardship but result in impossibility, not gross disproportion of performance.[11]

The guiding point for the issue of change is the recent Supreme Court case (the "Expert case").[12] The dispute arose over a settlement agreement based on the expert estimate of a real estate. The problem appeared after a new expert evaluation was produced (using newly provided aerial photos) estimating that the settlement amount should have been approximately four time higher than what was agreed under the original settlement. The disadvantaged party demanded an increase, arguing that the circumstances changed. Both the first and the second instance courts sided with the claimant, applied the hardship clause, and the settlement was eventually adjusted to a double of the original amount. The Supreme Court rejected such conclusion, ruling that the hardship clause did not apply. From the Supreme Court's point of view, there was no change in circumstances. The hardship clause states that the change of circumstances is relevant if it occurs or if the disadvantaged party becomes aware of it after the contract is concluded. It was the aspect of "awareness" or "foreseeability" what decided the Expert case. The Supreme Court stated that the new evaluation itself did not create a change of any circumstance in the physical world - the evaluated real estate was exactly the same regardless of the expert probing. The second expert opinion merely adjusted the parties´ understanding of the unchanged reality. Hence, the most important lesson of the Expert case is that when considering the awareness of the parties with respect of the future and its potential to change, it is necessary to evaluate whether the disadvantaged party should not be held accountable for their ignorance. Based on the Expert case, each party is responsible to be sufficiently informed about the status of circumstances present when contracting. These requirements thus restrict the concept of "change" under the hardship clause.

As for further Supreme Court guidance on the matter, there is very little to be found. Apart from the Expert case, the change of circumstances was addressed in only one other case concerning a dispute on an increase of rent. That case did not go into any detail but at least it was mentioned that "*common developments of the economy and the market*" do not qualify as an unforeseeable change.[13] The same point echoes with the lower courts which appear to have rather high expectations for what qualifies as a change. One court stated that the

[10] See also RÖSLER, Hannes. Hardship in German Codified Private Law – In Comparative Perspective to English, French and International Contract Law. *European Review of Private Law*. pp. 493-494.

[11] BERGER, Klaus Peter, and Daniel BEHN. Force Majeure and Hardship in the Age of Corona. *SSRN Electronic Journal* [online]. 2020 [viewed 8 October 2023]. ISSN 1556-5068. Available from: doi:10.2139/ssrn.3575869

[12] Decision of Supreme Court, Czech Republic, of 1 February 2023, no. 28 Cdo 2989/2022.

[13] Decision of Supreme Court, Czech Republic, of 22 May 2019, no. 26 Cdo 1670/2018.

change has to be "*extreme, shocking and unpredictable*"[14]). Similarly, another court stated that the hardship clause aims at "*an extreme situation*".[15] While this choice of words may seem to align with the restrictive interpretation requirement, neither the law maker, nor the Supreme Court used such language.

If "extremes" are not required is there some common understanding of what (type) of change qualifies under hardship? Many commentators answer this question indirectly by listing natural disasters (earthquakes and tsunamis) or drastic social/political/economic changes (war, civil revolution, embargo, prohibition etc.).[16] Similarly, in the Expert case, the Supreme Court listed: "*natural forces, illness, health damage or death, technical failure or damage caused by a third party, or changes in legislation, social or political conditions or general economic conditions (significant increase in the inflation rate , disruption of supplier-customer relations, etc.)*". There is also the opposite approach mentioned in the first Supreme Court case above and by some commentators, based on lists of what should not typically be included, for example: inflation[17], andcurrency fluctuations or price changes "*within the ordinary range of commercial probability*".[18] Some cases also correctly point out that what is "ordinary" varies based on the circumstances of the parties. In one case the court rejected the application of the hardship because of a newly found geological issue at a construction site, concluding that such discovery "*fell within the normal business risk in the construction industry*".[19]

From the authors point of view, the courts and commentators should not waste much time with making lists of changes because their use will be always debatable. Even textbook examples may fail to be relevant changes in a particular case. The lists may be also influenced by subjective experience, for example the above quoted list from the Expert case includes "*significant increase of inflation or supply chain disruptions*" which is significant addition to the usual pool used by commentators. Given the recent developments in the global economy, such items are understandable but also at odds with the generally rejected idea that

[14] Decision of the Regional Court in České Budějovice, Czech Republic, of 4 April 2022, no. 7 Co 70/2022.

[15] Decision of the Municipal court in Prague, Czech Republic, of 8 November 2022, no. 30 Co 333/2022.

[16] DVOŘÁK, Bohumil. § 1765 [Podstatná změna okolností]. In: PETROV, Jan et al. *Občanský zákoník*. 2 edition. Praha: C. H. Beck, 2019. ISBN 9788074007477 or OLIVA, Jakub. 6. Změna okolností. In: DOHNAL, Jakub et al. *Obchodní smlouvy*. Praha: C. H. Beck, 2016. ISBN 9788074004896. p. 118. PENADÉS, Javier Plaza, and Luz M. Martínez VELENCOSO. *op. cit*., p. 158.

[17] HULMÁK, Milan. In: HULMÁK, Milan et al. *Občanský zákoník V. Závazkové právo. Obecná část (§ 1721–2054)*. Praha: C. H. Beck, 2014, p. 293ISBN 9788074005350.

[18] BRUNNER, Christoph. Force majeure and hardship under general contract principles: Exemption for non-performance in international arbitration. Austin: Wolters Kluwer Law & Business, 2009, p. 409. ISBN 9789041127921.

[19] Decision of the Regional Court in České Budějovice, Czech Republic, of 4 April 2022, no. 7 Co 70/2022.

common developments of economy or market qualify as changes in circumstances. Why waste time listing items whose relevance always remains on the "it depends" basis?

What is more helpful, is a generalization of what aspects the court is looking for demonstrated in the Expert case by the requirement of real, physical change (not only change of understanding). That is a conclusion which should be noted going forward. If lists are to be made, it would be more interesting to target all relevant background aspects of the parties or the contracts that affect the consideration of a relevant change. For example, duration of the contract[20], experience or level of professionality.[21] The case law will never give enough examples of specific situations but it may identify the best practice of how the parties should approach their situation *pre contract* in order to cover all developments that are, for their specific case, foreseeable.

2. THE GROSS DISPROPORTION

Once the change is present, the next step is a successful claim that the change creates a gross disproportion between the parties. The law specifies that the gross disproportion manifests by either disproportioned increase in the costs of performance of the contract or a reduction of its value. Contrary to what was said about the change itself (see above), the disproportion within the contract has to be severe/extreme, just one step before the impossibility of performance.[22]

The Supreme Court so far only stated that the result of a change of circumstances has to be "*obviously unfair*".[23] Which is an interesting result since it is debatable whether the contracts are required to be fair to begin with. While fairness may be among reasons to include the hardship clause in the law, it does not help much to focus on it when evaluating a specific case. While the change is unfair to one party, the adjustment of the contract is often detrimental to the other.[24] If fairness is the measure, hardship would be hard to apply but that goes against the basic idea of hardship – redistribution of the inconvenience. Focusing on the unfairness of the change also implies that one party is disadvantaged while the other is benefiting, which is a construction without grounds in the law and refused by the courts.[25] The gross disproportion may be entirely on one side while the other party does not feel any negative effects of the change until the contract

[20] In case of long-term contracts, the rule should be stricter because the parties are deemed to understand that circumstances may evolve over time. BRUNNER, Christoph. *op. cit.*, p. 439.
[21] The hardship clause has the same wording for consumers and entrepreneurs, however the later will be held to a higher standard of what they should have reasonably foreseen. See PILÍK, *op. cit*, p. 38.
[22] ŠILHÁN, Josef. *op. cit.*,. p. 204.
[23] See Decision of Supreme Court, Czech Republic, of 22 May 2019, no. 26 Cdo 1670/2018.
[24] Decision of the District court in Prague 3, Czech Republic, of 31 March 2023, no. 20 C 232/2020.
[25] Decision of the Municipal court in Prague, Czech Republic, of 16 February 2022, no. 39 Co 395/2021.

is adjusted.

A successful proof of gross disproportion is a challenging exercise, probably the hardest point to prove in the context of hardship.[26] Generally, the claimants struggle with correctly phrasing their claims and using sufficiently specific claims and evidence. Often, the claim is based more on the general change in the situation of the claimant (its cashflow etc.) which does not really have anything to do with the contract. A good example of this is a case of an IT company, which suffered loss of revenues because of Covid-19 and invoked the hardship clause to reduce the rent of its office premises[27]. In its argumentation, the claimant focused almost solely on the loss of cashflow. The court provided a detailed analysis of both the average rents and the financial statements of the claimant, concluding that the full rent was a standard one and the claimant still had enough revenue to, at least theoretically, pay in full. The problem with the case is that neither of these considerations describe what the position of the parties within the contract was. The law requires an increase in cost of performance or a decrease in value, the court and the parties should thus focus on whether the claimant still gets enough value form office premises when all employees are forced to stay at home but that aspect was barely mentioned in the case. Why did the parties ignore it? My best guess is that the loss of revenue seemed steep (70%) and less challenging to argue. Some improvement was shown in a case of a fast-food restaurant affected by lockdowns[28] – here the claimant correctly focused on the reduction of the overall movement in the area which meant that customers stopped coming, neighbouring shops stopped working, no tourists arrived etc. Since the rented unit was no longer at a busy street, the value of the rent was reduced. The respondent claimed that the value of the rent is not based on the number of tourists but on the technical state of the building which did not change. Despite the logic in the argument, the court rejected the claimant´s reasoning because they made no objective quantification of the alleged value reduction and the court thus could not consider whether it was significant enough. That seems to be a lousy conclusion but it has one important note. Parties should communicate, ideally within the contract, what value they require in the performance, the proof would be much easier if the rent was somehow explicitly derived from the amount of people parading around the restaurant.

To summarize the two described cases, a successful claim of a gross disproportion cannot be general or based just on subjective statements[29]. The claim-

[26] PAVLÍK, Jan and Alice, KUBOVÁ BÁRTKOVÁ. Vliv koronaviru na smluvní vztahy se zvláštním zaměřením na nájem a přepravu. Právní rozhledy, 2020, 12, 430-440.
[27] Decision of the District court in Prague 3, Czech Republic, of 31 March 2023, no. 20 C 232/2020.
[28] Decision of the District court in Prague 2, Czech Republic, of 2 August 2021, no.10 C 1/2021.
[29] See also Decision of the District court in Příbram, Czech Republic, of 26 May 2022, no. 13 C 218/2021. Here the court refused the claim that distant schooling was generally worse than in-person education when no specific evidence was provided.

ants should quantify their struggle and focus on the performance under the contract, not their general worsened circumstances.[30]

CONCLUSION

So far, the case law developed the following limits on application of the hardship in the Czech Republic as follows: (i) changes in the physical world are required, if the change is based on parties awareness, it should be evaluated what due diligence was made by the parties and (ii) the claimant has to provide specific, quantified proof of gross disproportion, deterioration of its economic standing, regardless of its severity, is not sufficient and may not be even relevant. These are both important points which provide more clarity for future claimants but overall the approach of the courts, especially on the second point, is discouraging. The courts seem to be a bit hostile to the idea of the hardship clause and reluctant to thoroughly consider its application. Even in Covid-19 cases, where it was usually undisputed that pandemic is a relevant change beyond control and foresight of the parties, the parties struggled to identify how exactly was the cost or value of the contract performance affected and the courts also took the wrong lead and focused on arguments irrelevant to the gross disproportion issue.

While the hardship clause should set a high threshold, it should not be practically unreachable and the courts should not shy away from redistributing the burden of a change of circumstances if the requirements are met. With respect of the gross disproportion issue, the courts demand specificity but the case law did not yet develop any helpful method or measure thereof, leaving the parties to often misguided lines of argumentation. In that regard, the Supreme Court has missed its chance to provide more pointers for the lower courts in the Expert case. Hopefully it will not take another decade to provide the hardship clause with more specific interpretation.

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[30] Decision of the District court in Prague 9, Czech Republic, of 1 June 2021, no. 60 C 294/2020, Decision of the Municipal Court in Prague, Czech Republic, of 2 March 2023, no. 21 Co 385/2021 or Decision of the District court in Zlín, Czech Republic, of 7 May 2021, no. 46 C 332/2020.

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The legal issues of influencer marketing

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Abstract: *The proliferation of social networks brings entrepreneurs (competitors) more ways of interaction with consumers. Marketing strategies of social networks are coming to the fore, developing new methods of influence(r) marketing. In the article, we deal with the issue of regulation of this phenomenon, questions of competition law and (non)transparent marketing practices of influencers, potentially harmful to consumers. The aim of this article is to demonstrate correlation between influencer's practices and unfair competition in the legislation of Slovak Republic by using common scientific methods - analysis and synthesis.*

Keywords: *advertising, competitor, consumer, influence marketing, unfair business practices, unfair competition.*

INTRODUCTION

Digital transformation is radically changing our lives, providing us with more opportunities and a wider choice of goods and services. However, it is also necessary to reflect the flip side of the coin, the challenge of protecting legitimate interests of consumers.[1] One of the areas that came to the fore during the pandemic was the increase in deceptive marketing techniques and online shopping scams.[2] In 2022, up to 87 % of individuals of the age group of 25-34 years bought or ordered goods or services online.[3] With the increasing number of internet users

[1] Data collection and processing, combined with analysis of consumer behaviour and cognitive biases, can be used to influence consumers to make decisions that may be contrary to their best interests. For a literature review see CRISTANI, Federica, *Designing a Governance System for Cyber-security of Foreign Investment in Europe*, International Investment Law Journal Volume 3, Issue 2, July 2023, pp 102-120; or BOGDAN, Manole Decebal, *The Law of the Digital Economy a Reality for Legal Relations in the Future - New International Investment Protection*, International Investment Law Journal Volume 3, Issue 2, July 2023, pp. 146-155.

[2] This has undermined the effectiveness of rules designed to protect consumers in the digital environment from, among other things, unfair commercial practices. Important steps taken by the European legislator were the adoption of Directive (EU) 2019/2161 of the European Parliament and of the Council of 27 November 2019,as regards better enforcement and modernisation of Union consumer protection rules (the "Better Enforcement and Modernisation of Consumer Law Directive") and Directive (EU) 2019/770 of the European Parliament and of the Council of 20 May 2019 on certain aspects relating to contracts for the supply of digital content and digital services (the "Digital Content Directive").

[3] See further: EUROSTAT: E-commerce statistics for individuals. Available form: https://ec.euro

and social media, many businesses are focusing more on marketing tools such as social media advertising, newsletters, influencer marketing, blogs and customer referrals. An extremely popular marketing strategy is the influence(r) marketing.[4] These are modern marketing tools that bring in customers, but their legal basis is absent or as yet very limited. In the following sections of the article, we discuss the issue of influencer marketing through the prism of competition law as well as the question of whether and under what circumstances an influencer could potentially commit unfair competition. While drafting the article we used the methods of analysis and synthesis, which are common methods of research in social sciences. We have analyzed in detail the legal norms touching upon the issue of unfair competition and regulation of influencers, while we have also looked at the decision in the judgments of the German Federal Court of Justice (Bundesgerichtshof) under nos. IZR 125/20, 126/20, 90/20, with the prism of breaking down the problem under examination into its parts, features, and contradictions and examining them in order to uncover their essence. Through the method of synthesis, we attempted to link the elements under scrutiny so that we could observe the relationship between influencer marketing and unfair competition.

1. INFLUENCER MARKETING

Social influence is a universal phenomenon for interactions and connections between actors. *Ad primum* it is a concept of social psychology and according to van Avermaet it is *"the change of judgments, opinions and attitudes of an individual as a result of confrontation with the opinions of others".*[5] The social influence of an individual is related to their social position, role and status. Other authors state that social influence is the process by which individuals modify their opinions, revise their beliefs, or change their behavior as a result of social interactions with other people.[6] Today, social networks are becoming a key platform for the distribution of information, knowledge, technology and other resources due to the integration and development of social networking technologies and services.[7] Influence(r) marketing has naturally grown out of traditional marketing strategies, print and digital advertising. It is a new phenomenon that has seen

pa.eu/eurostat/statistics-explained/index.php?title=E-commerce_statistics_for_individuals.

[4] It is mainly, but not solely, a form of social media marketing that involves product placement through influencer accounts (on social media) that brands select to promote their products.

[5] VAN AVERMAET, Eddy. *Social influence in small groups*. In: Miles HEWSTONE and Wolfgang STROBE, eds. *Introduction to social psychology: A European perspective (3rd ed.)*. New Jersey*:* Blackwell Publishing, pp. 403– 444.

[6] MOUSSAID, MehdiI et al. Social Influence and the Collective Dynamics of Opinion Formation. PLoS ONE 8(11), 2013.

[7] YUN-BEI, Zhuang, and Li ZHI-HONG. Identification of influencers in online social networkss: measuring influence considering multidimensional factors exploration. Heliyon, 2021, volume 7 (4). Available at: https://www.sciencedirect.com/science/article/pii/S2405844021005776.

significant rise in 2016.[8] Most influencers are a product of social media, and their activities refer to platforms such as YouTube or Instagram and Facebook. Instagram is still one of the most downloaded apps today.[9] In general an influencer[10] is considered an individual who has a significant number of followers on a social media platform and can influence the decisions of their followers. As savvy consumers, we can agree that today audiences no longer connect with logos but connect with people. Influencer marketing is the personification of a brand in real time. However, so far we have been looking at the above mentioned issue mainly through the perspective of *de facto*, but the biggest challenge for us is to reflect on the *de jure* state of the issue. Under Directive 2021/C 526/01 on the interpretation and application of the Unfair Commercial Practices Directive of 29 December 2021, an influencer is generally defined as a natural person or a virtual entity that has a larger than average reach on the relevant platform. An influencer qualifies as (regardless of the number of their followers) a "marketer" or a person who "acts on behalf of a marketer".[11] Both the influencer-follower (consumer) relationship and the influencer-brand relationship significantly influence the consumer's attitude towards the brand as such.

2. LEGAL FRAMEWORK IN THE CONDITIONS OF THE SLOVAK REPUBLIC

The transposition of the EU´s Audiovisual Media Services Directive[12] into Slovak law triggered the adoption of a new Act, Act No. 264/2022 Coll. on Media Services and on Amendments to Certain Acts (the Media Services Act). The previous legislative framework of audiovisual media services was not sufficient and did not meet the requirements related to the regulation of the audiovisual media services environment. Questions related to the regulation of streaming and publishing videos were not new in the European Union. In 2015, the Court of Justice of the European Union (CJEU) already concluded that short videos can

[8] APPEL, Gil, et al. *The future of social media in marketing*. J. of the Acad. Mark. Sci. 2020, 48, pp. 79–95. Available at: https://link.springer.com/article/10.1007/s11747-019-00695-1.

[9] See also: BELANCHE, Daniel, et al. Understanding influencer marketing: The role of congruence between influencers, products and consumers. Journal of Business Research, 2021, Volume 132, pp. 186-195.

[10] For the purposes of this publication, we subsume the terms micro-influencer, middle-influencer, brand ambassador and brand advocate under the term influencer.

[11] See section 4.2.6 Influencer Marketing In: Guidance (2021/C 526/01) on the interpretation and application of the 2021 Unfair Commercial Practices Directive. Available at: https://eur-lex.europa.eu/legal-content/SK/TXT/?uri=CELEX:52021XC1229(05).

[12] Directive (EU) 2018/1808 of the European Parliament and of the Council of 14. November 2018 amending Directive 2010/13/EU on the coordination of certain provisions laid down by law, regulation or administrative action in Member States concerning the provision of audiovisual media services.

be considered "programmes" for the purposes of the 2010 Media Services Directive.[13] A radical change brought about by the Media Services Act was the inclusion of video sharing platforms in the regulatory framework for audiovisual media services.[14] The aim is to regulate commercial activities in the online space and to harmonise the requirements for the particular operators of linear (television, radio broadcasting) and non-linear (video sharing platforms, AVMS) content services. A new state administration authority with nationwide competence, the Media Services Council, was created to control and enforce compliance with legislation governing broadcasting, retransmission, the provision of on-demand audiovisual media services and the provision of content-sharing platforms. In the case of the legislation on the status of influencers, it is necessary to distinguish between two separate subjects, that is, the platforms that enable influencers to 'establish' themselves on the market, i.e. content sharing platforms (e.g. Youtube, Instagram, Tik Tok) and their provider, as well as the provider of the audiovisual media service itself – the aforementioned influencers. An on-demand audiovisual media service is also a channel on YouTube, Facebook Watch, TikTok, Instagram, OnlyFans or Twitch and other platforms that have been established or are provided for profit and at the same time fulfil the other conditions.

3. CONSUMER - INFLUENCER RELATIONSHIP

A characteristic element of influencer marketing is its inconspicuousness. It is difficult to examine these influencer practices because an influencer may also use social network space exclusively to express their personal opinion, but whenever there is no arbitrary recommendation of a product, but a paid collaboration, it can be concluded that it is advertising. As Lapšanský and Vozár point out, advertising is an important source of information for consumers when deciding whether to buy a product or service.[15] The definition of advertising can be found in Section 2(1)(a) of Act No. 147/2001 Coll. on Advertising. Section 2(1)(c) thereof provides that the advertiser is the natural or legal person who disseminates the advertisement. It is therefore important to note that if influencers present products or services in the content of their posts, whereby they receive remuneration for such promotion, and the post does not state that it is a paid collaboration, this would constitute an unfair commercial practice under Act No 250/2007 Coll. on Consumer Protection. The unfair commercial practice is

[13] Judgment of the Court of Justice of 21 October 2015. New Media Online GmbH v Bundeskommunikationssenat. Case C-347/14 [online]. In EUR-Lex. [accessed on 2023-10-10].
[14] In addition to broadcasters, providers of on-demand audiovisual media services, retransmission operators, multiplex providers, the new legislation also regulated the rights and obligations of video sharing platform providers and content service providers who are not among the named subjects.
[15] VOZÁR, Jozef and Lukáš LAPŠANSKÝ. *Comparative advertising in the Slovak legal order*. Právny obzor, 94, 2011, No.6, p.558.

defined in Section 7(2). In terms of legal practice, deceptive acts, deceptive omissions and aggressive commercial practices are in particular considered to be unfair commercial practices. In the list of commercial practices that are considered unfair in all circumstances, we also include the institute of disguised advertising as the use of editorial space in the media to promote a product when the seller has paid for the promotion of the sale, without this being explicitly explained in the content, image or sound and clearly identifiable to the consumer. Unless the influencer indicates that it is a form of paid collaboration, there is a real risk that the average consumer will not have the discriminating ability to recognise whether it is an advertisement or a *bona fide* product recommendation. Of course, it is also necessary to take into account the fact that, in addition to unfair commercial practices, there may also be deceptive conduct within the meaning of Section 8 of the Consumer Protection Act, according to which a commercial practice is deemed to be deceptive if it causes or is likely to cause a consumer to purchase a product or service because it contains incorrect information and is therefore untrue or in any way misleads or is likely to mislead the average consumer. However, proving the commission of such an unfair or deceptive practice may be problematic in legal practice, as it may potentially be a paid collaboration, disguised advertising, or solely reviews, or the opinion of an individual who has just purchased a product and has a need or desire to share their experience. A commercial practice which is likely to substantially distort the economic behaviour of a group of consumers who are particularly vulnerable by reason of their mental disorder or physical defect, age or credulity, in a way which the seller can reasonably foresee, shall be assessed from the point of view of the average member of that group. In the case of paid collaboration on various social media (e.g. Instagram, Facebook), the Slovak Trade Inspection Authority would in particular scrutinise the responsibility of the influencer for the dissemination of advertising from the point of view of ethics and good manners or the prohibition on the use of unfair commercial practices.

This part of the article explains how consumer behaviour is influenced by influencer marketing and identifies the most relevant influencer marketing practices that are potentially harmful to consumers[16]. Among the risky practices for consumers we include:

Ad primum, non-transparency, e.g. in the form of so-called affiliate marketing, where influencers do not disclose their business relationship with the brand or the label is not clearly recognisable as advertisement. These market practices also include cases where there is no formal contract between the influencer

[16] See for a comparative view: POPA TACHE, Cristina Elena, *About the Human Rights and Consumer Protection in the Digital Age of Digital Services Act 2022 or What Aspects Interested Investors Should Pay Attention To,* International Investment Law Journal Volume 3, Issue 2, July 2023, 121-132.

and the company whose products they are promoting, but there may be a buseiness purpose behind the post which is explicitly identified as advertising (e.g. consideration in the form of invitations to events, material gifts, etc.). The posts are without the use of the hashtags "advertising", "paid partnership", etc. Influencers do not state that they were approached by the project to test the product or that their brand otherwise "encouraged" consumers to use the product. In this context, we add that offering discount codes can also be considered as the affiliate marketing, as the code is linked to the profile of influencer who then receives a percentage of the sale based on the number of consumers who clicked on the link. The second practice lies in the lack of differentiation between advertisement content and editorial content. These are cases where the advertising is not divided from the content of the post (e.g., the influencer publishes lifestyle, fashion or travel blogs that are mainly intended to express the influencer's personal view of the goods/services and the influencer has not received anyconsideration from the company whose goods/services are featured within the blog).

There is thus a risk that consumers will not see a sponsored post as an ad, but as a personal reference of the influencer. The problem is to differentiate between post content and advertising. The third practice used is misleading information about the sponsored good/service, which includes, i.a. fake trademarks, fake descriptions of the goods or misleading omissions. This practice refers to providing reviews of goods and services promoting incorrect, ambiguous, exaggerated or inaccurate information about the sponsored goods and services. Claims that a particular nutritional supplement „boosts the immune system" when there is no scientific evidence. Another common phenomenon is, for example, discount codes that do not provide a "real discount" because the products have been previously discounted on the brand's website or give fake details about the use of the discount codes. The last of the pertracted practices is influencer marketing, targeting specifically vulnerable groups to buy products or services, exploiting their inexperience and gullibility. Young consumers and children are more vulnerable to influencer marketing practices than older consumers, and they are also increasingly active on social networks.[17] Alcohol consumption videos can be a problematic aspect, as well as sexist advertising.[18] Another problematic practice is the targeting of vulnerable consumers when advocating *buy now-pay later* apps. But how to look at the issue of influencerism from a *de lege lata* perspective? So far, there is no special regulation of influencerism, so it is necessary to rely on the legal regulation of advertising in the Advertising Act, the Consumer Protection Act[19], or the legal regulation of the law against unfair competition in Sections 41

[17] On the issue of vulnerable consumers, see also: DUFFETT, Rodney G. *Influence of social media marketing communications on young consumers' attitudes.* Young Consumers, Volume 18 No. 1, 2017, pp. 19 – 39.

[18] ZLOCHA, Ľubomír.Legal regulation of sexism in advertising - basic background. Právny obzor, 106, 2023, no. 2, p. 99.

[19] Act No. 250/2007 Coll. on Consumer Protection and on Amendments to Act No. 372/1990 Coll.

et seq. Commercial Code[20]

We have not yet found an analysis of what influencerism is and what its position is in the system of legal regulation in the domestic court decisions, unlike, for instance, in the judgments of the German Federal Court of Justice (Bundesgerichtshof) under nos. IZR 125/20, 126/20, 90/20. Germany as a Member State of the European Union is based on EU law, so we find them inspiring. The decisions in question show that the claimant in all three proceedings was the Association for the Protection of Commercial Interests, which challenged the unfair competition practices of the influencers in the form of obfuscation and non-transparent nature of the contributions. In particular, the infringement concerned, for example, the promotion of goods (*fitness raspberry jam*), where the posts on the Instagram profiles contained only the so-called "tap tag", which redirects the user to the Instagram profile of the relevant retailer. The court concluded that the Instagram posts at issue in the dispute constituted conduct with commercial intent within the meaning of Section 2(1)(1) of the UWG[21,] which defines that term as conduct by a person for the benefit of their own company or the activities of another company before, during or after a commercial transaction, which is intended to promote the sale or purchase of goods or services, or the conclusion or performance of a contract for related goods or services. The court also considered whether the mere fact that a social media post in which a product is displayed and bearing "tap tags" is (in)sufficient to satisfy the elements of advertising. In doing so, it concluded that if the influencer links in the post to the specific website of the manufacturer of the product in question (i.e. the "sponsor"), the definitional features of advertising are already fully satisfied. Since those Instagram posts are advertising, the consumer should be able to identify the real purpose of the post, i.e. that it is a promotion of a product or services for a certain consideration for the influencer. The shortage of transparency and the concealment of the business purpose of the post constitute a breach of the first sentence of Article 58(1) of the RTS[22], according to which advertising must be identifiable and separate from the rest of the content. The court further emphasizes that in order to identify whether (or not) an influencer's post is an advertisement, it is necessary to apply the proportionality test and to comprehensively assess the purpose and form of the so-

on Misdemeanours of the Slovak National Council, as amended (hereinafter referred to as the "Consumer Protection Act").

[20] Act No. 513/1991 Coll., the Commercial Code (hereinafter referred to as the "Commercial Code").

[21] Section 2(1)(1) of the German Unfair Competition Act (UWG): „A commercial practice shall be deemed to be deceptive if it contains misleading statements (Section 39) or is otherwise likely to mislead a participant in a product market as to one or more of the following facts, in such a way that the market participant is induced to take a decision on a commercial transaction which he would not otherwise have taken [...]."

[22] Section 58(1), first sentence, of the German Broadcasting and Retransmission Treaty (RTS): „The advertisement must be clearly recognisable as an advertisement and must be clearly separated from the rest of the content of the offer."

called *bussines msg*. However, if there is a link to the website of the manufacturer of the product in question, this usually fulfils the definition of advertising and thus the need to comply with legal obligations.

4. THE CONSUMER AS A POTENTIAL PERPETRATOR OF UNFAIR COMPETITION

The second supposition refers to a potential anti-competitive act, which the influencer can (mainly, but not exclusively) commit. From the provisions of Act no. 250/2007 Coll. on consumer protection, it follows that unfair business practices can only be committed by an entrepreneur (persons authorized by them, their employees or other persons acting on their behalf). According to Ondrejová, the scope of the Act on Consumer Protection is narrower compared to the scope of provisions in the Commercial Code, according to which a person other than an entrepreneur can also commit such an act.[23] According to Pelikánová, if a certain action would have an impact only on the consumer, but there would be no distortion of economic competition, we could not apply the provisions of the Commercial Code in the given case but should proceed according to the Act on Consumer Protection.[24] Ondrejová disagrees with her opinion on the grounds that the relevant provisions on unfair competition do not require that, in addition to the threat of causing harm (since it is enough that the harm is threatened, it does not have to be actually caused). The list of influencers who have e. g. their own blog[25] presents their opinions, experiences and reviews on the web, or through social media. The hypothesis we are dealing with in the post is whether a blogger, who is also an influencer, is capable of committing anti-competitive behaviour towards an entrepreneur in the position of a competitor. In this section we will not think at the level of a blogger, an influencer who is also an entrepreneur, but at the level of a blogger who remains in the position of a consumer who publishes reviews of the product or service of another entrepreneur. Primarily, it is necessary to examine whether such an entity could, under certain circumstances, become an entity committing anti-competitive actions. In addition to the application of the general provision, in the form of a general clause from the facts, trivialization would be considered. Section 50(1) of the Commercial Code defines depreciation, which is an action by which a competitor states or expands false information about the conditions, products, or performances of another competitor capable of causing harm to this competitor. According to Subsection 2 depreciation

[23] ONDREJOVÁ, Dana. *Legal protection against unfair competition*. Prague: Wolters Kluwer ČR, a. s., 2010, p. 34.
[24] PELIKÁNOVÁ, Irena. *A Commentary to the Commercial Code, Part 1. 4th ed.* Prague: ASPI Publishing, 2004, p. 402.
[25] Or originally a weblog as a website that allows registered users to easily publish their opinions, experiences, etc. on the web.

means also stating and spreading true data about the conditions, products, or performances of another competitor, if they are capable of causing harm to this competitor.

However, it is not unfair competition if the competitor was forced to do so by circumstances (justified defence) or if they provided such data in a comparative advertisement. Nevertheless, it does not follow from the wording of the law *expressis verbis* that a person other than the competitor could not commit such an act, especially with regard to Subsection 2 of the provision in question. The basic prerequisite for the fulfilment of the facts of the civil law offense of unfair competition is the fulfilment of the conditions established in the general clause according to Section 44(1) of the Commercial Code cited above.

Under Section 50(1) of the Commercial Code depreciation is an action by which a competitor states or expands false information about the conditions, products or performance of another competitor capable of causing damage to this competitor. According to Subsection 2 of the provision in question, the inclusion and dissemination of true data about the conditions, products or performances of another competitor, as long as they are capable of causing harm to this competitor, is also a depreciation. However, it is not unfair competition if the competitor was forced to do so by circumstances (justified defence) or if they provided such data in a comparative advertisement. We therefore opine that a review of an influencer who publishes their own blog can be considered a modern form of depreciation. In the case of reviews that are disproportionate, offensive, do not stem from the influencer's own experience, or these are fictitious (artificial) reviews, it is necessary to further examine whether the conditions of the general clause of unfair competition are met in accordance with the provisions of the Commercial Code. If all three conditions established in the general clause of unfair competition in accordance with Section 44 (1) of the Commercial Code are met, it is then necessary to evaluate whether this action can be subsumed under the factual essence of depreciation. Here, however, regarding the above, it is necessary to distinguish the situation according to the truthfulness of the information.

CONCLUSION

In the first part of the article, we dealt with influencer marketing from the consumer's point of view and the practices that the influencer uses most frequently in order to get the consumer to make an economic decision based on the information provided. We have come to the conclusion that one of the most frequent phenomena arising in the environment of social networks is the issue of hidden advertising as well as the fact that the contributions of influencers are presented (in whole or in part) as a personal recommendation of the influencer of a non-commercial nature, and not as a direct and clearly identifiable advertisement. In the second part of the article, we dealt with the postulate of the consumer – influencer as a potential perpetrator of unfair competition. We have come to the

conclusion that, subject to the fulfilment of certain conditions, such a situation may arise if the published review is not protected by the constitutional conformity of freedom of expression, which would potentially come into consideration in the case of reviews that are disproportionate, offensive, do not originate from the influencer's own experience or if these are fictitious (artificial) reviews and quite naturally it is necessary to further investigate whether the conditions of the general clause of unfair competition in case the provisions of the Commercial Code are met. In the event that all three conditions established in the general clause of unfair competition in accordance with Section 44(1) of the Commercial Code are met, this is unfair competition, and it is then necessary to evaluate whether this procedure can be considered as depreciation. Here, however, it is necessary to differentiate the situation according to the truthfulness of the information. As the digital transformation that online entrepreneurs are part of platforms and consumers with access to trustworthy digital services (content) on equal terms across the EU is an irreversible process, it will be interesting to follow the development of the legal framework and court decisions in this area as well, as fair adjudication by the courts, the willingness of competitors and consumers to assert their rights, as well as education may be helpful to further standardise the business environment in Slovakia.

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[1] European Parliament. The impact of influencers on advertising and consumer protection in the Single Market [online]. 2022 [viewed 10 October 2023]. Available at: https://www.europarl.europa.eu/thinktank/en/document/IPOL_STU(2022)7050

SECTION II
EUROPEAN AND INTERNATIONAL ASPECTS OF DOING BUSINESS

Alternative dispute resolution and artificial intelligence in the context of the new "EU AI act"

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Abstract: *The use of artificial intelligence (AI) in alternative dispute resolution (ADR) can represent several potential advantages, especially in terms of the effectiveness of the process and reducing its costs. However, it also faces various challenges and concerns, mainly legal and ethical. There is no uniform guidance on how to use AI in ADR to solve the issue of transparency or potential risks. The currently discussed and prepared Artificial Intelligence Act, proposed by the European Commission (EU AI Act), can be helpful in this area. The Artificial Intelligence Act follows a risk-based approach, classifying artificial intelligence systems according to the degree of risk. As the risks increase, so do the measures to be taken. This article focuses on exploring the use of AI in ADR in the context of the draft of the new EU AI Act and the potential implications for the possible implementation of AI in ADR.*

Keywords: *Alternative Dispute Resolution, AI, Artificial Intelligence Act*.

INTRODUCTION

It can be assumed that just like AI is used in various areas of society, such as healthcare, agriculture and farming, business or entertainment, it will also be used in law.[1] Artificial intelligence in law is also becoming very attractive, especially to make the work of lawyers easier and speed up specific processes, for example, in resolving disputes. In the "*most*" ideal world, there would be no disputes or conflicts; in the ideal world, it would be sufficient if their solution was fast, efficient, and financially affordable. However, this seems like a *utopia* for now. Here arises the question of whether the implementation and use of AI in dispute resolution can help. At the end of the last century, alternative dispute resolution mechanisms became popular as a reaction to lengthy and financially demanding dispute resolution through the courts.[2] Even today, society faces pressure to increase efficiency and speed in resolving disputes. The answer to this pressure may be automating specific processes and activities in both dispute resolution methods. However, this paper focuses only on alternative dispute-resolu-

[1] SURDEN, Harry. Artificial Intelligence and Law: An Overview, 35 Ga. St. U. L. Rev. (2019). p. 1326.
[2] STRAZISAR, Borut. Alternative Dispute Resolution Law: Journal of the Higher School of Economics, Vol. 2018, Issue 3 (2018), pp. 214-233.

tion methods. We can observe some use of AI systems in ADR in society, especially in certain administrative activities. We also recognise several pilot projects and studies, but no uniform rules exist for using AI in ADR. The question is whether the proposed new law can clarify this issue. This article aims to analyse the possibility of implementing AI in ADR in the context of the proposed EU AI Act - to determine whether it reflects crucial questions arising from this implementation and whether it provides a solution to possible risks. This article briefly defines the essential theoretical starting points in the introduction regarding the role artificial intelligence in alternative dispute resolution. Further in the article, we analyse the essential attributes of the implementation of AI in ADR, including how AI can be used in ADR and potential advantages or concerns in this implementation. Furthermore, the article focuses on analysing the prepared Artificial Intelligence Act that can be helpful in dispute resolution and which classifies artificial intelligence systems according to the degree of risk.

1. BRIEF OVERVIEW OF THE ROLE OF AI IN ADR

To improve access to justice, the idea of using AI systems within the judicial dispute resolution framework and also in alternative methods has been recognized.[3] In addition to the current efforts for this introduction and use of modern automated systems, there have already been various efforts in the past. These efforts were also unsuccessful due to the financial difficulty of their introduction and the lack of interest on the part of society. With the development of technology, this situation is changing. Society observes higher trust in technology, interest in improving access to justice, and interest in increasing the efficiency of dispute resolution.[4] This trust in technology as such, but especially in AI systems within the dispute resolution framework, can also be supported by the proposed regulation on artificial intelligence. As this article focuses on investigating the use of AI systems in ADR in the context of this regulation, it is necessary to briefly define the potential of how these systems can be used in ADR and what concerns this use entails.

1.1. Possibilities of using AI in ADR

As mentioned in the introduction, various studies currently examine the possibilities of how AI can work in ADR. There are also various pilot projects in

[3] *See* European Commission for the Efficiency of Justice (CEPEJ). 2018. "European Ethical Charter on the Use of Artificial Intelligence in Judicial Systems and Their Environment" Council of Europe (2018) [online]. Available from: https://www.coe.int/en/web/cepej/cepej-european-ethical-charter-on-the-use-of-artificial-intelligence-ai-in-judicial-systems-and-their-environment.

[4] LODDER, Arno, and John ZELEZNIKOW. Developing an Online Dispute Resolution Environment: Dialogue Tools and Negotiation Support Systems in a Three-Step Model', Harvard Negotiation Law Review, Vol. 10, 2005, p 292.

the form of artificial intelligence systems, which mainly facilitate the administrative work of lawyers, for example, to prepare draft contracts or lawsuits.[5] However, it cannot be assumed that these systems will fulfil the fully automated dispute resolution system role shortly.[6] These systems only fulfil a kind of support function. One of the possibilities of how AI can perform its function within ADR and for the entire dispute resolution follows directly from the above. For example, within online dispute resolution (ODR), AI support systems are used the most.[7] This method is particularly advantageous because the neutral arbitrator retains control over the entire dispute resolution process and can issue a final dispute by the generally accepted rules of ADR or ODR.[8] Individual artificial intelligence support systems can be classified based on the nature of the assistance provided. An AI support system can be used, for example, to support decision-making, in which this system determines the most optimal solution for a given case based on examining various factors. These systems can also be used as so-called assistive systems to propose possible solutions to a case based on the review of previous cases, including their results. In these platforms, AI systems can have different functions; for example, they can be diagnostic systems – they will indicate why something happened; descriptive systems that describe what happened; prescriptive in the ability to carry out actual decision-making and implementation; predictive systems that predict what will happen (based on statistics).[9]

The second method is a fully automated method of deciding disputes through an AI system, especially with the use of predictive analytics. Using these systems, it is possible to partially or entirely automate specific tasks in the decision-making process. Based on the use of predictive analytics, the AI system can reveal specific patterns and trends in a large amount of data; they could also, based on the analysis of previous cases, predict how similar disputes will be resolved in the future and thus speed up and facilitate the decision-making process.[10] In the sense of the above, a faster process would also mean lower financial costs and thus would enable improved access to justice, as it can provide less expensive legal advice in real time.[11] The use of these automated AI systems is

[5] For example beta version of the *Harvey system* - a large platform based on a language model intended to facilitate the legal analysis of contracts, lawsuits and due diligence in several world languages.

[6] SCHERER, Maxi. International Arbitration 3.0 – How Artificial Intelligence Will Change Dispute Resolution?, In: Austrian Yearbook on International Arbitration. 2019, pp. 503-514.

[7] HIBAH, Alessa. The role of Artificial Intelligence in Online Dispute Resolution: A brief and critical overview, Information & Communications Technology Law, 2022(31)3, pp. 319-342.

[8] ABBOTT, Richard, and Elliott, S. BRINSON, *Putting the Artificial Intelligence in Alternative Dispute Resolution: How AI Rules Will Become ADR Rules*. (2023). Amicus curiae: Journal of the Society for Advanced Legal Studies, Vol.4(3) p. 689.

[9] GIUFFRIDA, Iria. Liability for AI Decision-Making: Some Legal and Ethical Considerations, Fordham L. Rev. Vol. 88 (2019), p.440.

[10] *Ibid.* 690.

[11] CARNEIRO, Davide, et al. *Online Dispute Resolution: An Artificial Intelligence Perspective*.

the biggest concern in society. Despite the potential advantages, these systems may represent the most significant risks, mainly because these systems should decide disputes without any or with only minimal human supervision.[12]

As already follows from this chapter, using AI in ADR represents several advantages, such as providing a more efficient dispute resolution process, reducing costs and potentially making a more objective decision. However, it also presents several challenges, risks and concerns.[13] In the following sub-chapter, we will address several concerns that arise from the use of AI in ADR, and that could potentially pose a risk to society. Subsequently, in the context of the aforementioned, we will address selected potential risks within the context of the proposed law.

1.2. Should we be excited or worried?

Even though, within the framework of this article, we do not focus more on the possible benefits that result from the use of AI in ADR, the mere fact that the active use of AI systems could speed up dispute resolution processes[14] (especially with alternative methods, which in general mean a faster process) and thereby reduce the costs associated with the process, is not to be thrown away. However, only some things that may appear very beneficial to society can be beneficial without risks. Well, at least not at the beginning. As mentioned in the previous subsection, the use of AI in ADR and the initial implementation results in various risks, challenges, or even concerns. This article will address the most serious issues arising from this implementation.

One of the potential concerns arises from privacy protection.[15] AI systems depend on the ability to access and use enormous amounts of data. In today's world, great emphasis is placed on protecting personal data, so what amount of data would be needed to train AI systems for alternative dispute resolution? The concerns that arise from the above relate at least to the misuse of personal data, profiling or possible discrimination.[16] In order to ensure that AI systems (not only

Artificial Intelligence Review 41, no. 2 (2014): p. 211–240.

[12] *Supra* note 7, p. 690.

[13] BOSTROM, Nick and Eliezer YUDKOWSKY, *The Ethics of Artificial Intelligence*, In: The Cambridge Handbook of Artificial Intelligence.Cambridge: Cambridge University Press, 2014, pp. 316-344.

[14] GYURÁSZ, Zoltán, and Dominika GORNAĽOVÁ, *Use of Artificial Intelligence in Arbitration*. In MALACHTA, R. - PROVAZNÍK P. (eds.) Cofola International 2021: International and National Arbitration – Challenges and Trends of the Present and Future: Conference Proceedings. 1st edition. Brno: Masaryk University, 2021. p. 81.

[15] RABINOVICH, Orna, and Ethan KATSH, *Artificial Intelligence and the Future of Dispute Resolution: The Age of AI-DR*. Online Dispute Resolution: Theory and Practice. (2021). Eleven International Publishing. (2 ed.,) p. 477.

[16] WOLFF, Josephine, and William LEHR, and Christopher S. YOO. *Lessons from GDPR for AI Policymaking* U of Penn Law School, Public Law Research Paper, (2023).No. 23-32.

within the framework of use in ADR) are beneficial and, from the mentioned point of view, also safe, it is necessary to ensure strong regulation. In this context, AI is currently regulated by the comprehensive personal data protection law – Regulation (EU) 2016/679 (General Data Protection Regulation or GDPR), adopted in 2018 to update and unify the data protection regulation within the EU states. This regulation is relevant to all industries and governs all personal data, including automated data processing, which is strictly regulated. The regulation is based on the requirement to inform users how their data will be used and how it will be further handled. As stated, this regulation also applies to automated decision-making, including profiling, which requires the express consent of the data subject to data processing with certain exceptions. Legality, transparency and fairness are essential for AI systems regarding the GDPR.[17] Using personal data to develop or use AI is subject to regulation, but AI is only marginally regulated. However, the adoption of the EU AI Act will change this fact. This regulation classifies AI systems based on the risk their intended use poses. In terms of this scale, specific rules follow for the given category, which results in obligations for individual providers of AI systems, including data protection. Following on from above, the issue of transparency can be mentioned further. Some AI systems, often called "black boxes", lack transparency and explainability.[18] They lack a certain logic according to which decisions or recommendations are made, which can be explained in a way that makes sense to the system's users. The use of non-transparent dispute resolution systems can significantly weaken trust in such systems.[19] Another concern about using AI in ADR is the potential risk of biased decisions because the system is only good as the data is fed into it. The final decision would be equally affected if this system contained false or biased data. As with any technology, it brings many advantages, concerns, and risks. [20]It is possible to assume that it will not be easy to alleviate or deal with these concerns. The hope may be the EU AI Act, which comprehensively and broadly solves the problems arising from the use of AI in society. In the next chapter, we consider the potential effect of this regulation on ADR.

2. AI IN ADR IN THE CONTEXT OF THE NEW DRAFT "EU AI ACT"

The EU AI Act, proposed by the European Commission, will become the world's first comprehensive law for artificial intelligence. As follows from the previous chapter, the use of AI systems in society and the initial enthusiasm also

[17] LORÈ, Filippo and Pierpaolo, BASILE, and Annalisa, APPICE. et al. *An AI framework to support decisions on GDPR compliance.* (2023). Journal of Intelligent Information Systems. pp. 1-28.
[18] Ibid.
[19] CONDLIN, Robert, J., *Online Dispute Resolution: Stinky, Repugnant, or Drab?"* (2017). Cardozo Journal of Conflict Resolution. Vol. 18, pp. 717-758.
[20] *Supra note* 8, p. 442

raises several concerns. This act primarily focuses on how to address these concerns. In February 2020, the European Commission published a White Paper on Artificial Intelligence[21] and proposed creating a European regulatory framework for trustworthy artificial intelligence. In 2021, the European Commission presented a draft of a new law on artificial intelligence, in which it proposes, in addition to enshrining a technologically neutral definition of artificial intelligence systems in EU law, to apply to current and future artificial intelligence systems and to enshrine a set of rules adapted to a risk-based approach[22]. This act classifies artificial intelligence systems according to the degree of risk; as the risks increase, so do the measures that need to be taken. After presenting a preliminary version of the act, the Council of the EU mandated the Commission to set general requirements for the security and transparency of artificial intelligence technologies. In May 2023, the European Parliament approved new transparency and risk management rules for artificial intelligence systems to ensure artificial intelligence's ethical and human-centred development in Europe. In their amendments to the Commission's proposal, the European Parliament seeks to ensure that artificial intelligence systems are supervised by humans, secure, transparent, traceable, non-discriminatory and environmentally friendly. As mentioned, this act seeks to regulate systems that pose a potential risk to fundamental rights or human well-being and categorizes cases of AI use into four levels of risk: minimal, high and prohibited.[23]

Artificial intelligence systems with limited risk – such as spam filters or video games – can be used with few requirements apart from the transparency obligation. Systems that pose an unacceptable risk – such as government social assessment and real-time biometric identification systems in public spaces – are banned with few exceptions.[24] Because, in the sense of the proposed act, the use of AI technologies in the administration of justice, or the application of law to a specific set of facts as a high-risk application, is subject to stringent requirements. Since alternative dispute resolution also falls into this category, we will focus only on high-risk systems in the following sub-chapter.

2.1. AI systems in ADR as high-risk systems

According to this act, high-risk systems can negatively affect security or

[21] European Commission. White Paper on Artificial Intelligence (2020) [online]. Available from: https://commission.europa.eu/publications/white-paper-artificial-intelligence-european-approach-excellence-and-trust_en.

[22] Proposal for a Regulation of the European Parliament and the Council laying down harmonized rules on artificial intelligence (Artificial Intelligence Act) and amending certain Union legislative acts. COM(2021) 206 final.

[23] European Parliament. Press release. AI Act: a step closer to the first rules on Artificial Intelligence (2023) [online]. Available from: https://www.europarl.europa.eu/news/en/press-room/20230505IPR84904/ai-act-a-step-closer-to-the-first-rules-on-artificial-intelligence.

[24] Explanatory Memorandum of the Proposal for the Artificial Intelligence Act, p. 2

fundamental rights. The very classification of an artificial intelligence system as high-risk depends not only on the function performed by the artificial intelligence system but also on the specific purpose and ways in which this system is used.[25] As seen from the draft act and its explanatory report, special rules for artificial intelligence systems that create a high risk for health and safety or the fundamental rights of natural persons can be found in Title III. High-risk AI systems can be divided into two categories, namely artificial intelligence systems used in products covered by EU product safety legislation and other separate artificial intelligence systems with impacts, in particular on fundamental rights, which are explicitly listed in Annex III of this act.[26] This list of high-risk artificial intelligence systems in Annex III contains a limited number of artificial intelligence systems whose risks have already occurred or are likely to occur shortly.

As it follows from the rationale, the legislator believes that: "certain AI systems intended for the administration of justice and democratic processes should be classified as high-risk, considering their potentially significant impact on democracy, rule of law, individual freedoms as well as the right to an effective remedy and to a fair trial…"[27]

Under Annex III (1), point 8, it can be determined that they are considered a high-risk system: "AI systems intended to assist a judicial authority in researching and interpreting facts and the law and in applying the law to a concrete set of facts."[28] In this context, however, it is necessary to state that this is the original wording of the proposed provision, which did not explicitly include alternative dispute resolution. It is interesting that the amending proposal no. 738 intends to modify the original Commission draft as follows: "AI systems intended to be used by a judicial authority or administrative body or on their behalf to assist a judicial authority or administrative body in researching and interpreting facts and the law and in applying the law to a concrete set of facts or used in a similar way in alternative dispute resolution**.**"[29]

The same situation applies to justifying the inclusion of these systems as high-risk, when the original recital no. 40 was affected by an amending proposal no. 71 supplementing alternative dispute resolution as follows: "in particular, to address the risks of potential biases, errors and opacity, it is appropriate to qualify as high-risk AI systems intended to be used by a judicial authority or administrative body or on their behalf to assist judicial authorities or administrative bodies in researching and interpreting facts and the law and in applying the law to a concrete set of facts or used in a similar way in alternative dispute resolution."[30]

[25] Explanatory Memorandum of the Proposal for the Artificial Intelligence Act, p. 14
[26] Ibid.
[27] *Ibid.* Recital 40
[28] Annex III (1), point 8 of the proposal for the Artificial Intelligence Act.
[29] Amending proposal no. 738 of the Amendments of the proposal for Artificial Intelligence Act.
[30] Amending proposal no. 71 of the Amendments of the proposal for Artificial Intelligence Act

It needs to be clarified why the legislator did not include alternative dispute resolution methods in its original proposal. However, it can be assumed that it intended to subsume these alternative methods under the scope of this act; however, by explicitly defining it, it is possible to prevent the creation of a "gap" in the law and thus prevent any abuse of this fact. As follows from the above, the requirements for high-risk artificial intelligence systems are regulated in Title III. In particular, data management, record keeping, and documentation storage requirements are adjusted there. It also includes regulating transparency and providing information to users with human supervision, reliability, accuracy and security. Since in the previous chapter we addressed selected risks or concerns from the use of AI systems in ADR, in the following subsection, we will analyse selected provisions of the EU AI Act, mainly related to transparency, responsibility or data protection.

2.2. Is the proposed act sufficient?

Since in the previous chapter, we defined some of the potential risks or concerns that come into consideration when using AI in ADR, in this chapter, we describe how the proposed act deals with it. Given that the use of AI systems within ADR is considered high-risk within the meaning of the AI Act, in the following chapter, we deal with the analysis and examination of the relevant provisions relating to this category of systems, which can be applied analogously to AI in ADR. Likewise, the relevant provisions of the GDPR can also be applied by analogy to AI in ADR, especially regarding automatic decision-making. One of the main concerns is the issue of personal data protection. For AI systems to operate, they need to access a considerable amount of data. So, the concerns are justified. As follows from the previous chapter, the use of personal data within the EU is governed by the GDPR.

One of the two legal bases used by the European Commission to justify the draft act on artificial intelligence is Article 16 of the Treaty on the Functioning of the European Union (TFEU), which mandates the EU to establish rules regarding the protection of individuals concerning the processing of personal data. The rules of the EU AI Act would at least partially complement the protection provided to data subjects under the GDPR. In this context, it is appropriate to state that the GDPR and the EU AI Act target different subjects. While the EU AI Act focuses on the providers and users of artificial intelligence systems, the GDPR focuses primarily on obligations for data controllers and data processors.[31] One of the most important articles, which we can also discuss in connection with AI systems in ADR, is Article 5 (1) letter a) of the GDPR, according to which the operators of such systems must process personal data fairly, transparently and

[31] *Supra* note 15.

legally.[32] We would look for direct links or references to the GDPR in the EU AI Act in vain, with a few exceptions. If we look more closely at the individual provisions of the regulations in question, it is possible to mention Article 9 of the GDPR, which prohibits operators from processing data of a particular category[33] unless an exception applies. Unlike the GDPR, the EU AI Act contains an explicit exemption from this article. Article 10 (5) of the EU AI Act states, "*to the extent that it is strictly necessary for the purposes of ensuring bias monitoring, detection and correction in relation to the high-risk AI systems, the providers of such systems may process special categories of personal data referred to in Article 9(1) GDPR*"[34], subject to adequate guarantees of the fundamental rights and freedoms of natural persons, including the technical limitation of repeated use, security and privacy protection measures. It follows from the above that the subjects could have conflicting requirements. Another exception is Article 29 (6), which states that users of high-risk AI systems will use the information provided under Article 13 to fulfill their obligation to carry out a data protection impact assessment under Article 35 of the GDPR. However, this is problematic as it follows from the explanatory report that the providers will not always be able to assess all possible system uses.[35] Since these legal arrangements can overlap or complement each other, such as in the issue of bias and discrimination, risk assessments, or solely automated decision-making, it will be necessary for users to clarify which of the mentioned regulations they will follow or both. As we have already stated in the introduction, in the case of the GDPR law, in connection with AI, provisions regarding automated decision-making can be mentioned in ADR.

Another significant issue is transparency. In this context, the GDPR can be mentioned again, establishing certain protections and guarantees for individuals if they are subject to certain decisions based exclusively on an automated personal data processing system, including profiling—these obligations related to transparency contain Article 22 of the GDPR.[36] Analogously, this provision can be applied to AI systems in ADR. As the very purpose of the EU AI Act implies, this is its crucial priority. In this context, it is also necessary to mention Article 15 of the GDPR, which gives individuals the right to access their data. This right also includes obligations for operators of AI systems in ADR to provide information about the existence of automated decision-making, including profiling and explaining the logic and justification of the decision taken. It can be assumed

[32] Article 5 of the GDPR.

[33] Article 9 of the GDPR - personal data revealing racial or ethnic origin, political opinions, religious or philosophical beliefs, or trade union membership, and the processing of genetic data, biometric data for the purpose of uniquely identifying a natural person, data concerning health or data concerning a natural person's sex life or sexual orientation.

[34] Article 10 (5) of the proposal for Artificial Intelligence Act.

[35] Explanatory Memorandum of the Proposal for Artificial Intelligence Act.

[36] PANIGUTTI, Cecilia, et. al. *The role of explainable AI in the context of the AI Act*. In 2023 ACM Conference on Fairness, Accountability, and Transparency (FAccT '23), June 12–15, 2023, Chicago, IL, USA. ACM, New York, NY, USA, 12 p.

that if automated decision-making directly affects individuals, they will be interested in how the system arrived at such a decision.[37] The above is closely related to the issue of transparency, which is one of the most critical aspects of the implementation of AI in ADR. Transparency is essential to create public trust in AI systems in general, but mainly in that system and ensure their responsible deployment. Following this, the act establishes certain obligations, partially regulated in articles 13, 14 and 52. However, introducing these obligations can present several problems – considering the comments on the original wording of the individual provisions, it did. In the sense of the draft act, AI systems must be transparent in functioning so that users understand how decisions are made and their logic. It is essential to state that this includes explaining how the AI system arrived at its decisions, as well as information about the data used to train the system and the accuracy of the system. The application of this provision, especially to decision-making through AI systems in ADR, can be seen as a hope that individuals would better understand such decision-making and trust the system more, which could overall contribute to a faster implementation of such systems in society. In this context, however, obtaining transparent information will be necessary for individuals to challenge such a decision, either with the operator or the relevant supervisory authority. Article 14 deals with the so-called human supervision, when high-risk artificial intelligence systems should be designed and developed so that natural persons can supervise their operation, in particular, to minimize risks to health, safety or fundamental rights that may arise from using high-risk AI systems.[38] It is also necessary to point out that even in terms of the GDPR, such a system can only exist with a certain degree of supervision. Operators of AI systems in ADR will have to be ready to be available at any time to individuals who request the provision of information and also an explanation, e.g. about the logic of algorithms. Overall, the issue of transparency will be a challenge in practice in the context (not only) of AI in ADR, as, on the one hand, there are complex definitions of algorithms. On the other, some individuals are entitled to a basic and simple explanation.

The regulation of transparency is laid down in Article 13. This article was amended by the amending proposal and supplemented with the following wording: *„…reasonably understand the system's functioning. Appropriate transparency shall be ensured in accordance with the intended purpose of the AI system, with a view to achieving compliance with the relevant obligations of the provider and user set out in Chapter 3 of this Title..."*[39]

However, it should be noted that the issue of transparency, as defined in the draft act, was not met with enthusiasm among experts. Indeed, the draft act only requires transparency for an intended purpose but needs to explain the level

[37] Article 15 of the GDPR.
[38] Article 14 of the proposal for Artificial Intelligence Act.
[39] Article 13 (1) of the proposal for Artificial Intelligence Act.

of transparency and distinguish what is adequate for different types of systems. Furthermore, the following was added to the original article: *„transparency shall thereby mean that, at the time the high-risk AI system is placed on the market, all technical means available in accordance with the generally acknowledged state of art are used to ensure that the AI system's output is interpretable by the provider and the user. The user shall be enabled to understand and use the AI system appropriately by generally knowing how the AI system works and what data it processes, allowing the user to explain the decisions taken by the AI system to the affected person pursuant to Article 68(c)"*.[40]

In this part of the provision, the legislator tries to bring us closer to what we can interpret under the term transparency, but it is still relatively vague. This wording of the act, however, represents room for flexible interpretations of this provision, which may not be entirely expedient. In order to ensure a high level of protection of fundamental rights, the act should simplify to determine whether they are exposed to or affected by an AI system.[41] The obligation to inform users that they are integrating with the AI system, in turn, is based on Article 52. The original wording of the provision was amended as follows: *„Providers shall ensure that AI systems intended to interact with natural persons are designed and developed in such a way that the AI system, the provider itself or the user informs the natural person exposed to an AI system that they are interacting with an AI system in a timely, clear and intelligible manner, unless this is obvious from the circumstances and the context of use."*[42]

Compared to the original wording, the entities with this information obligation have been added to the AI system, the provider itself or the user. Considering that this gap has been filled, this provision more clearly defines who must inform a natural person about a collision with an AI system. Concerning the risk of a potentially biased decision based on the provision of biased data, the proposed EU AI Act deals with this in Article 15, which states that high-risk systems must be designed and developed in such a way that, given their intended purpose, they achieve an appropriate level of accuracy, reliability and cyber security and to perform consistently in these respects throughout their life cycle.[43] It further states that AI systems must be fault-tolerant and resistant to attempts by unauthorized third parties to alter their use or performance by exploiting system vulnerabilities, noting that users should be informed of the level and metrics to measure accuracy. In the above sense, the selected concerns defined in this article are also partially addressed within the draft EU AI Act. The original wording of the draft law was moved forward by a significant step after various comments. The

[40] Article 13 (2) of the proposal for Artificial Intelligence Act.
[41] GYEVNAR, Balint, and Nick, FERGUSON, and Burkhard SCHAFER, Bridging the Transparency Gap: What Can Explainable AI Learn From the AI Act? (2023) [online]. Available from: https://doi.org/10.48550/arXiv.2302.10766.
[42] Article 52(1) of the proposal for Artificial Intelligence Act.
[43] Article 15 (1) of the proposal for Artificial Intelligence Act.

issue of transparency, protection of personal data, or the risk of biased decision-making are critical aspects of this law. They are necessary for considering trust in the use of these systems. Only practice will show whether they are set in this law adequately and appropriately for the intended aim and purpose.

In connection with the use of AI in ADR, other guiding regulations are also related, such as the European Ethical Charter on the use of Artificial Intelligence in judicial systems and their environment, which was adopted by the European Commission for the Efficiency of Justice (CEPEJ) in 2018. The document lists five ethical principles for using AI in judicial systems, including ADR or ODR. All these principles can be applied by analogy to ADR processes; however, in connection with the concerns presented, the *Principle of transparency* from which it can be deduced that accessible and comprehensible methods must be used for data processing by ADR providers and *Principle of quality and security* - processing of judicial or ADR decisions/data must use verified sources and data that are processed in a secure technological environment.[44] From the above, it can be assumed that the emerging AI rules will also apply to ADR. However, it appears that users should assess the appropriateness and degree of integration of AI into the dispute resolution process to ensure compliance with all requirements and that these technologies must not interfere with the rights guaranteed in all civil, commercial and administrative proceedings.

CONCLUSION

Technological progress in society also means a boom in the use of AI systems. This use is connected mainly with various benefits and facilitation of processes in the society. The use of AI systems also requires a certain amount of caution, especially in certain areas, such as AI systems within ADR. In particular, such use requires comprehensive and consistent regulation that will consider ethical and legal concerns. The EU AI Act aspires to this position of the unified and first regulation of artificial intelligence in the world. Currently, there are several ways in which AI systems can be used in ADR. Even though various pilot projects and AI systems are currently in the decision-making or used by the legal profession, experts need to be convinced due to the number of risks and challenges that result. It is more than clear that, given that such systems are qualified as high-risk for their risk of possible interference with fundamental human rights, it is unlikely that such a system will be able to issue an ultimate decision without human supervision. However, even AI systems only as support systems must be used transparently, reliably and with an emphasis on protecting personal data. The upcoming act, together with other guiding regulations, has great potential to alleviate concerns about the use of AI systems within ADR, but also in general,

[44] See *supra* note 3.

which will also increase the society's trust in these systems. Notably, the comments on the draft law were constructive and thus filled potential gaps in the draft act compared to the original wording. However, their adequacy and appropriateness will probably be revealed only once the Act has been adopted and put into practice. It is assumed that the final wording of the law will be adopted at the beginning of 2024, and its entry into force is expected at the turn of 2025/2026. We can only hope that even though there are currently no rules for the use of AI in ADR, the upcoming law will enable a more effective, safer and more transparent implementation.

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The scope of the United Nations convention on contracts for the international sale of goods in the face of technological inventions

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Abstract: *The article deals with the scope of the UN Convention on Contracts for the International Sale of Goods (CISG) facing technological inventions. The paper aims to answer the question of the application of the CISG to these technological inventions (e.g. drones). It will examine if drones can be considered as ships, vessels, hovercraft, or aircraft under Article 2(e) CISG and can therefore be excluded from the application of the CISG. The issue is analysed based on published court decisions with references to legal scholarship. The author concludes by commenting on the application of the criteria formulated in case law and by legal scholarship and provides a recommended solution as to whether the scope of the Convention should be modified in light of recent technical progress.*

Keywords: *Aging of the CISG, international sale of goods, scope of CISG, technological inventions, United Nations Convention on Contracts for the International Sale of Goods (CISG).*

INTRODUCTION

The United Nations Convention on Contracts for the International Sale of Goods (CISG) is considered, for many reasons, to be the most successful state-level unification of substantive law, and sometimes the most important instrument for the regulation of international commercial law ever developed at the United Nations Commission on International Trade Law (UNCITRAL). Among the reasons for the CISG's success are the generally worded and relatively uncomplicated text of the Convention, but also its relatively broad scope of application. The Convention was adopted on 11 April 1980 and came into force on 1 January 1988. However, international trade, like many other sectors, is evolving. Advances in transport, changes in payment terms, innovations in contract negotiation processes, and technological advances all require a gradual adjustment of contractual terms, commercial legal relationships and the corresponding adjustment in legal regulations. Considering the age of the CISG it is not surprising that its wording does not correspond to the latest innovations. The process of crafting new legal rules lags significantly behind the swift evolution of communication

technology. Legislation addressing specific technological advancements may quickly become outdated due to ongoing technological progress.[1] In this respect, CISG, with its general focus, may have the advantage of never going out of fashion.

It is the scoping of the Convention that this article will deal with. The Convention applies to contracts of sale of goods between parties whose places of business are in different States when the States are Contracting States; or when the rules of private international law lead to the application of the law of a Contracting State.[2] Sale according to Article 1 includes also contracts which are not strictly contracts of sale and for which the scope of the Convention is extended in Article 3. Under this Article, the distinction between contracts for the supply of goods to be manufactured, which are subject to the Convention, and contracts for labour or services, which are governed by national law, depends on whether or not the material supplied by the party ordering the goods is substantial.[3] The subject of the sale is to be the goods. However, the CISG does not explicitly define it but instead lists certain types of goods which it excludes. According to the case-law, goods are typically goods which, at the time of delivery, are movable and tangible, whether used or new, inanimate or animate.[4]

In Article 2 the Convention excludes certain sales. According to this article the Convention does not apply to sales: (a) of goods bought for personal, family or household use, unless the seller, at any time before or at the conclusion of the contract, neither knew nor ought to have known that the goods were bought for any such use; (b) by auction; (c) on execution or otherwise by authority of law; (d) of stocks, shares, investment securities, negotiable instruments or money; (e) of ships, vessels, hovercraft or aircraft;(f) of electricity.

This exclusion can be divided into three types: exclusion based on the purpose for which the goods were purchased (subparagraph (a)), based on the type of contract of sale, (subparagraphs (b) and (c)), based on the type of goods sold (subparagraphs (d), (e) and (f)).[5] The purpose of Article 2 is to limit the material scope of the Convention as the authors of the Convention concluded that

[1] ASSADUZZAMAN, A., Legal issues in the application of CISG in online sale (e-commence) contracts. 2016. Computer Law & Security Review. Vol. 32, no. 6, pp. 840–851. DOI 10.1016/j.clsr.2016.07.012.

[2] Art. 1(1) CISG.

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unification of the legal rules on these matters could not be achieved by the Convention.[6] It is essential that the exceptions to the Convention regime set out in Article 2 are regulated exhaustively. The exclusion thus must be interpreted restrictively. The number (or types) of exceptions cannot be expanded and analogy is not allowed in order to maintain the widest possible scope of the Convention.[7] The success of the CISG lies in its precise interpretation, involving recognition of its limited applicability. Understanding the limitations of the CISG underscores the necessity of referring to non-CISG legal frameworks when needed.[8] The purpose of this contribution is to answer the question as to whether new technologies will be excluded from the scope of the Convention based on Article 2(e) without any additional requirement. And whether today's latest inventions, given what they are capable of today, and the innovations that await us in the near future, given the speed of development and research, can even be included within the text of the Convention. And to make a conclusion about the CISG's adaptability to the contingencies that have arisen since its inception.

These questions will be answered by thoroughly analyzing the scoping of CISG. The methodology involves a structured approach to understanding the Convention's applicability and limitations. Firstly, it will review historical discussions leading to the adoption of the CISG in 1980 to understand the original intentions behind Article 2(e) CISG formulation. Subsequently, on the basis of an analysis of relevant cases and legal scholarship, the requirements that are a prerequisite for exclusion under Article 2(e) CISG or, conversely, for keeping the goods within the scope of the Convention will be identified. It should be noted that there is no centralised judicial body interpreting the CISG and that the case law of the various national courts interpreting it is accessible in the Digest of Case Law[9] on the CISG, albeit with some delay. Hence, there is a possibility that a national court may have already made a decision on the legal classification of drones within the ambit of CISG. Therefore, this possibility cannot be excluded from our analysis.

In conclusion, based on the findings, propose potential amendments to modernize CISG's scope while maintaining its effectiveness and relevance in the evolving international trade landscape and will suggest best practices for busi-

[6] TICHÝ, Luboš. Článek 2 [Výjimky z působnosti]. In: TICHÝ, Luboš. CISG - Úmluva OSN o smlouvách o mezinárodní koupi zboží: komentář. Praha: C. H. Beck, 2017. p. 29-30, ISBN 9788074006494.

[7] TICHÝ, Luboš. Článek 2 [Výjimky z působnosti]. In: TICHÝ, Luboš. CISG - Úmluva OSN o smlouvách o mezinárodní koupi zboží: komentář. Praha: C. H. Beck, 2017. p. 29-30, ISBN 9788074006494.

[8] WALT, Steven. The CISG's Expansion Bias: A Comment on Franco Ferrari. International Review of Law and Economics. September 2005. Vol. 25, no. 3, p. 342–349. DOI 10.1016/j.irle.2006.02.003.

[9] For the 2016 Digest of the CISG case law see: https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/cisg_digest_2016.pdf.

nesses and legal practitioners to navigate the scope and exclusions of CISG effectively in contemporary international trade scenarios.

1. ARTICLE 2(e) AND LEGISLATIVE HISTORY OF THE EXCLUSIONS FROM THE CONVENTION

Article 2 finds its antecedent in Article 5 of the former uniform law, the Convention relating to a Uniform Law on the International Sale of Goods, 1964, the Hague (ULIS). According to Article 5(1)(b) of ULIS, the specified law excluded sales "of any ship, vessel, or aircraft subject to registration." The exception for ships and aircraft was retained in CISG, although forceful arguments for its elimination were raised in Vienna.[10] For example, the Canadian delegation questioned the sufficiency of these reasons and argued in favor of removing the exemption. However, the proposed resolution seeking to remove the exclusion did not receive the necessary support.[11] Although the CISG has undergone textual changes regarding exemptions in comparison to ULIS, this paper will begin by outlining the reasons for the absence of a unified regulation for ships, vessels, hovercraft, or aircraft.

There are several reasons for excluding these specific categories of "goods". Firstly, this exclusion is attributed to the existence of national mandatory provisions concerning different registration requirements applicable to certain ships, vessels, hovercraft and aircraft.[12] The regulations determining which of these items require registration differ considerably from jurisdiction to jurisdiction. Secondly, the exclusion of ships, vessels, hovercraft and aircraft results from differences in legal classification in different jurisdictions. In some jurisdictions, the sale of ships, vessels, hovercraft, and aircraft is considered a transaction in goods, while in others the sale of ships, vessels, hovercraft, and aircraft is considered a sale of real estate.[13] As stated above, goods according to CISG are typically goods that are movable and tangible. The exclusion under Article 2(e) avoids an issue that arises in some countries where remains undecided if ships,

[10] SCHLECHTRIEM, Peter. Uniform sales law: The UN-Convention on contracts for the international sale of goods. Wien: Manz, 1986. [online]. [viewed 9 October 2023]. Available from: https://iicl.law.pace.edu/sites/default/files/cisg_files/schlechtriem.html#a15.

[11] ZIEGEL, J. S., SAMSON, C. Report to the Uniform Law Conference of Canada on the Convention on Contracts for the International Sale of Goods, 1981 [online]. Institute of International Commercial Law, Pace Law School. [cit. 4. 10. 2023]. Available from: https://iicl.law.pace.edu/sites/ default/files/bibliography/english2_0.pdf.

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[13] HALLA, Slavomír; HRNČIŘÍKOVÁ, Miluše; MALACKA, Michal. CISG: (Úmluva OSN o smlouvách o mezinárodní koupi zboží): komentář s judikaturou a výkladem k otázkám souvisejícím. Komentátor. Praha: Leges, 2021. ISBN 9788075025142.

hovercraft, or aircraft should be classified as goods under their sales legislations.[14]

As previously mentioned, paragraph (e) of this provision originates from Article 5(1)(b) of ULIS, with the addition of hovercraft. This inclusion occurred for the first time during the Vienna Conference. The addition transpired following a request made by India, advocating for hovercraft to be encompassed within the list of exceptions. The rationale behind this addition was based on India's legal treatment of hovercraft, aligning them with ships or aircraft. From this standpoint, it is reasonable to infer that this exception pertains exclusively to hovercraft designed for use as boats, excluding other forms of vehicles or vessels that operate on the principle of a pneumatic cushion.[15] Additionally, this inclusion to the provision renders the determination of whether hovercraft are deemed as ships, vessels or aircraft unnecessary.[16]

Article 2(e) of the CISG excludes the sale of ships, vessels, hovercraft, and aircraft from the Convention. Unlike the corresponding provisions in ULIS, there is no mention of registration as the standard for exclusion. This limitation has been removed from the Convention as national legislation contains a number of rules or guidelines which could potentially cover "registration". Therefore, the application of the CISG is not dependent on the laws of the country concerned anymore. To prevent ambiguity concerning the inclusion of ships, vessels, hovercraft, or aircraft within this Convention, particularly considering that the relevant place of registration and governing laws may not be known at the time of sale, the sale of such transportation modes is excluded from the scope of the Convention.[17] However, according to Yearbook UNCITRAL II (1971) the aim was not to exempt smaller boats from the Convention, even if they undergo local registration for tax or safety reasons. The focus of this provision pertains to larger ships and vessels, typically subject to national registration for taxation or safety. The intent was not to base the exclusion on the vessel's current or mandatory registration status at the time of sale. Instead, the goal was to exclude vessel types that, under standard circumstances, would be subject to national registration.[18]

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[14] KHOO, Warren. Comments on Article 2 CISG [Exclusions from Convention]. In: BIANCA, C. Massimo and BONELL, Michael Joachim. Commentary on the international sales law: the 1980 Vienna Sales Convention. Milano: Giuffrè, 1987. pp. 34-40. ISBN 978-88-14-01276-1.

[15] SCHLECHTRIEM, Peter. Uniform sales law: The UN-Convention on contracts for the international sale of goods. Wien: Manz, 1986. [online]. p. 30-31, [viewed 9 October 2023]. Available from: https://iicl.law.pace.edu/sites/default/files/cisg_files/schlechtriem.html#a15.

[16] KHOO, Warren. Comments on Article 2 CISG [Exclusions from Convention]. In: BIANCA, C. Massimo and BONELL, Michael Joachim. Commentary on the international sales law: the 1980 Vienna Sales Convention. Milano: Giuffrè, 1987. pp. 34-40. ISBN 978-88-14-01276-1.

[17] WINSHIP, Peter. Aircraft and International Sales Conventions. [online]. Journal of Air Law and Commerce. 1985, Vol. 50, no. 4, p. 1053. [viewed 4 October 2023]. Available from: https://scholar.smu.edu/jalc/vol50/iss4/19.

[18] United Nations Comission on International Trade Law YEARBOOK Volume II: 1971, p. 56 [viewed 11 October 2023]. Available from: https://uncitral.un.org/sites/uncitral.un.org/files/media-

Consideration was also given to excluding only vessels of a specified tonnage; this attempt also was abandoned.[19]

2. REQUIREMENTS ON SHIPS, VESSELS, HOVERCRAFT OR AIRCRAFT

Art. 2(e) CISG states that the CISG does not apply to sales of "ships, vessels, hovercraft or aircraft". The exclusions of the sale of ships, vessels, hovercraft, and aircraft in Article 2(e) fall within the same category as the exclusion of stocks, shares, investment securities, negotiable instruments and money, that is, sales excluded on the basis of the nature of the goods sold.[20] The final wording of Article 2(e) does not indicate any further limitations and CISG does not define the meaning of a ship, an aircraft or any vehicle stated in Article 2 (e).

2.1. Registration criterion

With the removal of the registration criterion, it has become uncertain whether and to what extent smaller boats - rowing boats, canoes, dinghies, and yachts - fall within the subject matter excluded from the application of the Convention. Boats and rowing boats theoretically include small pleasure craft such as sailboats and rowing boats. However, the exclusion of these small pleasure crafts from the scope of the Convention cannot be justified by their compulsory registration or their treatment as immovable property. There is disagreement among experts as to where (or whether) to draw the line between (e.g.) an excluded 'ship' or 'vessel' and a (smaller) 'boat.'[21]

Honnold, referring to Article 7(1), proposes an unqualified interpretation of Article 2(e) that would make it easier to maintain a uniform international interpretation than judicial efforts to narrow the scope of the provision.[22] Article 7(1) CISG states that "*In the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade.*" According to Honnold, the Convention therefore does not apply to the sale of small recreational craft either, as these are vessels and are excluded from the scope of the

documents/uncitral/en/yb_1971_e.pdf.

[19] HONNOLD, John, Uniform law for international sales under the 1980 United Nations convention. 1999. 3rd ed. The Hague: Kluwer Law International. ISBN 978-90-411-0648-3.

[20] FERRARI, Franco, 2012. PIL and CISG: Friends or Foes? Internationales Handelsrecht. Vol. 12, no. 3, pp. 89–113. DOI 10.1515/ihr.2012.12.3.89.

[21] LOOKOFSKY, J. The 1980 United Nations Convention on Contracts for the International Sale of Goods, Hague: Kluwer Law International, 2000 [online]. Institute of International Commercial Law, Pace Law School. [viewed 9 October 2023]. Available from: https://iicl.law.pace.edu/sites/default/files/cisg_files/lookofsky.html.

[22] HONNOLD, John, Uniform law for international sales under the 1980 United Nations convention. 1999. 3rd ed. The Hague: Kluwer Law International. ISBN 978-90-411-0648-3.

treaty. Some scholars have argued for a distinction between small vessels for personal use, such as yachts, motorboats, and other sporting equipment, where the CISG may be applied in their sale.[23] For example, Professor Schlechtriem suggests that in many cases the obligation to register should remain an important criterion. He suggested that this exclusion should not apply to the sale of boats which, under national law, do not fall within the specific provisions of national law relating to boats.[24]

The registration requirement is addressed in the Barge case by The District Court Rotterdam. The court ruled that an inland vessel meets the standard of movable and tangible things. The circumstance that, pursuant to Article 2, opening words and (e), the CISG applies that treaty on the purchase of inland vessels also indicates that an inland vessel falls under the concept of "movable [tangible] property" in the CISG. After all, if an inland vessel could not be regarded as a movable [tangible] property, exclusion from the application of the CISG to the purchase agreement regarding an inland vessel would be unnecessary. The fact that the inland vessel "Fellowship" is registered in the Dutch shipping register does not change the above, because the ship does not lose its movable and tangible character through registration.

It can be concluded from this decision that the registration requirement is not relevant for determining the scope of Article 2(e) CISG. Moreover, all the reasons that have led to the removal of the words "subject to registration " from the text of Article 2e of the treaty, which are set out above, remain against this criterion.

2.2. Purpose criterion

The International Commercial Arbitration Court of the Chamber of Commerce and Industry of the Russian Federation, concluded on April 6, 1998 that the Convention was not applicable to contracts for the purchase of a decommissioned military submarine.[25] „*The Commission ruled that the Convention did not apply to the dispute by virtue of Article 2(e). In the opinion of the arbitrators, the submarine had been excluded from the list of the Russian Navy because of loss by this submarine 'of its Navy vessel status and for loss of that part of its specific functional descriptions, which brought about that status'. Nevertheless, it still had general qualities (although limited) of a sea vessel. Therefore, the arbitrators*

[23] HALLA, Slavomír; HRNČIŘÍKOVÁ, Miluše; MALACKA, Michal. CISG: (Úmluva OSN o smlouvách o mezinárodní koupi zboží): komentář s judikaturou a výkladem k otázkám souvisejícím. Komentátor. Praha: Leges, 2021. ISBN 9788075025142.

[24] HONNOLD, John, Uniform law for international sales under the 1980 United Nations convention. 1999. 3rd ed. The Hague: Kluwer Law International. ISBN 978-90-411-0648-3.

[25] Tribunal of International Commercial Arbitration at the Russian Federation Chamber of Commerce, Russian Federation, April 27th, 2005, Available from: https://www.unilex.info/cisg/case/ 1201.

ruled that 'as long as this submarine [had] the possibility to he afloat, though with assistance of other exterior appliances, it [was] to be regarded as a sea vessel'. According to this interpretation, a sea vessel within the meaning of Article 2(e) also includes 'inoperative' sea vessels even those excluded from the Navy list as well as from the registry. A possibility that a vessel can be afloat will suffice for it to fall under Article 2(e)." In this judgment, the International Commercial Arbitration Court of the Chamber of Commerce and Industry of the Russian Federation completely ignored the purpose for which the decommissioned submarine was purchased and judged the object of the purchase solely on the basis of its ability to float.

However, there was also criticism of this decision. Saidov[26] states that the contracts in question were not contracts for the sale of a vessel, but for the sale of scrap iron and the vessel was not intended to be used as a means of transport. Saidov argues that the purpose of the transaction should be relevant to the interpretation of Article 2(e) of the CISG and the approach taken in this decision should not be followed.

According to the Sailing yacht case from April 2nd, 2008, the relevant criterion for assessing whether a sailing ship is excluded from the scope of the CISG is its "seaworthy".[27] In the view of District Court of Middelburg the sailing ship in question must be regarded as a seagoing vessel within the meaning of Article 2(e) of the CISG. The Convention does not explain what is meant by a seagoing vessel, so it must be assumed that it means a vessel intended for use in the open sea. As this was the case and the vessel was a sailboat fit for sailing, the Vienna Sales Convention therefore does not apply to the sales contract.[28] In contrast to those cases, the CISG was applied in Auto-Moto Styl S.R.O. v. Pedro Boat B.V.[29], which involved the purchase of six boats, and in Ship case II[30], which also involved the purchase of a boat. In the latter case, a commentary by Ulrich G. Schroeter is published on this decision, stating that the Dutch District Court arguably overlooked Art. 2(e) CISG and that the Dutch domestic law should have been applied to the transaction, and not the CISG.

The criterion of seaworthiness has no clear definition in the context of the CISG. Nor can it be inferred from the judgments that the assessment of the substance of vessels under the CISG is systematic.

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[26] SAIDOV, Djakhongir, Cases on CISG Decided in the Russian Federation, [online] 2013 Institute of International Commercial Law, pp. 9-10 [viewed 9 October 2023], Available from: https://iicl.law.pace.edu/cisg/scholarly-writings/cases-cisg-decided-russian-federation.

[27] Sailing yacht case [District Court Middelburg, Netherlands, April 2nd, 2008], CISG-online number 1737, Available from: https://cisg-online.org/search-for-cases?caseId=7655.

[28] Ibid.

[29] Auto-Moto Styl S.R.O. v. Pedro Boat B.V., Gerechtshof Leeuwarden, Netherlands, August 31st, 2005, [online]. Available from: https://iicl.law.pace.edu/cisg/case/netherlands-august-31-2005-gerechtshof-appellate-court-auto-moto-styl-sro-v-pedro-boat-bv.

[30] Ship case II [District Court Midden-Nederland, Netherlands, January 8th, 2020], CISG-online number 4775, Available from: https://cisg-online.org/search-for-cases?caseId=12689.

2.2.1. Purpose for transport

Other experts go even further with their criteria, arguing that Article 2(e) does not include ships (rather than boats) that are not of a certain size, like air - and watercraft that do not serve a transport purpose.[31]

As for the size of vessels, this criterion is often associated with vehicle registration. A related contrary view is that since the CISG text does not imply a registration obligation or a specific minimum size, it is more likely that there will be no minimum size requirement for the exemption to apply. However, it would be ridiculous that the CISG could not be applied to the purchase of model or toy aircraft or ships and therefore it is argued that such goods fall within the scope of the CISG. Here again, the question arises as to the extent to which the goods can be considered a toy or model, and what qualities and characteristics they possess. There was also highlighted the requirement of a vehicle being intended to serve for transport (versus intended to serve as sporting equipment). It is also a criterion that results indirectly from criticism of the case dealing with the decommissioned military submarine by professor Saidov, where the submarine was not able to sail without assistance and thus neither itself to transport people nor goods. With this criterion, however, a number of questions arise. First, when considering the purchase of a vehicle, it is important to determine whether the intended use is for transportation or purely for recreational purposes. This distinction revolves around the objective possibility of using the vehicle for transport as opposed to the subjective intention of using it solely for sport. Do not forget that if the vehicle is capable of transportation and therefore usable for transport, the buyer cannot be prevented from altering the method of using the purchased goods. Second, there is no agreement or clear rules about what is meant by transport. It is conceivable that there would be clearly defined criteria that would set out, for example, how many people it could transport. However, there might be a circumvention of this rule, for example, by the vehicle not being intended primarily for the transport of people but for goods. In that case, it would be more appropriate to set conditions on the basis of the weight that the vehicle is capable of carrying and the distance.

3. PARTS AND CONSTRUCTION OF SHIPS, VESSELS, HOVERCRAFT OR AIRCRAFT

For the sake of consistency of this article, the author considers it necessary to state that the Convention may cover the purchase of parts of ships, vessels, aircraft and hovercrafts. An example would be the purchase of engines for an

[31] BRUNNER, Christoph, GOTTLIEB, Benjamin and AKIKOL, Diana, Commentary on the UN Sales Law (CISG). Alphen aan den Rijn: Kluwer Law International B.V. 2019. ISBN 978-90-411-9978-2.

aircraft.[32] Furthermore, the transaction involving essential voyage supplies (such as fuel) or equipment required for a ship's journey, even if regulated by national maritime laws, would fall within the scope of the Convention, provided that the remaining conditions outlined in Article 1 are satisfied.[33]

4. ADAPTING ART. 2(E) CISG TO MODERN TECHNOLOGIES

The rapid development of technology has resulted in remarkable advances in transportation such as drones, and flying cars expected to become available soon. A drone, also known as an unmanned aerial vehicle (UAV) or an unmanned aircraft system (UAS), is a remotely piloted or autonomously operated aircraft. Drones are typically controlled by a human operator on the ground using a remote control or a computer-based control system. They can also operate autonomously through pre-programmed flight plans or by following a set of guidelines using artificial intelligence. Overall, drones offer a flexible and cost-effective way to access aerial perspectives and collect data in a variety of applications, making them increasingly popular across different industries. Flying cars, also known as vertical takeoff and landing (VTOL) vehicles or urban air mobility (UAM) vehicles, are a type of transportation technology designed to combine the capabilities of traditional automobiles with those of aircraft, enabling them to operate both on the road and in the air. These vehicles are designed to take off and land vertically, eliminating the need for traditional runways. They could be a solution to urban congestion by allowing vehicles to bypass road traffic and travel directly through the air. The concept of flying cars holds the promise of faster and more efficient transportation, especially in densely populated urban areas. While there have been significant advancements and prototypes developed in recent years, the widespread adoption and integration of flying cars into daily transportation systems remain a subject of ongoing research and development.

From the above expert opinions and case law, the criteria to be considered before excluding goods from the application of the CISG based on Article 2(e) were identified. The vehicle's size, the existence of national registration requirements, and the vehicle's purpose. It follows that these criteria will also have to be applied to new technologies, such as drones or flying cars, which could theoretically fall under a hovercraft or an aircraft under the Convention. The inclusion of these modern vehicles in the CISG categories presents a unique challenge.

Hachem states that “drones should not be considered aircraft at all.”[34]

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[32] United Technologies International Inc. Pratt and Whitney Commercial Engine Business v. Magyar Légi Közlekedési Vállalat (Málev Hungarian Airlines), Fovárosi Bíróság [Metropolitan Court], Hungary, January 10, 1992 [online]. Available from: https://iicl.law.pace.edu/cisg/.

[33] HONNOLD, John, Uniform law for international sales under the 1980 United Nations convention. 1999. 3rd ed. The Hague: Kluwer Law International. ISBN 978-90-411-0648-3.

[34] HACHEM, Pascal In: SCHROETER, Ulrich, ed. Commentary on the UN Convention on the

However, according to the author, this view cannot be fully agreed with. As drones come in various shapes and sizes, ranging from small consumer-grade drones for recreational purposes to larger, more sophisticated drones used for commercial, industrial, or military applications the absolute exemption of drones from possible assessment as aircraft under CISG seems premature. In a scenario where a vehicle, referred to as a drone by both the seller and buyer, is intended for transporting people over long distances, its name alone cannot be relied upon. In such a situation, it would be appropriate to examine the characteristics of the vehicle, taking into account the inferred criteria. However, it should be borne in mind that these are criteria that do not arise from the convention itself, but from the practice of the courts and the opinions of experts. Similar principles apply to flying cars. In this context, the presumption of exclusion based on classification as 'cars' does not apply. The determination of their inclusion or exclusion from the scope of the Convention should be based on a careful examination of their different characteristics and alignment with the criteria defined for ships, vessels, aircraft, and hovercraft under the CISG.

CONCLUSION

CISG plays an essential role in promoting international trade by providing a uniform legal framework for sales contracts between parties from different states. However, in the face of an evolving global business environment marked by technological progress, questions arise about the continued relevance and adequacy of CISG. The generality and flexibility of the CISG have allowed it to continue to be used in modern international trade however, the application of the CISG remains vaguely uncertain.

Interpretation of Art. 2(e) CISG has been the subject of extensive discussion since the CISG entered into force. Various criteria have been proposed over time, including seaworthiness, size, and registration, to narrow this Article's scope. However, none of these proposed criteria or comments has been accepted by the entire professional public, let alone applied uniformly by all courts of the Contracting States. To eliminate ambiguity in the application of the CISG, it is prudent for parties entering into a contract to expressly clarify that, in their assessment, the goods in question do not fall under the classification of a ships, vessels, hovercraft, or aircraft as per Article 2(e) CISG.

New technologies are now entering this jumble of views. Adding another vehicle to the text of the Convention would not be a satisfactory solution, according to the author. It would also not be accurate to explicitly exclude drones from the scope of the CISG. To facilitate a judicious and pragmatic application of the CISG, it is essential to resist premature absolute exemptions for drones and flying

International Sale of Goods (CISG). Fifth edition. Oxford, United Kingdom: Oxford University Press, 2022. p. 72, ft. 121, ISBN 978-0-19-886867-5.

cars. In both cases, there is the potential for the same ambiguities to continue as before.

The preferred approach for the author would be to establish clear criteria according to which the hitherto broadly regulated exception from the scope of the Convention should be assessed. The categorization of these innovative technologies under the CISG should be contingent upon their actual characteristics, functionalities, and alignment with the criteria defining ships, vessels, aircraft, and hovercraft within the Convention.

The author of this article believes that, given the general nature of the Convention, it is possible to apply it today and hopefully for a long time in the future. The only question remains whether the intentions with which the text of the Convention was formulated remain valid today if they apply to cases about which no one could have known at the time of the adoption of the text of the Convention.

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The conceptual understanding of taxonomic criteria and objectives for environmentally sustainable economic activities

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Abstract: *The UN 2030 Agenda and the Political guidelines with six priorities of the current EU Commission, including the European Green Deal, vigorously and systematically advance sustainability, particularly its environmental pillar. The EU strategies, policies and law have engaged in promoting a genuine corporate social responsibility and the reporting about it and in fighting against greenwashing. After a sectorial regulation (Sustainable Finance Disclosures Regulation in 2018), a general regulation came to standardize the information about environmentally sustainable activities (the Taxonomy Regulation in 2019). Considering the dramatic expansion of the pool of subjects of the non-financial reporting duty, European businesses need to consider their social responsibility pursuant to criteria and objectives of environmentally sustainable economic activities set forth by the Taxonomy Regulation. Consequently, the interpretation and application of these criteria and objectives is not only challenging but also important on theoretical as well as practical levels. The goal of this paper is to contribute to their deeper conceptual understanding (i) by identifying them, (ii) by exploring them and their roots, in the context and while considering mischief, purposive and teleological rules, and (iii) by engaging with a critical and comparative juxtaposition. This reveals selective preferences and trends which are to be reflected on while balancing the six priorities of the European Commission for 2019-2024.*

Keywords: *EU, environmental sustainability, greenwashing, Taxonomy Regulation.*

INTRODUCTION

In a setting, globally of increasingly aggressive competition,[1] the EU,

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more and more, has promoted sustainability's three pillars (economic, environmental and social) concept as launched by the United Nations[2] ("UN").[3] Both the multi-stakeholder approach and cross-sector co-operation[4] are used to coax the social responsibility of businesses also known as corporate social responsibility ("CSR"),[5] in changing their environmental, social and governance ("ESG") strategies and following the higher win-win form, [6] i.e. the authentic synergy of creating economic and societal values labelled as creating shared value ("CSV")[7] in its ecosystem.[8] The sustainability of a business (and its products/services) needs to be communicated to stakeholders, via CSR/CSV/ESG reports or other forms, clearly and truthfully, allowing internal and external stakeholders to make educated decisions.[9]

The 1997 Amsterdam Treaty, amending the Treaty on EU (TEU), introduced sustainability, and particularly development in EU law and in many secondary EU law instruments during the era of Europe 2020 strategy.[10] This was speeded up by the Agenda 2030 and its endorsement by the EU of two new leg-

[2] See the famous UN Annex to document A/42/427 Report of the World Commission on Environment and Development Report: Our Common Future from 1987 ("Brundtland Report") and UN Resolution A/RES/71/1 Agenda for Sustainable development 2030 from 2015 ("UN Agenda 2030").

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islative measures concerning mandatory sustainability informing. The 1st, general, is Directive 2014/95/EU on non-financial reporting ("NFRD")[11] updating Accounting Directive 2013/34/EU[12] with the initial version of Art. 19a, imposing a CSR reporting duty upon certain large businesses.[13] The other, sectorial, was Regulation (EU) /2019/2088 on sustainability-related disclosures in the financial service sector ("SFDR").[14] The EU law didn't order businesses to practice sustainable activities or spell out clearly what sustainable activities meant, it was more about the double materiality informing – informing how sustainability affects businesses ("outside-in" perspective) and how businesses affects society and environment ("inside-out" perspective).[15] During this time, the dependence between exports from some EU Member States and the GDP of other EU Member States became clear[16], so regional intra-dependency and the single internal market operation made sustainability more than an abstract term at the full discretion of EU Member States.[17]

Among the many crises,[18] faced by the current European Commission

[11] Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32014L0095.

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were the COVID-19 pandemic[19], and the war in Ukraine. which fomented social[20] and economic disparities,[21] magnified pre-existing differences in society [22] and sped up trends in place.[23] Indeed, the Political Guidelines 2019-2024[24] with the six common priorities, as proclaimed by future Commission President Ursula Von der Leyen in 2019, won't be changed until 2024, if at that. The first priority, the European Green Deal,[25] became the big leitmotif of the current EU Commission tasks. The terminology of CSR/ESG reporting is standardized via Regulation 2020/852 on framework to facilitate sustainable investment ("Taxonomy Regulation")[26] and the duty to provide it is enlarged by Directive 2022/2464 on corporate sustainability reporting ("CSRD")[27] which updated the Accounting Directive in the wording by the NFRD. This leads to a non-evitable conclusion – an ever growing pool of European businesses must provide information about the sustainability, or lack of, of its conduct and products in a standardized manner, this

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while using clear and anti-greenwashing language to avoid manipulation and sustainability trade-offs and not limited to the banking and financial sector.[28] Considering the increasing implications of the European Green Deal[29] plus the general demand across society,[30] even businesses beyond the reach of CSRD keep engaging in pro-sustainability declarations. Thus, almost all European businesses must consider their social responsibility pursuant to standards and goals of environmentally sustainable economic activities set out by the Taxonomy Regulation. Thus, they need to not only find the definition of "sustainable economic activities", but also understand it. To grasp a deep conceptual understanding is hard, requiring right data and proper methodology (1.) and a rigorous three step approach: identification (2.), contextual conceptual exploration (3.) and critical and comparative juxtaposition (4.). This reveals selective preferences and trends indispensable for a right understanding of "sustainable economic activities".

1. DATA AND METHODOLOGY

The conceptual understanding of the taxonomic term "environmentally sustainable economic activities" via set criteria and objectives needs completion by three mutually inter-related steps. First off, the definition and related criteria and objectives need to be found, conceptually anchored and based on a clearly stated literate rule. Second, a deeper holistic exploration of the criteria and objectives and their roots, via the contextual interpretation based on mischief, purposive and teleological rules, needs to be done. Finally, the propositions revealed by each of them are to be critically assessed and comparatively juxtaposed.

The 'go to' source of data is Eur-Lex and the domain with the Websites of the European Commission plus recent and academically sufficiently robust analyses published in the WoS and Scopus database. Considering the legislative nature with a strong policy command, the legal modelling, systemic interpretation and a rather argumentative than an axiomatic attitude is to be used. The ultimate command is to find the legal meaning also known as the meaning endorsed originally by its author. Considering the EU context and the particularities of the taxonomy, an open-minded and flexible processing is to be adjusted to each type of

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data[31] and engaged with a thematic content analysis,[32] namely test analysis,[33] with both inductive and deductive features addressing its reporting focus.[34] For boosting the academic robustness, the revealed information is further processed by a strong forensic juxtaposition leading to the critical comparison, refreshed by Socratic questioning[35] and glossing,[36] and new propositions regarding the understanding of "environmentally sustainable economic activities."

2. THE LITERAL DEFINITION OF "ENVIRONMENTALLY SUSTAINABLE ECONOMIC ACTIVITIES" BASED ON CRITERIA AND OBJECTIVES

The origin of the definition of "*environmentally sustainable economic activities*" and related parameters go back to the UN Agenda 2030 with its 17 Sustainable Development Goals ("SDGs") and 5 areas also known as dimensions: people, planet, prosperity, peace and partnership ("5 Ps"). Sustainable development is the alpha and omega, both leitmotif and ongoing concern of the UN Agenda 2030 and only one of these 5 Ps deals with "*sustainable/ility*" not directly connected with "*development*". In the preamble of the UN Agenda 2030 is the text under the Planet heading reads as follows: "*We are determined to protect the planet from degradation, including through sustainable consumption and production, sustainably managing its natural resources and taking urgent action on climate change, so that it can support the needs of the present and future generations.*" Pursuant to the literal interpretation, an environmentally sustainable economic activity must (help to) protect the planet.

The top supra-strategy of the current EU, i.e. Political Guidelines 2019-2024, present the six common priorities, and the first is the European Green Deal - Europe aims to be the first climate-neutral continent by becoming a modern, resource-efficient economy. Following a literal interpretation of these Political Guidelines, an environmentally sustainable economic activity must contribute to

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climate-neutrality and take advantage of new technologies without (!) destroying the rule of law, EU´s core values and properly informed democracy.

The first of these six common priorities, the European Green Deal,[37] entail 9 strategies:

- EGD1 Biodiversity strategy for 2030
- EGD2 Chemicals strategy
- EGD3 New circular economy action plan (CEAP)
- EDG4 Environment action program to 2030
- EGD5 Forest strategy
- EGD6 Plastics strategy
- EGD7 Soil strategy
- EGD8 Textiles strategy
- EGD9 Zero pollution action plan

Via a literal interpretation of the European Green Deal, an environmentally sustainable economic activity must be multispectral (biodiversity, circularity, not polluting, etc.). Indeed, the very wording of the European Green Deal is self-explanatory: "*The Green Deal is an integral part of this Commission's strategy to implement the United Nation's 2030 Agenda and the sustainable development goals, and the other priorities announced in President von der Leyen's political guidelines*." Thus, the goals of climate neutrality by 2050, reducing greenhouse gas emissions (by 55% by 2030 compared to 1990) and limiting global warming, are merely the start.

The top Taxonomy Regulation "*establishes the criteria for determining whether an economic activity qualifies as environmentally sustainable …*" (Art.1) and "*environmentally sustainable investment' means an investment in one or several economic activities that qualify as environmentally sustainable under this Regulation*;" (Art.2). There are two key substantive criteria for the "environmentally sustainable economic activity (Art.3):

- Contributing substantially to one or more of the environmental objectives set out in Art.9;
- Not significantly harming any of the environmental objectives set out in Art.9.

Hence, six environmental objectives, set by Art.9, are absolutely critical:

a) climate change mitigation;
b) climate change adaptation;
c) sustainable use and protection of water and marine resources;
d) the transition to a circular economy;
e) pollution prevention and control;
f) the protection and restoration of biodiversity and ecosystems.

[37] COM/2019/640 final The European Green Deal [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52019DC0640&qid=1694878065652.

The Taxonomy Regulation needs no implementation instruments and is both binding in its entirety and directly applicable in all EU Member States. Yet the proper interpretation and application of "environmentally sustainable economic activity" cannot be reduced to a literal rule and must reflect the battery of EU methodological tools centred around the famous interpretation trio - mischief, purposive and teleological rules.

3. THE LITERATE, MISCHIEF, PURPOSIVE AND TELEOLOGICAL DEFINITION OF "ENVIRONMENTALLY SUSTAINABLE ECONOMIC ACTIVITIES"

The mischief rule became one of England's traditional statutory interpretation tools through the famous Heydon case (1584). Despite its common law background, it can potentially find the legal meaning, as against the plain (literal) meaning, even for continental law. Thus, it ranks as one of the tools for exploring "environmentally sustainable economic activities." The main question forming the interpretation is what was the problem (mischief) that was intended to be addressed and rectified by the Taxonomy Regulation. The mischief(s) for the UN Agenda 2030 are poverty, lack of dignity and win-win, later on followed by environmental concerns, while the mischief for the Political guidelines and Green Deal are climate and environmental-related challenges. The mischief for the Taxonomy Regulation itself, as revealed by the Preamble, is market fragmentation and greenwashing.

Highly suitable for the EU law is the purposive rule, which is autonomous and mixes the intergovernmental and supra-national approach, i.e. it is proper to ask for the purpose of an EU law instrument and read it "in, out, and down" accordingly. The UN Agenda 2030 wants "*the path towards sustainable development, devoting ourselves collectively to the pursuit of global development and of "win-win" cooperation which can bring huge gains to all countries and all parts of the world"* (at 18), while the Political Guidelines and Green deal want "*to transform the EU into a fair and prosperous society, with a modern, resource-efficient and competitive economy where there are no net emissions of greenhouse gases in 2050 and where economic growth is decoupled from resource use*" (at 1). The Taxonomy Regulation indicates the purpose in the light of the general pro-integration command, i.e. "*The criteria for determining whether an economic activity qualifies as environmentally sustainable should be harmonised at Union level in order to remove barriers to the functioning of the internal market with regard to raising funds for sustainability projects, and to prevent the future emergence of barriers to such projects*" (Preamble at 12).

The teleological rule, based on the spirit of the (treaty) law, is the peerless leader of tools of the Court of Justice of EU ("CJEU") since the famous C-26/62 van Gend & Loos, i.e. the interpretation needs to consider the values, legal, social and economic goals to be achieved by the provisions so that it will fit in the entire

system. Thus, the question is about the true spirit of the Taxonomy Regulations which needs to be revealed from both intrinsic and extrinsic sources. The source *par excellence*, CJEU case law, has not yet been established so it can be only speculated on, based on various proclamations from the European Commission, that it is about supporting sustainable investment, increasing market transparency and a net zero trajectory by 2050.

4. CRITICAL AND COMPARATIVE JUXTAPOSITION

The wording of the Taxonomy Regulation clearly states that the six environmental objectives must be either advanced, or at least respected and not violated, or else the economic activity can NOT be "environmentally sustainable." These six are both virtues and vetoes. Although the Taxonomy Regulation gives their description in Art. 10 – Art. 15, for their proper interpretation and application, one must appreciate them conceptually and in the contextual light of comparison by these four interpretation tools. To provide more clarity, Table 1, below, juxtaposes such information, i.e. for each taxonomic environmental objective the order of conceptual relevancy is shown regarding each of the involved sources (UN Agenda 2030 with its SDGs and Political Guidelines with European Green Deal strategies).

Tab. 1. Taxonomic environmental objectives in the light of four rules – extrinsic

taxonomic environmental objective	Literal	Mischief	Purposive	Teleological
climate change mitigation	SDG13/ EGD4	Low/strong	Strong/strong	Strong/strong
climate change adaptation	SDG13/ EGD4	Low/strong	Strong/strong	Strong/strong
the sustainable use and protection of water and marine resources	SDG6+14/ --	Low/medium	Medium/medium	Strong/strong
the transition to a circular economy	--/EGD3	Medium/strong	Medium/strong	Medium/strong
pollution prevention and control	--/EGD9	Medium/strong	Medium/strong	Medium/strong
the protection and restoration of biodiversity and ecosystems	SDG15,EGD1	Medium/medium	Medium/medium	Medium/medium

Source: prepared by the Author based on his analysis of indicated pertinent documents and sources.

This rather fragmented conceptual setting of key underlying documents (UN Agenda 2030 and Political Guidelines with the European Green Deal) leads to the Taxonomy Regulation which, based on the literal rule, should harmonize

the rule for sustainable investment, which, based on the mischief rule should battle against market fragmentation and greenwashing. At the same time, it, based on the purposive rule, should remove barriers to functioning of the internal market, and, based on the teleological rule, support sustainable investment, increase market transparency and gain the net zero trajectory by 2050. Table 2, below, provides a fast key word summary of the Taxonomy Regulation and objectives in the light of the four rules.

Tab. 2 Taxonomic environmental objectives in the light of four rules - intrinsic

	Literal	Mischief	Purposive	Teleological
Taxonomy Regulations and objectives	Harmonization of investment	Fragmentation, greenwashing	Removing barriers	Transparent sustainability

Source: prepared by the Author based on his analysis of the wording of the Taxonomy Regulation.

Well, plainly many varying general, specific and even particular motivations and goals are involved, and the conceptual fragmentation goes even unto the Taxonomy Regulations and its six taxonomic environmental objectives. Namely, the EU is at the crossroads and conceptually hesitates between the endorsement of SDGs en block, attempting to gain the world sustainability leadership, the complex green transition and the unification of reporting (which is misleadingly called harmonization).

CONCLUSION

What next, EU? The term of the current European Commission ends in 2024, time to settle accounts. One achievement to be appreciated and assessed is the Taxonomy Regulation. A deeper conceptual understanding of the Taxonomy Regulation, particularly its criteria and objectives for "environmentally sustainable economic activities" shows strong fragmentation and many interpretation options based on literal, mischief, purposive and teleological rules. Their critical and comparative juxtaposition denotes selective preferences and targets not easily to be reconciled, see the need for harmonization of investment v. the fight against greenwashing v. the removal of barriers v. the push for a transparent sustainability. This shows that the balancing of the six priorities of the European Commission for 2019-2024 in a global context is a very challenging, if at all doable, task. The EU is at the crossroads and clear preferences, voiced in clear and standardized language, are desperately needed. European businesses need a transparent, stable and enforceable framework, and the Taxonomy Regulation is a nervous step in the right direction. Now, it is time to listen to others and make a strategic cut. *He that hunts two hares catches neither*.

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EU strategic autonomy and state aid control. Case-study on the important projects of common European interest

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Abstract: *From the mid-2010s, strategic autonomy appeared in the political and economic narrative of several EU policies. EU industrial policy is also linked to the capacity of the EU to improve its competitiveness, invest in human capital, and R&D, and address market failures. On the other hand, EU State aid rules have often been perceived as too stringent on Member States' competence to support national industries. The changing geopolitical and economic environment and later the COVID-19 triggered a more assertive EU to defend its market against third-country competitors and to tackle the vulnerability of sectors dependent on supply chains. Consequentially, the implementation of projects of common European interest has been accelerated. The paper investigates Article 107(3) Treaty on the Functioning of the EU (TFEU) as a broad mandate to contribute to the strategic autonomy of the EU, which will reveal that the category of important projects of common European interest (IPCEI) is a tool to authorise pan-European R&D and industrial projects. These projects were steered by the Commission and the Member States together to achieve EU objectives, as set out in various EU policy documents (e.g. European Green Deal). We have applied desk research by analysing the relevant policy documents and Commission decisions to conduct our research. IPCEI, as a broad undefined TFEU exception, is, in our view, apt to accommodate diverse EU policy goals.*

Keywords: *EU strategic autonomy, industrial policy, IPCEI, state aid.*

INTRODUCTION

While industrial policy has formally remained the competence of the Member States (MSs), several EU competencies limit its exercise by imposing positive rules (e.g., internal market rules) or limitations on the implementation of this national competence. State aid (SA) rules are considered the most stringent straitjacket on MS's autonomy to support undertakings. EU industrial policy is

mainly based on recognizing free market forces, where intervention should be limited to correct market failures.[1] SA rules and its enforcer, the European Commission, exercising its exclusive competence to decide on the compatibility of draft SA, are viewed as limiting the discretion of MSs on how and when to intervene in the economy.[2] EU industrial policy has struggled to add value to MS industrial policies, and it is since the mid-2010s that EU industrial policy has become more pronounced.[3] Ambroziak highlighted how like-minded states steered the debate in the EU towards more economic interventions.[4] The Friends of Industry, an MS group, achieved a shift in the Commission's policy-making.[5] One of the tools to promote cross-national and cross-sectoral R&D&I in the internal market was the reinterpretation of important projects of common European interest (IPCEI).[6] Considering the maximum length of this paper, we present it as a case study and omit to deal with other manifestations of strategic autonomy in SA control. We aim to show how an old tool in the toolbox of SA law was reinvented to steer newly established EU industrial policy goals[7]. In other words, IPCEI, an exception provided in the TFEU and conditioned by the discretion and exclusive competence of the Commission, has been used instrumentally to greenlight shared MS projects linked to the implementation of EU strategies.

1. EU STRATEGIC AUTONOMY (EU-SA)

The shift towards a more interventionist EU industrial policy manifested in other Commission policy documents.[8] But instead of openly admitting that the EU is willing to take on board industrial policy goals, the communication was

[1] JANSEN, Pim. The Interplay Between Industrial Policy and State Aid: Natural Combination or Strange Bedfellows? European State Aid Law Quarterly 15(Issue 4/2016) 575-602.
[2] TRAVERSA, Edoardo and SABBADINI, Pierre M. Industrial policy and EU state aid rules in: EU Industrial Policy in the Multipolar Economy, Edward Elgar, 2022. 45-79.
[3] DI CARLO, Donato and SCHMITZ, Luuk. Europe first? The rise of EU industrial policy promoting and protecting the single market, Journal of European Public Policy, 30(10/2023) 2064.
[4] AMBROZIAK, Adam A. State Aid Policy and Industrial Policy of the European Union in: AMBROZIAK, Adam A. (ed.): The New Industrial Policy of the European Union, Springer, 2017. 87-112. and 102-103.
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[6] DI CARLO, Donato and SCHMITZ, Luuk. Europe first? The rise of EU industrial policy promoting and protecting the single market, Journal of European Public Policy, 30(10/2023) 2069.
[7] New Industrial Strategy for Europe (COM/2020/102 final, Brussels, 10.3.2020. In the Industrial Strategy update (2021) (Strategic dependencies and capacities, Brussels, 5.5.2021, SWD(2021) 352 final).
[8] JANSEN, Pim and DEVROE Wouter. Industrial policy, competition policy and strategic autonomy in: EU Industrial Policy in the Multipolar Economy (edited Jean-Christophe Defraigne, Jan Wouters, Edoardo Traversa, Dimitri Zurstrassen), Edward Elgar, 2022. 80-121.

softer and less pronounced.[9] Enhancing the EU-SA became more pronounced after the COVID-19 pandemic. The need to build a more resilient or autonomous EU economy in specific sectors has emerged, and it is a reaction to a changing geopolitical and economic environment in world politics and the economy. According to the European Parliament's report, 'EU strategic autonomy refers to the capacity of the EU to act autonomously – that is, without being dependent on other countries – in strategically important policy areas.'[10] In this sense, strategic autonomy was borne after realizing the vulnerability of Europe's capacities and its economic dependence in strategic areas. The European Council endorsed the concept of EU-SA first in 2020[11] and they emphasized that it has relevance not only in the defence and energy sectors but in the economy generally[12]. Meanwhile, the Commission has already started to reinterpret the role of IPCEIs in the economy. After warning that the European economy is at a remarkable crossroads, the European Commission´s Directorate General for Competition highlighted the need for an economic recovery from a deep crisis, the green and digital transitions, its future competitiveness, and open strategic autonomy globally in key strategic areas such as batteries, semiconductors, cloud and edge computing, scaling up financing large-scale research and infrastructure projects, where there is a need to combine public and private efforts.

2. IPCEI CASE STUDY

Article 107(3) TFEU, letter b) lays down the rules under which aid to promote the execution of an important project of common European interest may be considered by the Commission as compatible with the internal market. The new IPCEI Communication (Communication) was adopted in 2021,[13] and the

[9] DAMEN, Mario. EU strategic autonomy: EU strategic autonomy 2013-2023, From concept to capacity. European Parliament Briefing, EU Strategic Autonomy Monitor, [July 2022] Frank Hoffmeister: Strategic Autonomy in the European Union's External Law, Common Market Law Review 60/2023. 667–700. HELWIG, Niklas and SINKKONEN, Ville. Strategic Autonomy and the EU as a Global Actor: The Evolution, Debate and Theory of a Contested Term. European Foreign Affairs Review Special Issue 27(2022). 1–20. DE COCK, Wout and KEGELS, Gregory and BUTS, Caroline and DU BOIS, Cind. Article 346(1) TFEU and Strategic Autonomy, European State Aid Law Quarterly, 22(Issue 2/2023) 150-160.

[10] DE COCK, Wout and KEGELS, Gregory and BUTS, Caroline and DU BOIS, Cind. Article 346(1) TFEU and Strategic Autonomy, European State Aid Law Quarterly, 22(Issue 2/2023) 150-160.

[11] Conclusions of 1–2 October 2020, European Council, https://www.consilium.europa.eu/media /45910/021020-euco-final-conclusions.pdf [viewed 1 October 2023].

[12] Informal meeting of the Heads of State or Government Versailles Declaration [10-11 March 2022] https://www.consilium.europa.eu/media/54773/20220311-versailles-declaration-en.pdf [1 October 2023].

[13] Communication from the Commission Criteria for the analysis of the compatibility with the internal market of State aid to promote the execution of important projects of common European interest. European Commission, 2021/C 528/02 of 30 December 2021.

Commission linked its approval to projects based on EU policies. In the Commission's view, 'IPCEIs can make a very important contribution to sustainable economic growth, jobs, competitiveness and resilience for industry and the economy in the Union and strengthen its open strategic autonomy, by enabling breakthrough innovation and infrastructure projects through cross-border cooperation and with positive spill-over effects on the internal market and the society as a whole.'[14] Each project has been approved by the Commission, which is of the discretion of it, however, the renewed Communication sets up the self-boundaries of it, which has been adapted to the new, post-2020 economic reality. The combination of EU and MS sources is not a target of our research, however, it is worth mentioning that the Commission takes joint funding as a positive circumstance when deciding on the compliance of SA with EU rules. Further success, however, is also to be determined by the all-time general EU economic environment and it is an open question whether Treaty tools may turn out to be effective to overcome difficulties, as there are financial differences between MSs, reflected by the non-participation of certain MSs in IPCEIs, as well.

2.1. Microelectronics

The 2018 microelectronics project was the first joint notification made by more than two MSs in the past 20 years, just like it is also the first non-infrastructure project that is classified as an IPCEI.[15] A single project or an integrated project, that is to say, a group of single projects inserted in a common structure, roadmap or programme aiming at the same objective and based on a coherent systemic approach, might be subject to a project.[16] This touches upon the *differentia specifica* of the IPCEIs that their subsidizing does not focus on the beneficiaries but rather on the economic sector[17], and we believe, this character outcrops even more distinguishably when the IPCEI consists of multiple sub-projects. This has been the case regarding this very measure, just like all the other IPCEIs mentioned in this paper. It is worth mentioning that almost 80 % of the budget of the project is being financed by private investors, state aid being limited only to the financing gap.

[14] Ibid, para. 2.
[15] Decisions of the European Commission SA.46578 (2018/N), SA.46705 (2018/N), SA.46595 (2018/N), SA.46590 (2018/N), [18 December 2018], NICOLAIDES, Phedon. An Important (and so far, Unique) Project of Common European Interest. Lexxion [online]. [12 February 2020] [viewed 1 October 2023] https://www.lexxion.eu/en/stateaidpost/an-important-and-so-far-unique-project-of-common-european-interest.
[16] Paras. 12 and 13 of the Communication cited above.
[17] MASSEY, Patrick, and Moore MCDOWELL. *EU Competition Law: An Unaffordable Luxury in Times of Crisis? World Competition* [online]. 2021, 44(Issue 4), [viewed 1 October 2023]. 419.

Under the IPCEI Communication, approval is conditioned on the incentive effect of state intervention to solve a market failure.[18] The conducted counterfactuals affirmed that in absence of public financing, some of the aid beneficiaries would have not or not this ambitiously undertaken their individual projects.[19] Furthermore, some of the beneficiaries have had considered relocation of their activities outside the EU due to offers they allegedly have received from third countries.[20] Some years after approval, in March 2021, the EU adopted its own strategy in the form of the 'Digital Compass 2030', aiming that by 2030, the gross value of advanced semiconductors in Europe shall account for at least 20 % of the global production. In June 2021, the US Senate voted for the American Innovation and Competition Act, allocating 52.7 billion dollars to set up the so-called 'US Chip Funds'.[21] Correspondingly, the European Union also engaged itself by the European Chips Act[22], by which the EU seeks to address semiconductor shortages and is set to mobilise 43 billion euros to be able to swiftly respond to supply chain disruptions.[23]

The second microelectronics project approved in 2023[24] has clearly been triggered by these global events. Fourteen states teamed up to provide subsidies, which is almost threefold of the 2018 one. The project is set to avoid the distortion of the competition besides the inherent distortion and reshaping of the existing competition by replacing old structures with new ones.[25] To avoid the disproportionate use of public resources, the so-called claw-back mechanism was included, which means in case the projects are to generate a revenue surplus, the companies shall retrieve parts of the aid provided.

[18] Para 30 of the Communication cited above.
[19] Decisions of the European Commission SA.36558 (2014/NN), SA.36662 (2014/NN), SA.38371 (2014/NN) C(2018) 8864 final, [15 October 2014] 320.
[20] Ibid., 322.
[21] WANG, Yinghao. Research Progress on Key Technologies of Microelectronics for Industry 4.0. *Academic Journal of Science and Technology* [online] **2**(3/2022), 4 [viewed 1 October 2023].
[22] Proposal for a Regulation of the European Parliament and of the Council establishing a framework of measures for strengthening Europe's semiconductor ecosystem, *European Commission and Council*. COM/2022/46 final.
[23] European Chips Act. *European Commission* [viewed 1 October 2023]. https://commission.europa.eu/strategy-and-policy/priorities-2019-2024/europe-fit-digital-age/.
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[25] NICOLAIDES, Phedon. The Pricing of Access to an Important Project of Common European Interest - State Aid blog article. Lexxion [online]. 22 September 2015 [viewed 1 October 2023]. Available from: https://www.lexxion.eu/stateaidpost/the-pricing-of-access-to-an-important-project-of-common-european-interest/.

2.2. IPCEIs in the fields of batteries and hydrogen

The setting up of an innovative and green-transitioning battery project has been approved by the Commission in 2019.[26] To avoid the distortion of the competition, the implementation shall be monitored via a dedicated and transparent structure composed by stakeholders. The second battery IPCEI project (2021),[27] may be considered, in our opinion, a pool of national champions joining their forces, just to mention Varta, BMW, Borealis or Enel.

The objective of the first hydrogen project (2022)[28] is to contribute to the development of technological breakthroughs, including innovative transport and involves the greatest market players, for instance Alstom, Bosch, Daimler or Iveco. The project explicitly aims at directly creating 20,000 new jobs. Just two months after the approval of the first project, the second one was greenlighted by the Commission.[29] It covers the construction of hydrogen-related infrastructure, thereby reducing dependency on natural gas, and in some regions of the EU it may be viable, after the project, to make solar energy-based green hydrogen a commercially viable alternative[30]. We have found the lowest rate of private participation of all mentioned IPCEIs in this project, nonetheless, still contributing 57.4 % of the total value.

CONCLUSION

Regarding the first Microelectronics decision, there are clear signs that the Commission based its decisions on the threat of eventual relocation of EU companies outside of the EU as aids granted by third states were more generous. If IPCEIs turn out to be real competitors of or even surpass their Chinese or US counterparts, it may even trigger the adverse effect of an even more intense subsidy war between the three 'longitudinal thirds': the USA, the EU, and China. Until recent times, the Commission's focus has been to keep the internal market undistorted, while remaining relatively insensitive to the fact that strict EU SA

[26] Decisions of the European Commission SA.54793 (2019/N), SA.54809 (2019/N), SA.54794 (2019/N), SA.54801 (2019/N), SA.54806 (2019/N), SA.54808 (2019/N), SA.54796 (2019/N), C(2019) 8823 final [9 December 2019].

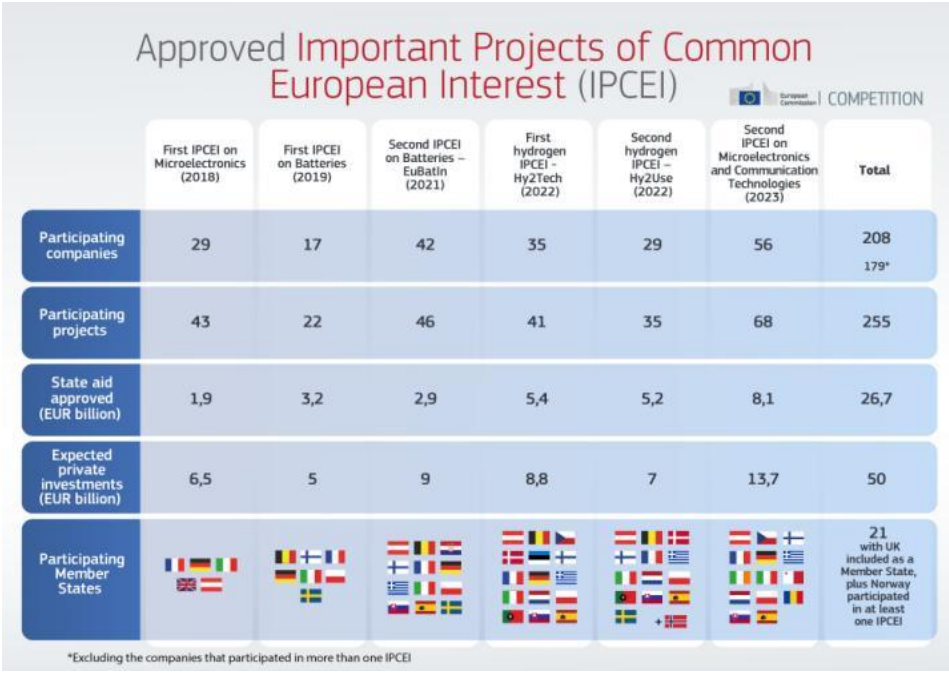
[27] Decisions of the European Commission SA.55855 (2020/N), SA.55840 (2020/N), SA.55844 (2020/N), SA.55846 (2020/N), SA.55858 (2020/N), SA.55831 (2020/N), SA.56665 (2020/N), SA.55813 (2020/N), SA.55859 (2020/N), SA.55819 (2020/N), SA.55896 (2020/N), SA.55854 (2020/N) [6 January 2021] (2nd Battery IPCEI Decision).

[28] 2nd Battery IPCEI Decision.

[29] Decisions of the European Commission SA.64631, SA.64641, SA.64636, SA.64628, SA.64670, SA.64654, SA.64645, SA.64650, SA.64627, SA.64754, SA.64634, SA.64623, SA.64652 [1 September 2022].

[30] PARRA, Alonso Rubén. The project, called "IPCEI Hy2Tech". IPTEK Journal of Engineering [online]. 2023, 01(09/2023), 2 [viewed 1 October 2023]. https://www.researchgate.net/publication/373977758.

control also has the potential to hinder EU competitiveness. IPCEIs may be a tool not only to merely mitigate the internal subsidy war between MSs but also to pick up the global fight in the US-China-EU subsidy war, tearing down another piece of individual sovereignty[31], which, as a paradox, also leaves more room for manoeuvre on national state aid policies[32] to achieve an EU policy goal.



Source: IPCEI. European Commission [online]. [viewed 1 October 2023]. Available from: https://competition-policy.ec.europa.eu/state-aid/legislation/modernisation/ipcei_en

Our contribution revealed that IPCEI is an effective legal tool to achieve pan-European R&D and industrial projects as it is subject to the Commission's approval, and a detailed soft law framework guides MSs when implementing the projects. With this instrument, the Commission can guarantee that the risk of potential subsidy races between the MSs is reduced (SA policy goal) and, on the

[31] Editorial comments: Keeping Europeanism at bay? Strategic autonomy as a constitutional problem. *Common Market Law Review* [online]. 2022, 59(Issue 2). [viewed 1 October 2023] 314.
[32] BLAUBERGER, Michael. Of 'Good' and 'Bad' Subsidies: European State Aid Control through Soft and Hard Law. West European Politics [online]. 2009, 32(4), [viewed 1 October 2023] 722. For specific comparative and connected issues from literature review see: NOVÁČKOVÁ, Daniela and Jana VNUKOVÁ, *Competition issues including in the international agreements of the Eropean Union*, Juridical Tribune Volume 11, Issue 2, June 2021, pp. 234-250; XU, Chaowei and Banggui JIN, *Digital currency in China: pilot implementations, legal challenges and prospects*, Juridical Tribune Volume 12, Issue 2, June 2022, pp. 177-194.

other hand, facilitate the execution of the IPCEI (goal linked to strategic autonomy). The success of these projects will also depend on the willingness and capacity of participating companies to cooperate efficiently. By pooling together, a large number of companies, the Commission can avoid the emergence of national champions and, at the same time, rebalance the asymmetric EU SA prohibition vis-à-vis third countries. Further research is needed to uncover the downside of IPCEIs, for example, that although these cooperations are open to any MS on paper, fiscal capacity will determine actual participation. In a similar vein, easing the strict EU SA prohibition by no means guarantees business success for these projects.

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Corporate transparency in the EU after the Wm and Sovim SA v. Luxembourg business registers judgment

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Abstract: *For many years, the European Union has been a pioneer of legislation that prevents the abuse of corporate structures to conceal the flow of illegal funds or the financing of criminal activity and terrorism. Several anti-money laundering (AML) directives have also been adopted in recent years, harmonizing the laws of Member States and increasing the resilience of the entire bloc. The transparency of companies' ownership structures in the EU gradually increased, as they first had to collect data on their beneficial owners and later register them in central registers so that this data was available to the relevant authorities. Finally, these registers were made available to the general public. The decision of the Court of Justice of the European Union in the case WM and Sovim SA v. Luxembourg Business Registers brought about a reversal of this situation when the Court annulled the provision of the 4th AML Directive that allowed the general public access to the data on beneficial owners due to the violation of the right to privacy and protection of personal data. With this decision, the Court also set criteria for the publication of data on private entities by states. The article deals with the Court's decision, its reasoning, and the Court's considerations concerning the method of publishing beneficial ownership data. The author analyzes the direction in which corporate transparency in the EU will most likely develop in the near future based on the judgment, the Opinion of the Advocate General and current developments in the EU institutions.*

Keywords: *AML, beneficial ownership, corporate transparency, register of ultimate beneficial owners, right to privacy, Sovim case.*

INTRODUCTION

During the last decade, anti-money laundering ("AML") legislation has experienced significant growth, especially in the European Union ("EU"), from where the new regulations are taken over to different countries of the world. The reason for the development of AML regulation is, on the one hand, the work of various inter-governmental bodies such as the Financial Action Task Force ("FATF"), which regularly updates its Recommendations[1], or non-governmental organizations such as Tax Justice Network, Transparency International or Open

[1] The FATF Recommendations. Financial Action Task Force [online]. [2023] [viewed 5 October 2023]. Available from: https://www.fatf-gafi.org/en/publications/Fatfrecommendations/Fatf-recommendations.html.

Ownership, which try to assist states in the fight against corruption, tax evasion or legalization of income from criminal activities. These non-profit organizations have been active on the international scene for a long time and are advocates for adopting new and more targeted measures, while the EU often updates its AML directives to increase the effectiveness of the regulation in force.[2] Another reason for the frequent changes and development of AML regulation is also the social development and the rapid advancement of technologies. The opinion on this regulation and its need was largely influenced by, for example, the Panama Papers case and the disclosure to the public of what dimensions the legalization of finances from criminal activity and the hiding of assets can have on a global scale.[3] The development of information technology, the electronification of banking and business, and cross-border business opportunities are also reasons why legislation must evolve along with the state of society to stay up-to-date and effective.

The regulation of beneficial ownership is such a measure, which aims at the abuse of opaque corporate structures which cover up the flow of money and its beneficiaries. The regulation is based on the opinion that states should have accurate and adequate information about the persons who are the ultimate owners of companies to protect their financial systems. Under the term 'beneficial owner', we understand a natural person(s) who ultimately effectively controls or exercises control over a legal entity.[4] Following the FATF Recommendations, the EU was one of the first jurisdictions to adopt beneficial ownership regulation.[5] In 2015, the EU implemented an updated regulatory structure that included Directive (EU) 2015/849 on preventing the use of the financial system for money laundering or terrorist financing ("4AMLD"). This directive addressed various concerns to advance the most stringent anti-money laundering standards and combat the funding of terrorism, however, one of the significant innovations was the collection of information about beneficial ownership. By virtue of the 4AMLD Member States must ensure that companies and other legal entities within their jurisdiction acquire and maintain adequate, accurate and current information regarding their beneficial ownership.[6] Furthermore, the directive required Member States to collect data on beneficial owners in a central register in each Member State, for example, a commercial register or a companies register[7]. Information from these

[2] BERGSTRÖM, Maria. The Global AML Regime and the EU AML Directives: Prevention and Control. In: *The Palgrave Handbook of Criminal and Terrorism Financing Law*. Cham: Springer International Publishing, 2018, pp. 50.
[3] RADON, Jenik, and Mahima ACHUTHAN. Beneficial Ownership Disclosure. *Journal of International Affairs*. 2017, 70(2), 86.
[4] DAUDRIKH, Yana. Beneficial Owner Central Registry as a Tool to Fight Money Laundering and Terrorist Financing. *Financial Law Review*. 2021, 24 (4). 138.
[5] GILMOUR, Paul Michael. Lifting the veil on beneficial ownership. *Journal of Money Laundering Control*. 2020, 23(4), 721.
[6] 4AMLD, Art. 30(1).
[7] *Ibidem*, Art. 30(3).

registers should also be accessible to competent authorities and financial intelligence units, obliged entities within the framework of customer due diligence and any person or organization that can demonstrate a legitimate interest.[8] The concept of legitimate interest was relatively problematic because various watchdog organizations, journalists and civil activists use public registers in their activities, and information about beneficial ownership is essential to them. However, the directives or case law did not further explain this term, so access for such non-state entities was not guaranteed, and the approach of individual Member States could differ.

The solution to some of the shortcomings of 4AMLD, but also a response to new challenges such as cryptocurrencies or changes in the behaviour of perpetrators of financial crime[9], was the adoption of new legislation in the form of the Directive (EU) 2018/843 of the European Parliament and of the Council of 30 May 2018 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and amending Directives 2009/138/EC and 2013/36/EU ("5AMLD"). 5AMLD in the field of beneficial ownership brought a fundamental change in approach. It deviated from the need to demonstrate legitimate interest and opened the previously established registers of beneficial owners to the general public[10], and the transparency on demand approach was thus changed to transparency as a standard.

Many non-profit organizations and advocates of the policy of openness approved the approach of the 5AMLD and claimed that it is a new standard of AML regulation which should be adopted abroad and on which it is possible to build new measures in the fight against money laundering.[11] On the other hand, defenders of the rights to privacy and protection of personal data claimed that this is a too intensive interference with these rights and that the scope of the published data is disproportionate.[12] The measures aimed at countering money laundering were perceived as increasingly imposing over fundamental privacy rights. The

[8] *Id*., Art. 30(5).

[9] KORDÍK, Marek. Nedostatky postihu legalizácie príjmov z trestnej činnosti – finančné vyšetrovanie. In: Bratislavské právnické fórum 2015 – zborník príspevkov z medzinárodnej vedeckej konferencie. Bratislava: Univerzita Komenského v Bratislave, Právnická fakulta, 2015, p. 1229.

[10] 5AMLD, Art. 1(15)(c).

[11] E.g.: ABBOTT PUGH, Stephen. The value of connecting beneficial ownership data across the European Union. *openownership.org* [online]. 27 September 2022 [viewed 3 October 2023]. Available from: https://www.openownership.org/en/blog/the-value-of-connecting-beneficial-ownership-data-across-the-european-union/.

[12] E.g.: NOSEDA, Filippo. CRS and beneficial ownership registers—what serious newspapers and tabloids have in common: The improbable story of a private client lawyer turned human rights activist. Trusts & Trustees [online]. 2017, 23(6), p. 602., or PRINCE MICHAEL VON UND ZU LIECHTENSTEIN, H. S. H. Public register: a populist tool to control the citizen. *Trusts & Trustees*. 2017, 23(6), p. 693.

need for striking a fair balance between safeguarding financial privacy and enforcing these preventive measures was perceived.[13]

For a longer time, it was apparent that this conflict between the right to respect for private and family life and the right to the protection of personal data, according to Articles 7 and 8 of the Charter of Fundamental Rights of the European Union ("the Charter") with the public interest in publishing data on beneficial owners will ultimately have to be resolved by the Court of Justice of the EU ("CJEU"). The decision of the CJEU sitting as the Grand Chamber, in Joined Cases C-37/20 and C-601/20 in WM and Sovim SA v. Luxembourg Business Registers ("WM and Sovim SA v. Luxembourg Business Registers"), reached the solution. The Court decided to invalidate the provisions of 5AMLD, which amends 4AMLD in the sense that information on the beneficial ownership is accessible to any member of the general public.

This article delves into the matter of beneficial ownership registers in the context of the discussed judgment. In a concise overview, we will scrutinize the factors that influenced the Court's verdict, primarily focusing on these registries' ongoing and prospective evolution. The analysis will encompass the rationale behind the Court's decision and emphasize the potential implications and forthcoming advancements pertaining to these important registers.

1. WM AND SOVIM SA V. LUXEMBOURG BUSINESS REGISTERS

CJEU Joined Cases C-37/20 and C-601/20 concerned the preliminary questions submitted to the Court by the Luxembourg District Court regarding the pending dispute between the Luxembourg Business Register and two Luxembourg companies. One of the companies asked the Business Register for an exemption[14] from the publication of data on the beneficial owner, and the other objected to the publication of this data due to an alleged infringement with the rights to respect for private and family life, protection of personal data and violation of several provisions of the General Data Protection Regulation ("GDPR"). Thus, the preliminary questions mainly concerned the nature of exceptions from the publication of data on the beneficial owners and the compliance of the publication of data on beneficial owners in registers for the general public with the guaranteed rights of persons.

[13] LE NGUYEN, Chat. Preventing the use of financial institutions for money laundering and the implications for financial privacy. *Journal of Money Laundering Control*. 2018, 21(1), p. 56.

[14] The 4AMLD as amended by the 5AMLD allows Member States in Article 30(9) to grant applicants an exception from public access to their data in the register on an individual basis, *in exceptional circumstances, where such access would expose the beneficial owner to the risk of fraud, kidnapping, blackmail, violence or intimidation, or where the beneficial owner is a minor or otherwise incapable.*

1.1. Opinion of the Advocate General Pitruzzella

The Advocate General Giovanni Pitruzzella addressed individual preliminary questions and reached interesting conclusions. From the point of view of the compliance of public access to data on beneficial owners with the rights to respect for private life and protection of personal data established by the Charter, he dealt with the questions of whether the publication of data in the register constitutes an interference with these rights and how serious it is.[15] The Advocate General stated that the rights outlined in Articles 7 and 8 of the Charter are not absolute and may be limited to some extent.[16] In this case, in his opinion, there is no doubt that the published data on beneficial owners are personal data and that the right to privacy and data protection has been affected by this measure.[17] The Advocate General further commented on the seriousness of the intervention, where even if the dissemination of such published data cannot be ruled out, the scope of personal data is relatively limited, and its nature is not too sensitive. The potential harm to individuals is therefore determined to be moderate, and for that reason, the Advocate General does not perceive interference with the right to privacy and protection of personal data as severe, as it does not directly and seriously affect the intimacy of their private life.[18] However, what the Advocate General considered inconsistent with the EU law was the third subparagraph of Article 30(5) of 4AMLD, which allowed the Member States to expand the scope of data on beneficial owners that will be published and the second subparagraph of the same provision, which specifies that the public should have access "at least" to the specified data, which in his opinion is not sufficiently certain.[19] In addition to the conclusions concerning preliminary questions, the Advocate General, in his Opinion, also discussed several considerations on a theoretical level, which dealt with, for example, the technical way of publishing data, access to data by subjects from third countries or the provision of exceptions, which we will discuss in the next part of the article.

1.2. Judgement of the Court

With defined preliminary questions and the Opinion of the Advocate General, the case went before the Grand Chamber of the CJEU. Of all the preliminary questions raised, the Court addressed only one of them, the question of the

[15] Opinion of Advocate General Pitruzzella delivered on 20 January 2022. Joined Cases C-37/20 and C-601/20 WM (C-37/20) Sovim SA (C-601/20) v Luxembourg Business Registers. para. 34. [online]. [2023] [viewed 5 October 2023]. Available from: https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:62020CC0037.
[16] *Id.*, para. 78.
[17] *Id.*, para. 86.
[18] *Id.*, para. 104.
[19] *Id.*, para. 280.

validity, in the light of Articles 7 and 8 of the Charter, of Article 1(15)(c) of the 5AMLD, in so far as that provision amended point (c) of the first subparagraph of Article 30(5) of 4AMLD in such a way that the Member States must ensure that information on the beneficial ownership of companies and other legal entities incorporated within their territory is accessible in all cases to any member of the general public.[20]

First, concerning the examined question, the Court stated that since the published data include information on identified individuals, allowing access to them by the public affects the fundamental right to respect for private life, regardless of whether this data is professional. It also follows from the Court's settled case law that making personal data available to third parties interferes with the rights enshrined in Articles 7 and 8 of the Charter, whatever the subsequent use of the information communicated.[21] Where the Court departed from the Advocate General's assessment is the seriousness of the interference, which, according to the Court, is serious. In the opinion of the Court, published data on the beneficial owner allows a profile to be drawn up concerning certain personal identifying data, for example, the state of the person's wealth and the economic sectors, countries and specific undertakings in which they have invested, or the material and financial situation of the beneficial owner.[22]

Considering the seriousness of the interference with the rights to privacy and the right to the protection of personal data, the Court conducted a proportionality test in which the disclosure of data on beneficial owners to the general public did not pass. According to the Court, the provision of the 5AMLD observed the principle of legality[23], and the general public's access to information on beneficial ownership does not undermine the essence of the fundamental rights[24]. At the same time, the CJEU considered the objective of publishing information on beneficial ownership - to prevent money laundering and terrorist financing, to be an objective of general interest that can justify even serious interferences with fundamental rights.[25] However, the Court found deficiencies when examining whether the interference was appropriate, necessary and proportionate.

The CJEU recognized the publication of data on beneficial owners as an appropriate measure for preventing money laundering and terrorist financing[26] but not a strictly necessary measure. The 4AMLD, before the changes brought by the 5AMLD, made access to information on beneficial ownership conditional upon the ability to demonstrate a legitimate interest. As we stated in the introduc-

[20] WM and Sovim SA v. Luxembourg Business Registers, para. 34.
[21] *Id.*, para. 38-39.
[22] *Id.*, para. 41-42.
[23] *Id.*, para. 49.
[24] *Id.*, para. 54.
[25] *Id.*, para. 59.
[26] *Id.*, para. 67.

tion, the directives did not sufficiently define this concept; thus, there were different interpretations. However, the Court states that the fact that this concept is difficult to define does not justify the legislator's opening up access to data for everyone.[27] Also, with regard to achieving the objectives of the measure under review, the CJEU states in the judgment that public access to data was adopted so that data on beneficial owners would be subjected to greater scrutiny by the press, civil society organizations or business partners, yet these entities have an apparent legitimate interest in access the data.[28] Concerning the proportionality of the measure, the Court then criticized the directives for the same shortcomings as the Advocate General, regarding the fact that the public should have access "at least" to the specified data and the possibility of Member States to expand the scope of data on beneficial owners that will be published.[29] The CJEU also examined the responsibility of addressing money laundering and terrorist financing, recognizing it as a primary duty for public authorities and institutions like banks. The delegation of these responsibilities to the public by disclosing data on beneficial ownership was found to aggravate the impact on the right to privacy and personal data protection. However, the Court concluded that this deepening interference with the rights of persons did not bring any fundamental benefit compared to the previous regime.[30]

For the stated reasons, the CJEU decided to invalidate point (c) of the first subparagraph of Article 30(5) of the 4AMLD as amended, allowing the general public to access data on beneficial ownership. Based on this decision, dealing with the remaining preliminary questions was unnecessary.

2. THE CONSEQUENCES OF THE JUDGMENT OR THE BEGINNING OF THE END FOR CORPORATE TRANSPARENCY?

The Court's decision in the case of WM and Sovim SA v. Luxembourg Business Registers was a much-discussed jurisprudence in the following period, at the beginning of 2023. It caused different reactions and a broad discussion about the correct protection of rights, or, on the contrary, some considered it a step back in the fight against money laundering and terrorist financing.

In addition to discussions about the correctness of the judgment, its significant consequence was the responsible authorities' reaction at the level of the EU or Member States. While in the EU institutions, alongside efforts related to the new AML legislative package[31], work also began on solving the issue of ensuring access to registers for persons with a legitimate interest, some Member

[27] *Id.,* para. 72.
[28] *Id.,* para. 74.
[29] *Id.,* para. 81-82.
[30] *Id.,* para. 85.
[31] Anti-money laundering and countering the financing of terrorism legislative package. *European Commission* [online]. 2021 [viewed 5 October 2023]. Available from: https://finance.ec.euro

States temporarily suspended public access to registers of beneficial ownership. These are mainly countries where confidentiality in business relations prevailed for a long time, such as Austria, Belgium, Cyprus, Germany, Finland, Greece, Ireland, Luxembourg, Malta and the Netherlands.[32] However, some other Member States have decided, for various reasons, to keep the public access to the data in beneficial ownership registers, although they risk a possible legal dispute with persons whose rights could be affected; these are, for example, Estonia, Slovakia, France, Denmark, Bulgaria, Czechia, Slovenia, Latvia, and Poland.[33]

The apparent critics of the decision are non-governmental organizations and investigative journalists who promote the openness of data, arguing that the judgement is a threat to democracy[34] and corporate transparency should be a matter of course since "legal persons were never meant to be a vehicle to hide the identity of a natural person"[35]. Even pointing to the fact that the EU was a world leader in this area, many activists feared that this decision would set back the AML legal development in the world by years and that the momentum gained after the Panama Papers case would disappear.[36]

On the contrary, a number of lawyers and experts in data protection law highlight a victory for human rights and a yellow card for the legislator.[37] In their view, the justification for the open approach of the AML Directives was unsustainable, and the long-term decision-making activity of the CJEU indicated that this regime would need revision. Others see the decision as a guideline for where further regulation in this area should go.[38] That is the approach the author of this article also decided to take since the decision itself is immutable and indicated that some areas of AML regulation, despite its indisputable social benefit, needed to be reconciled with the rights of individuals. In this context, both the judgment

pa.eu/publications/.

[32] LORENZO, Florencia. Split among EU countries over beneficial ownership ruling mirrors rankings on Financial Secrecy Index. *Tax Justice Network* [online]. 13 July 2023 [viewed 5 October 2023]. Available from: https://taxjustice.net/2023/07/13/split-among-eu-countries-over-beneficial-ownership-ruling-mirrors-rankings-on-financial-secrecy-index/.

[33] *Id.*

[34] PANTAZATOU, Katerina. A Never-Ending Battle Between Privacy and Transparency: The Case of Registers of Beneficial Ownership before the CJEU. *EC Tax Review*. 2023, 32(3), p. 103.

[35] MARTINI, Maíra. Why are EU public registers going offline, and what's next for corporate transparency.*Transparency.org* [online]. 22 November 2022 [viewed 5 October 2023]. Available from: https://www.transparency.org/en/blog/cjeu-ruling-eu-public-beneficial-ownership-registers-what-next-for-corporate-transparency.

[36] THOMAS-JAMES, Dominic. Editorial: The Court of Justice of the European Union and the beginning of the end for corporate transparency? *Journal of Financial Crime*. 2023, 30(2), p. 306.

[37] BREWCZYŃSKA, Magdalena. Privacy and data protection vs public access to entrepreneurs' personal data. Score 2:0. *European Law Blog* [online]. 15 December 2022 [viewed 5 October 2023]. Available from: https://europeanlawblog.eu/2022/12/15/.

[38] NOSEDA, Filippo. FATCA and CRS: Recent EU judgment on public BO registers shines a light on the direction of travel. *Trusts & Trustees*. 2023. 469.

and the Opinion of the Advocate General provide vital suggestions that the legislator will use in the planned changes to the AML legislation so that it is functional and can continue to fulfil its goals effectively, but at the same time would contain essential safeguards for the protection of rights. Fundamental goals that we can name in the further development of corporate transparency in the EU today are defining the concept of legitimate interest, ensuring controlled access to data on beneficial owners and adopting a planned package of new measures in the area of AML.

2.1. Legitimate interest

Access to data in beneficial ownership registers, according to the 4AMLD, before its amendment, was based on the tasks of entities in the fight against money laundering. Therefore, competent authorities and obliged entities, such as banks or lawyers, primarily had access. The remaining entities interested in accessing the register had to demonstrate a legitimate interest, which, as we mentioned, did not always work. However, the CJEU made it clear that the difficulty of defining the concept of legitimate interest is not a reason for the complete and uncontrolled opening of the registers to the public[39]; therefore, this very concept will again be a key criterion in the re-functionalization of the registers of beneficial owners in the EU and ensuring that the largest number of interested stakeholders are granted access.

The Court is also clearly aware of the importance of enabling access for civil society organizations, investigative journalists, or other interested entities because it directly admits in the decision that this type of stakeholder in the AML regulations has a legitimate interest in accessing the registers. Although a majority of these subjects do not agree with the decision of the Court in question, we cannot talk about a complete return to the vague regime given by the 4AMLD because the authorities at the level of the Member States should no longer refuse to grant them access to the data in the registers based on this judgment. The entities that the CJEU directly named are the press and civil society organizations because they are connected with the prevention and combating of money laundering and terrorist financing, and also persons who wish to know the identity of the beneficial owners of a company because they are likely to enter into transactions with them, or the financial institutions and authorities involved in AML, if they do not already have access based on points (a) and (b) of the first subparagraph of Article 30(5) of the 4AMLD.[40]

Of course, non-governmental organizations are also aware of the importance of defining a legitimate interest. Since the decision has been issued, they

[39] WM and Sovim SA v. Luxembourg Business Registers, s*upra note* 27.
[40] Id., supra note 28.

have been trying to get involved and influence how the legislation, which is supposed to solve this interim situation, will look. Transparency International even presented its critical points that the revised concept of legitimate interest should include. In their opinion, the automatic and non-discriminatory process of granting permits for public organizations working in the field of AML, both inside and outside the EU, is essential. In addition to these entities and possible business partners, which are mentioned in the CJEU decision, according to Transparency International, other interested entities should also have access, such as government authorities (other than those that have competences directly in the area of AML), foreign competent authorities tasked with the AML, academics working on studies and analysis or any other member of the public that can demonstrate a legitimate interest.[41]

The EU institutions also started following the decision in the case of WM and Sovim SA v. Luxembourg Business Registers to work on a possible modification of the regime of access to data on beneficial owners, which they also connected with ongoing work and the 6th AML Directive. Fairly early, already in March 2023, the European Parliament announced the approval of new EU measures against money laundering and terrorist financing, which also contain adjustments in the area of beneficial owners' registers.[42] As part of the legislative process, the 6th AML Directive was also commented on in the Committees on Economic and Monetary Affairs and Civil Liberties, Justice and Home Affairs of the European Parliament, in which amendments were proposed so that it was in line with the decision of the CJEU. The Committees proposed to change Article 12 of the 6th AML directive, which regulates public access to data in the registers of beneficial owners. The basis is legitimate interest, which they state is fulfilled by at least persons performing activities related to the prevention or combating of money laundering, such as:

- journalists,
- civil society organizations,
- higher education institutions,
- persons who are likely to enter into transactions or business relationships with a corporate entity,
- persons who are likely to perform a task or engage in a business relationship that requires them to assess whether an entity or its beneficial owner is subject to targeted financial sanctions,
- financial institutions, external agents, service providers and authorities in

[41] TRANSPARENCY INTERNATIONAL. Legitimate interest 2.0: Enabling journalists and activists to follow the money in the EU. *Transparency.org* [online]. 23 August 2023 [viewed 6 October 2023]. Available from: https://www.transparency.org/en/news/.

[42] EUROPEAN PARLIAMENT. *New EU measures against money laundering and terrorist financing* [press release]. 28 March 2023 [viewed 6 October 2023]. Available from: https://www.euro parl.europa.eu/news/.

so far as they are involved in the AML and do not already have such access.[43]

- the European Parliament passed these proposals to the following stages of the legislative process; therefore, it is possible to assume, that the range of persons meeting the criterion of legitimate interest in accessing data in the registers of beneficial owners, shall be defined in the manner set forth above.

2.2. Method of access to data on beneficial owners

In addition to the definition of the range of persons who should have access to the registers of beneficial owners, another fact is also important, namely how access will be technically secured for persons.

The Advocate General has already discussed this area, where in his opinion, if a person enters the register, he becomes a processor and has to abide by the duties of the GDPR in order for the authorities to take action in case of misuse of data, it is necessary for them to know who accessed the register, which, however, was not possible with open general access to the registers without the need for registration.[44] In the view of the Advocate General, it is necessary for the authorities responsible for maintaining the registry to ascertain the identities of individuals accessing the data.[45] The possibility for Member States to condition access to the register of beneficial owners by registering the accessing person is given directly in Article 30(5a) of the 4AMLD. This is an option, but not an obligation, which was also analyzed by the Court, stating that it is not a sufficient safeguard for the protection of rights, but at the same time, it did not state that it recommends registration as a best practice in the future.[46]

In their proposal to change Article 12 of the 6th AML directive, the Committees of the European Parliament left the condition of access by registration as an option that Member States can apply but dropped the option to request fees for such access.[47] At the same time, however, the Commission proposes establishing conditions for the Member States so that granting access to designated entities with a legitimate interest is efficient and fast. The assessment of legitimate interest should take place, for example, based on the submission of a declaration of

[43] EUROPEAN PARLIAMENT. REPORT on the proposal for a directive of the European Parliament and of the Council on the mechanisms to be put in place by the Member States for the prevention of the use of the financial system for the purposes of money laundering or terrorist financing and repealing Directive (EU) 2015/849. April 2023 [viewed 6 October 2023]. Report – A9-0150/2023. Amendment 168.
[44] Opinion of Advocate General Pitruzzella, *supra note* 15, para. 207-208.
[45] *Id.*, para. 280 – 3.
[46] WM and Sovim SA v. Luxembourg Business Registers, para. 86.
[47] EUROPEAN PARLIAMENT, *supra note* 43, Amendment 176.

honour and proof of identification by the applicant. The request will be automatically granted if it is not assessed within 10 days. Access to the register will be given for at least 2.5 years, and the legitimate interest will be recognized by one decision in all Member States.[48] Since this approach is relatively advantageous for applicants, the proposal further regulates the procedure in the case of false data in the application.

The approach proposed by the European Parliament appears advantageous for civil society organizations and allows access by many relevant entities over a sufficiently long time. It also addresses the concerns of organizations from the non-governmental sector, who considered access on a case-by-case basis to be an inappropriate solution and were concerned about the inconsistent procedure of the Member States and the administrative burden for applicants, which should discourage them from applying for access.[49] Other proposals for securing access in the future, which can be encountered in professional articles, count on modern technologies such as data wallet, blockchain or EU eID to verify a person's identity and assign access rights to the register.[50]

2.3. New measures in the area of AML

Approved new EU measures against money laundering and terrorist financing, in addition to the actual topic of access to registers of beneficial owners, deal with AML regulation as a whole. This legislative package included the EU "single rulebook" - regulation, the 6th Anti-Money Laundering – directive, and the regulation establishing the European Anti-Money Laundering Authority.

Based on named regulations, even innovative business forms such as crypto assets managers, real and virtual estate agents, and high-level professional football clubs must know their client's identity and their beneficial owner. A huge change should affect the definition of a beneficial owner, where today, the generally accepted limit for a person to meet the definition is 25% plus one share. This limit also follows the recommendations of the FATF[51] and other international organizations and is valid in most countries where beneficial owners are regulated. However, according to information from the European Parliament[52], a new definition can be established, which stipulates that beneficial ownership means having 15% plus one share, or voting rights, or other direct or indirect ownership interest, or 5% plus one share in the extractive industry or a company exposed to a higher risk of money laundering or terrorist financing. This change would be significant, and the number of persons identified as beneficial owners

[48] *Id.,* Amendments 169 – 171.
[49] TRANSPARENCY INTERNATIONAL, *supra note* 41.
[50] MOOIJ, A. M. Reconciling transparency and privacy through the European Digital Identity. *Computer Law & Security Review*. 2023, 48. 8. Available from: doi:10.1016/j.clsr.2023.105796.
[51] The FATF Recommendations, *supra note* 1, p. 15.
[52] EUROPEAN PARLIAMENT, *supra note* 42.

would increase substantially. It would involve additional administrative obligations for new registrations and costs for all affected entities, whether obliged or legal entities.

Another problem would be the incompatibility of assessing the fulfilment of the beneficial owner definition for international companies operating in several legal systems. Today, as long as uniform international rules apply, the same person is considered the beneficial owner, even in different countries. If the EU were to deviate from international standards, there could be a need to identify different persons, and it could become challenging to cooperate with foreign authorities, for example, in tax matters. Such a change could also impact other institutes in individual Member States linked to the current definition of a beneficial owner. For example, Slovakia also has a special register of beneficial owners for contractual relations between the state and the private sector.[53] Also, information about the company's beneficial owner can be a very important factor in other areas of law, for example in liquidation or bankruptcy of the company.[54] Accordingly, not all the consequences of such a change can be foreseen, and the legislator should approach it only after a solemn consideration and thorough assessment of its need.

Furthermore, concerning corporate transparency, it is planned to expand the information in the beneficial ownership register with historical data on previous beneficial owners, which is a very beneficial measure when conducting investigative activities, and the information must be available digitally in the EU official languages plus English. A big topic is the creation of the New European Anti-Money Laundering Authority to enforce rules, which will have powers to supervise specific institutions, conduct verification and impose sanctions.[55]

CONCLUSION

The article dealt with the very current topic of the transparency of corporate structures in the EU in relation to the recent decision of the CJEU, which prohibited the publication of data on the end users of benefits to the general public. The author analyzed the long-term development in this area, which indicates why this decision was an unpleasant surprise for some entities while others welcomed this solution. The article provides the reasoning of the legal situation that preceded the WM and Sovim SA decision in the Luxembourg Business Registers

[53] LUKÁČKA Peter and SMALIK Matej. Výzvy advokáta pri identifikácii konečného užívateľa výhod v RPVS. In: *Poskytovanie právnych služieb v kontexte skupín spoločností.* Bratislava: Právnická fakulta UK, 2020, p. 6. ISBN 978-80-7160-570-6.

[54] PINTÉROVÁ, Dominika. Teoreticko-aplikačné fundamenty koncepcie zodpovednosti ovládajúcej osoby za úpadok ovládanej osoby. In: Bratislavské právnické fórum 2020: výzvy advokáta v kontexte skupín spoločnosti, teoretické a aplikačné problémy. Bratislava: Univerzita Komenského v Bratislave, Právnická fakulta, 2020, 28-40. ISBN 978-80-7160-562-1.

[55] EUROPEAN PARLIAMENT, *supra note* 42.

case and also explains the essential points from the Opinion of Advocate General Pitruzzella. In analyzing the judgment itself, the author dealt with the legal reasons that led the Court to the final decision. In the opinion of the CJEU, the fundamental right to respect for private life and protection of personal data was seriously affected by the publication of data on beneficial owners. When the proportionality test was carried out, this measure did not pass because it did not meet the conditions of proportionality and necessity.

The decision also provides the legislator with some guidance on ensuring the AML legislation's functioning while not violating fundamental rights. As a reaction to the judgment, public access to the registers of beneficial owners ended in some Member States, and it continues to work in others. However, steps taken by EU institutions and non-governmental organizations to create new AML rules are essential for further development. Several fundamental points from these rules were introduced in March 2023 as part of the new EU measures against money laundering and terrorist financing.

The most important task for the EU legislator concerning the registers of beneficial owners is to define the definition of legitimate interest for persons interested in gaining access to the registers. It follows from the proposals presented to the public that it will be a relatively broad calculation of state and non-state sector entities involved in the fight against money laundering. An equally important part is how access will be enabled. So far, the proposals have resulted in a relatively undemanding solution, enabling quick, long-term access to authorized persons.

However, in addition to measures directly related to beneficial owners' registers, the EU plans to adopt additional rules affecting the transparency of corporate structures in the field of AML. The author considers many of them constructive, but there is also a proposed change in the definition of the beneficial owner, which brings many question marks, so the legislator should approach it responsibly.

If we are to answer the question posed in the title, even the decision of the CJEU in the case of WM and Sovim SA v the Luxembourg Business Registers cannot stop the momentum of AML legislation and bring an end to corporate transparency. Legislation in the field of AML will continue to develop, and even if access to the registers for some entities will not be as convenient as before, organizations involved in the fight against money laundering will not lose their valuable source of information. Nonetheless, the judgment defined clear boundaries between fundamental rights and obligations in the public interest, which can be applied in the future to beneficial owners regulation and other instruments where the legislator transfers transparency to private sector entities.

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SECTION III.
BANKING, FINANCE AND INSURANCE LAW

Asymmetrical business-to-consumer terms in insurance contracts and enforceability deprivation for non-disclosure

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Abstract: *The paper approaches the problematics of assessing the unfairness of asymmetrical terms in B2C insurance contracts and the enforceability deprivation for non-disclosure at the pre-contractual stage, as reflected in recent case law of the Court of Justice of the EU (CJEU), particularly in the CJUE's decision pronounced in the Ocidental – Companhia Portuguesa de Seguros de Vida case (C-263/22), which permits the courts to assess the unbalanced nature of adhesion terms relating to the exemptions from professionals' liability, based on the transparency criteria. Saliently, in hypotheses where the consumer requested eliminating the asymmetrical terms of B2C insurance contracts, related to the excluding of specific risks or the restricting of the insured risks coverage, the unfairness of litigious terms would be interconnected to the (in)opposability of the non-disclosed terms, at the pre-contractual stage. The paper addresses the unenforceability of B2C contractual terms classified as unfair or unbalanced when depriving the consumer from the possibility of invoking the professional insurer's liability, seen through the lens of the transparency criteria. Congruently, the significant imbalance in the mutual obligations of the parties may arise from the depriving the consumer of the rights to become acquainted to the contractual terms addressing the exclusion of specific risks from the sphere of B2C insurance clauses, prior to concluding the litigious contract.*

Keywords: *asymmetrical terms, consumer, duty of disclosure, enforceability, insurance contract.*

INTRODUCTION

Transparency of asymmetrical business-to-consumer terms raised, during the last decade, multiple questions for legal practitioners, on a subject that has been frequently depicted as being the 'central pillar' of repressing unfair terms, in the assessing of the transparency requirements in B2C insurance contracts.

Legal controversies have been fuelled by the gap established between the ability of the professional, in the position of *proferens*, to exercise control over the procedures for the formation of adhesion contracts and, on the other side, the inability of the consumer, hypothesized as an adherent, to overcome the inequality of forces[1] characterising the B2C relations, which justifies the existence of the

[1] DE ELIZALDE, Francisco. Partial Invalidity for Unfair Terms? CJEU in Abanca – C-70 & 179/17. Journal of European Consumer and Market Law. 2019, 8(4), 208–216. See for a comparative

judicial mechanisms of repressing the unbalanced contractual provisions. The legal definition of unbalanced clauses captures as determinants, in the analysis of asymmetrical terms, the elements such as the absence of the possibility of direct individual negotiation of the litigious contractual stipulations (i), the disregarding of the transparency[2] requirements and of contractual loyalty by the professional provider of financial services (ii). The median element, the one that refers *expressis verbis* to the criterion of contractual good faith, firstly worried the practitioners by confronting them with a salient question concerning its legal nature: shall it be considered as a subjective criterion, related to the psychological or subjective state of the *proferens* at the time of the formation of the adhesion contract or, on the contrary, does one witness the application of an objective criterion, by reference to economic or procedural elements which, under the 'archery' of the precept of good faith, designate a genuine manner of justifying (or legitimizing) the presence of the contentious clause in the B2C insurance contract? Favouring the contractual position of the professional services provider, as an effect of maintaining the contested clause left aside, a second question was added to the controversial context, which aims to clarify the meaning of the 'good faith' exigencies, particularly in terms of establishing what is the role procedurally assigned to the good faith of the professional insurer[3], hypostasised as a defendant in the consumer's action in eliminating the unbalanced clauses, especially from the perspective of the procedural administration of the relevant evidence on the contractual disequilibria?

Thirdly, the problematics of assessing the significant imbalance in the mutual obligations of the parties may arise from the depriving the consumer of the rights to become acquainted to the contractual terms addressing the exclusion of specific risks, prior to concluding the litigious insurance contract. The latter controversial path was contoured on solving the question on whether resorting to a refutable presumption of culpable conduct on the part of the professional insurer would entangle the necessity of assessing the prerequisites of asymmetrical terms

view TOMESCU, Raluca Antoanetta, *The Financial Leasing Market from the Perspective of Current Legal Realities*, Perspectives of Law and Public Administration Volume 11, Issue 2, June 2022, pp 246-251; GOJANI, Skender and Egzonis HAJDARI, *Theoretical Aspects Related to the Insurance Contract in Kosovo*, Perspectives of Law and Public Administration Volume 10, Issue 2, June 2021, pp. 115-119; NEMEȘ, Vasile and Gabriela FIERBINȚEANU, *Mutual Insurance Company - a New Form of Company in the Landscape of Romanian Legal Entities*, Perspectives of Law and Public Administration Volume 9, Issue 1, May 2020, pp. 117-123.

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including, in the B2C contracts, of certain provisions suspected of having potential unbalanced effects, in terms of procedural prerogatives or in terms of purely economic aspects?

The European legislator, in the text of Directive 93/13/EEC, defined the abusive clause on the basis of two elements - a subjective one (a bifurcated element, consisting both in the constraint applied to the consumer, in the absence of the possibility of negotiating the B2C clauses[4], and in the disregard of the requirements of contractual loyalty) and an objective element, referring to the economic or procedural imbalance entangled by the clause unilaterally drafted by the professional provider. The last element refers to the significant imbalance or disproportion between the mutual benefits of the parties and, therefore, the procuring of an excessive advantage for the professional, at the expense of the consumer (in the position of adherent). In a brief enumeration, under the doctrinal approach[5], the elements of the legal definition assigned to the abusive clause are placed on the following tripod: (1) the absence of direct and effective negotiation of the clauses of the B2C contract between the professional and the consumer; (2) violation of the requirements of good faith by the professional, by inserting the respective clause (while disregarding, at the same time, the prohibition postulated in Article 3(1) Directive 93/13/CEE, as amended)[6]; (3) the possibility of requesting the elimination of the disputed clause, in the perimeter of judicial mechanisms regarding the enforceability deprivation of unbalanced terms for non-disclosure, the pros and cons of which will be addressed in the following sections.

1. FACETS OF THE DUTY OF TRANSPARENCY ENTANGLED BY INSERTING ASYMMETRICAL TERMS

1.1. Insurer's pre-contractual obligation to provide transparent access to the derogatory content

Recently, by the CJEU's decision pronounced on April 20, 2023, in the *Ocidental – Companhia Portuguesa de Seguros de Vida* case (C-263/22)[7], it has been stated that, in situations where, under the national law provisions, the professional provider is exempted from the obligations of warning the consumer on

[4] IAMICELI, Paola. *The 'Punitive Nullity' of Unfair Terms in Consumer Contracts and the Role of National Courts: A Principle-Based Analysis'*. Journal of European Consumer and Market Law [online].2023, 12(4), 142-150 [viewed 7 October 2023]. Available from: https://kluwerlawonline.com/journalarticle/Journal+of+European+Consumer+and+Market+Law/12.3/EuCML2023030.

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[7] C.J.E.U.'s decision pronounced on April 20th, 2023, in the *Ocidental – Companhia Portuguesa de Seguros de Vida* case (C-263/22), https://curia.europa.eu/juris/document/document.jsf?t ext=&docid=272691&pageIndex=0&doclang=en&mode=lst&dir=&occ=first&part=1&cid=2025196.

the specific content of the general conditions of a group insurance contract (while the duty of diligent informing remains incumbent, on the policyholder) and where, accordingly, the insured would not be able to rely, against the insurer, on a non-compliance to the duty to provide pre-contractual information on the risks excluded from the policy coverage, the insurer will not be exempt from the obligation to provide transparent access to the integral content of the of the B2C insurance contract, including the asymmetrical, derivative terms on the non-coverage of certain risks, or on the potentially differentiated legal effects of the exonerating clauses (the content of which remain derogatory from the suppletory provisions on the risks coverage).

Saliently, the main jurisprudential trend set by the CJEU's decision pronounced on April 20, 2023, in the *Ocidental – Companhia Portuguesa de Seguros de Vida* case, refers to the fact that, pursuant to Article 4(2) and to Article 5 of Directive 93/13/EEC, the professional insurer is expected to afford the insured consumer the genuine opportunity to become acquainted with the full content of the derogatory terms which the *proferens*, namely the insurer unilaterally drafted. Additionally, the CJEU.'s decision in case C-263/22 stated that, pursuant to Article 3(1) and to Articles 4 to 6 of Directive 93/13/EEC, in cases where a B2C insurance contractual term covering the excluding or limiting of insured risks (based on the insurer's unilateral selection of covered risks) has not been expressly disclosed to the insured consumer at the pre-contractual stage, the national courts[8] maintain the possibility of eliminating the litigious term form the B2C contract, while supressing its binding effects[9] towards the insured consumer.

1.2. Reasonable levels of professional diligence in disclosing the potential effects of asymmetrical terms

Seen through the lens of the principle of adversarial conduct of litigious procedures, the enforceability deprivation refers to a two-staged procedure, under which the court that examined the unbalanced nature of B2C contractual provisions is expected to debate the manner under which the disputed clause[10] was inserted in the contractual text, permitting the professional insurer to bring specific evidence on the pertinency of the recourse to asymmetrical terms, from the perspective of the reasonable level of professional diligence, and in accordance

[8] JOZON, Monika. *The methodology of judicial cooperation in unfair contract terms law*. In: CAFAGGI Fabrizio and LAW Stephanie (eds), *Judicial Cooperation in European Private Law*. Cheltenham: Edward Elgar Publishing, 2017, pp. 129–166.

[9] ȚIȚ, Nicolae-Horia. *Încuviințarea executării silite a debitorului consumator-exigențe europene, realități naționale.* Analele Științifice ale Universității Alexandru Ioan Cuza din Iași, seria Științe Juridice. 2020, 66(2), 91–110. ISSN 25373048.

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with the rigors of the competence specific to the insurer' field of activity, reasonably applied. From this perspective, the role of the transparency requirements pursuant to art. 3(1)[t] of Directive 93/13/EEC, amended by Directive (EU) 2019/2161, seems not to be limited to the scope of substantial effects, as its relevance would also reflect several procedural facets, concerning the progressing of the adversarial litigious debate and the administration of evidence: the professional, on whom the rebuttable (praetorian) presumption of non-compliance to the duty of transparency hovers (since the insurer unilaterally managed the process of drafting the clauses of the B2C adhesion contract), will have the opportunity to overturn the mentioned presumption, while bringing arguments to support the preservation of the asymmetrical clause in the contractual perimeter, for reasons related to certain economic objectives (if justified as reasonable) or to the usages of its profession (with the specification that the usages of the profession are not *per se* opposable to the consumer, who is not numbered among the practitioners of the respective profession; yet, these arguments may shape, possibly, the court's decision regarding the justification for the presence of the contentious clause in the litigious contractual text).[11]

The unnegotiable nature of the asymmetrical terms remains the ostensible characteristic of the adhesion contracts[12], in the perimeter of which the presence of unbalanced stipulations can be signalled; yet, the interpretation of B2C contractual clauses susceptible to multiple meanings will be practiced against the professional insurer who, as *proferens*, controlled the process of unilaterally drafting the B2C asymmetrical clauses[13]. In the assessment of the unbalanced nature of the adhesion contractual stipulations, under current judicial practice, the professional insurer's culpable omitting to adequately inform the consumer on the existence of derogatory terms or to disclose the excluding of certain types of situations from the sphere of the provisions on risk coverage is subject to a rebuttable presumption of misconduct[14]. The mentioned rebuttable presumption of inadequate professional conduct is also applied by the courts when approaching the insurer's duty to transparently inform the consumer[15], while assessing the pertinency of the insurer's conduct, in which capacity the latter would have mastered

[11] GOICOVICI, Juanita. *Dreptul relațiilor dintre profesioniști și consumatori*. Bucharest: Hamangiu, 2022. 9786062720247, 127-131.
[12] MICKLITZ, Hans-Wolfgang. Unfair Terms in Consumer Contracts. In: Norbert REICH, et al., eds. *European Consumer Law*. 2nd ed. Cambridge: Intersentia, 2014, pp. 125–132. ISBN 9781780684598.
[13] JOZON, Monika. *Unfair contract terms law in Europe in times of crisis: Substantive justice lost in the paradise of proceduralisation of contract fairness*. Journal of European Consumer and Market Law. 2017, 6(4), 157–166.
[14] GOICOVICI, Juanita. *Consumatorul apparent și profesionistul veritabil. Frontierele (volutele) noțiunii de „consumator"*. In: VARSTA, Ioana, ALMĂȘAN, Adriana and ZAMȘA, Cristina Elisabeta (eds), *In honorem Flavius Antoniu Baias. Aparența in drept*, Bucharest: Hamangiu, 2021, pp. 727-752. 9786062718459.
[15] LUZAK, Joasia, and Mia JUNUZOVIĆ. Blurred Lines: Between Formal and Substantive

the forming of the B2C agreement. Omitting to deliver the relevant information on the limitations applicable to risk coverage under the B2C insurance contract, particularly when the *proferens'* choice generated a consequential imbalance[16], represent deviant conduct that can materialize as malicious intent or as gross negligence, or inexcusable omission[17] at the stage of forming the adhesion contract.

2. PERFORMING THE INSURER'S OBLIGATION OF TRANSPARENCY

2.1. Assessing the unbalanced nature of clauses that restrict or suppress the consumer's prerogatives

From the perspective of the nature of the imbalances triggered as a result of producing the effects of the B2C terms, it is worth highlighting the fact that such imbalances do not invariably take an economic form, since these clauses can materialize in imbalances of responsibility shifting or as imbalances in allocating contractual risks[18], as in the case of clauses whereby the professional preserves the right to transfer the contractual obligations to a third party without the consumer's consent, if this transfer serves to diminish the B2C guarantees or to exempt the professional provider from liability; such litigious stipulations include the clauses that allow the professional provider to request damages from the consumer or the application of penalties incumbent on the consumer, without providing for the existence of compensations in an equivalent amount for the consumer or the clauses that restrict or suppress the possibility of the consumer to resort to the exception of contractual non-performance in order to temporarily suspend the performance of their obligations, as an extrajudicial manner of persuading the professional provider to proceed with the performance of the correlative obligations incumbent upon the latter.[19]

Co-substantial to the principle of transparency, the requirement to demonstrate lawful conduct characterized by good faith at the stage of forming

Transparency in Consumer Credit Contracts. Journal of European Consumer and Market Law. 2019, 8(3), 97–107.

[16] PAVILLON, Charlotte, and Benedikt SCHMITZ. *Measuring Transparency in Consumer Contracts: The Usefulness of Readability Formulas Empirically Assessed*. Journal of European Consumer and Market Law. 2020, 9(5), 191–200.

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[19] FARINA, Marco. *Unfair Terms and Supplementation of the Contract* [online]. European Review of Private Law. 2021, 29(3), 441-462. Available from: https://kluwerlawonline.com/JournalArticle/European+Review+of+Private+Law/29.3/ERPL2021023.

the B2C adhesion contract will imply, for the professional insurer hypostasised as a *proferens*, an obligation to provide relevant information[20], to warn and provide adequate advice to consumers, as well as an obligation to draft contractual clauses clearly and intelligibly, avoiding ambiguous terminology.

In the perimeter of analysing the validity of unbalanced clauses, the courts' assessment refers to a 'hybrid' criterion, intertwining subjective and objective elements. Symmetrically, the rebuttable presumption of culpable omission[21] applied (jurisprudentially[22] or praetorian) to the professional insurer involves the fact that the insurer is expected to prove compliance to the pre-contractual duty of informing the consumers. Therefore, a salient procedural facet of the professionals' good faith criterion pursuant to art. 3(1) of Directive 93/13/EEC implies, for the professional insurer, the mission to overturn, through conclusive evidence, the rebuttable presumption of omissive misconduct[23]; if the insurer fails in this mission of convincing the court about the pertinency and legitimacy of preserving the litigious clause in the respective contractual context, the insurer is presumed to have omitted to disclose the relevant information[24] for configuring the consumer's consent, and when the professional resorted to an unbalanced clause excluding certain categories of risks from the risk coverage, without alerting the consumer on the existence and content of these derogatory terms, might be considered as derogatory from the exigences of the professional diligence.

2.2. Professionals' duty of transparency, as reflected in recent jurisprudence

Most of the cases brought to the attention of the CJEU concerned unbalanced terms inserted in B2C financial services contracts, such as credit contracts[25], not particularly addressing the issues of resorting to exemption clauses

[20] WIECZERZYCKI, Martin. *Power asymmetry and value creation in B2C relationship networks*. International Journal of Management and Economics. 2021, 57(2), 161-176. DOI: https://doi.org/10.2478/ijme-2021-0006.

[21] GOICOVICI, Juanita. *Mandatory rules of public policy concerning consumer protection in recent jurisprudence*. Transylvanian Review of Administrative Sciences. 2012, 38, 44–60.

[22] SERAFIN, Riccardo. *The Court of Justice on Unfair Terms and Supplementation of the Contract: How Far Is Too Far?* Journal of European Consumer and Market Law. 2023, 12(4), 150-158.

[23] PATTI, Francesco Paolo. *Personalized Unfair Terms Control: EU Law Meets Innovative US Doctrines* [online]. European Review of Private Law. 2020, 28(6), 1249-1272. Available from: https://kluwerlawonline.com/JournalArticle/European+Review+of+Private+Law/28.6/ERPL2020075.

[24] GOICOVICI, Juanita. *Volatilitatea formalismului informativ interconectat formării online a contractelor bussiness-to-consumer: comentariu asupra deciziei CJUE în cauza c-249/21*. Studia Universitatis Babeș-Bolyai Iurisprudentia [online]. 2023, 67(3), 143–182 [viewed 7 October 2023]. ISSN 2065-7498. Available from: doi:10.24193/subbiur.67(2022).3.5.

[25] MIHALI-VIORESCU, Lucian. *Clauzele abuzive în contractele de credit*. 2nd ed. Bucharest: Hamangiu, 2018. ISBN 9786062709303, 67-83.

in B2C insurance contracts.

In the reasoning exposed in the recitals of the CJEU's decision in the *Banco Santander* case (C-447/23), the requirement regarding the transparency of the contractual clauses was invoked *expressis verbis*, pursuant to the provisions of Article 4(2) and of Article 5 of Directive 93/13/CEE, noting that, for a consumer, the accessing of detailed information regarding the full content of contractual terms and the extent of their legal reverberations, remains of fundamental importance for shaping their decision to engage, in the position of adherent, in the contractual relationships the conditions of which were drawn up unilaterally by the professional (as stated in the judgment of the CJEU of September 20, 2017, in the *Andriciuc* case, C-186/16, point 48). Recalling the premises of consecrating specific legal protection, namely the desiderata of counterbalancing the informational and economic inferiority of the consumer in relations with the professional, the requirements of the obligation of transparency incumbent on the professional must be understood 'extensively' (according to a statement reiterated in the recitals of the CJEU's decision in the *Banco Santander* case, after it had been previously mentioned in the judgment of the CJEU of September 20, 2017, in the *Andriciuc* case, C-186/16, point 44).

Responding to the question on the meaning of the phrase 'clearly and intelligibly expressed contractual clause', in recital 53 of the CJEU's judgment in the *Banco Santander* case, it was highlighted that this implies, for the professional creditor and, generally, for the providers of B2C financing services, the obligation of offering sufficiently pertinent information[26] to grant consumers the possibility to adopt prudent decisions and to calibrate the informational texts as to address the needs derived from the concrete context in which the consumer contracted. The reference to the standard of the 'normally informed and sufficiently advised' consumer has been reiterated in recital 54 of the CJEU's decision in case C-265/22, from the angle of the transparent informing of consumers.

As stated in recital 66 of the C.J.E.U.'s decision of July 13, 2023, in the *Banco Santander* case (C-265/22), the consumer should be provided with information, particularly on the existence and content of asymmetrical terms (which are derogating from suppletory provisions); the argumentative points enunciated in the previous jurisprudence of the CJUE are re-emphasised, according to which the degree of transparency[27] constitutes a crucial criterion in the assessment of the unbalanced nature of the B2C clauses (CJEU's decision of October 3, 2019,

[26] BAKOS, Yannis, Florencia MAROTTA-WURGLER, and David R. TROSSEN. 'Does Anyone Read the Fine Print?' Consumer Attention to Standard-Form Contracts. Journal of Legal Studies. 2014, 43(1), 1–35.

[27] DWORNICZAK, Dominik. Consumer Law Entangled: Comparative Approaches in European Private Law After Aziz and Addiko Bank. European Review of Private Law [online]. 2023, 31(4), 823–844. Available from: https://kluwerlawonline.com/journalarticle/European+Review+of+Private+Law/31.4/ERPL2023031.

in *Kiss and CIB Bank* case, C-621/17, point 49), when the litigious terms generated a significant imbalance between the prerogatives available to the parties of the B2C relationship[28]. When confronted with the professional's recourse, in the position of *proferens*, to ambiguous language, exploiting in its favour the ambiguity of the contractual text, the consumer may request for the judicial establishing of the enforcement derivation (as retained in the CJEU's Order of November 17, 2021, in the *Gómez del Moral Guasch* case, C-655/20, point 37).

As retained in recitals 54 to 56 of the CJEU's decision in the *Ocidental – Companhia Portuguesa de Seguros de Vida* case (C-263/22), the insurer may request for the unenforceability[29] of B2C contractual terms classified as unbalanced, including in cases where the policyholder resorts to invoking the insurer's civil liability for culpable non-disclosure of the content of the terms of an insurance contract addressing 'core issues' such as the excluding or the limiting of insured risks coverage. Thus, when restoring the legal *status quo ante*, should the unfair term had not been inserted in the B2C insurance contract, the courts are expected to examine the professional's compliance to the exigences of the transparency principle (as stated in the CJEU's judgment of 12 January 2023, C-395/21, point 54).

3. 'RE-DESIGNING' THE CONTOURS OF THE PROFESSIONALS' PREROGATIVE OF RESORTING TO 'CONTRACTUALIZED' SUPPLETORY NORMS

The excluding from the sphere of incidence of the mechanism of repressing the unfair clauses of contractual provisions that reflect mandatory or supplementary legal norms has been reiterated in the CJEU's decision in case C-186/16, *Andriciuc and others*, assessing that the national courts[30] are expected to verify whether the disputed clause has 'incorporated' a national legal provision and to what extent the litigious clause, although it addresses the onerous object of the B2C contract, it was unambiguously expressed in the B2C discussions prior to engaging into the agreement. Resuming the reasoning from the judgment handed down in case C-81/19, *Banca Transilvania*, it is worth recalling that the CJEU's decision pointed out, in the same manner as in the judgment in case C-243/20, *Trapeza Peiraios*, that B2C clauses which reflected supplementary legal provisions or national administrative rules of a supplementary nature, remain excluded from the scope of Directive 93/13/EEC, in situations where the disputed clause

[28] JOZON, Mónika. *Judicial governance by unfair contract terms law in the EU: Proposal for a New Research Agenda for Policy and Doctrine*. European Review of Private Law. 2020, 28(4), 909–930.

[29] ȚIȚ, Nicolae-Horia. *Încuviințarea executării silite*. Bucharest: Universul Juridic, 2018. 9786063902345. 112-116.

[30] ȚIȚ, Nicolae-Horia. *Rolul activ al judecătorului în identificarea și calificarea actelor și faptelor deduse judecății. Câteva considerații*. Revista Română de Drept Privat. 2021, (1), 174–199.

was not subject to an individual negotiation.

The reflecting or 'mirroring' of the mandatory or supplementary legal norms in the clauses of the B2C adhesion contract would exclude the courts' possibility of analysing, the potential unfair nature of these clauses, with the argument that the professional's option was limited to transposing certain mandatory legal provisions or supplementary (i) and that, thus, the requirement of breach of good faith is not verified, since the professional who incorporated the imperative legal norms (that were incidental *ope legis* in the respective contractual perimeter) does not derogate from the requirements of contractual transparency (ii); similarly, the premise of their unilateral drafting by the professional insurer, does not compromise the automatic applicability of mandatory or supplementary legal norms, reflected (expressly or tacitly) in the B2C contractual terms.

Notwithstanding the adequacy of the solution of enforcement deprivation, it is worth emphasizing that the supplementary legal norms 'imported' in the B2C terms from the texts of the 'classicised' Contract law developed on voluntarist and egalitarian premises applicable to contractual relationships, which would be inadequate in addressing the consumer's ostensible vulnerability (of informational, economic, procedural nature). The core of the argumentation exploits the idea that the supplementary legal norms were drafted by the national legislator starting from the premise of equality of forces between the contracting parties, and that this 'simplification of paradigm' negatively or positively reverberates in terms of the pertinency of selecting supplementary legal norms as an integral part of B2C insurance contracts.

The logic of a (presumably) balanced character of the supplementary legal norms (selected by the *proferens* and incorporated in the text of the B2C contract concluded without negotiation) is compromised by the fact that such a unilateral selection could become a subterfuge for the professional to impose certain directions or certain solutions which have been subject to discussion and which have not been explained to the prophane party. Saliently, it is worth emphasising that, in these hypotheses, the consumer (in their capacity of adherent) was deprived of the possibility to request the inserting of the derogatory clauses from the supplementary legal norms, which materialized both parties' intention to adapt the supplementary legal solution, punctually deviating from the suppletory provisions. The consumer's choice in the sense of selecting the incidence of supplementary legal norms is not only compromised, but becomes altered in the perimeter of adhesion contracts containing clauses that incorporate, through the unilateral option of the professional creditor, the solution established by legal norms whose nature was, at origins, substitutive of parties' indecision; thus, the resorting to the 'contractualization' of supplementary legal norms should be seconded by the offering to the consumer, of the alternative of obtaining the replacement of these supplementary norms with contractual provisions freely negotiated by both parties (alternative which remains the essence of the nature of the supplementary terms).

CONCLUSION

When addressing the insurers' compliance to the requirements of affording the consumer the opportunity of becoming acquainted with all the contractual terms, particularly those terms limiting the sphere of the covered risks in B2C insurance contracts, national courts are expected to examine the manner under which the litigious terms have or have not been disclosed to the insured party. Specifically, the fact that the consumer would have been able to access throughout the carrying of individual efforts, the complete content of the litigious derogatory terms does not *per se* exonerate the insurer of performing the duty of informing the consumer on the existing of limitations applicable to the categories of the covered risks, since the latter represent 'core elements' based on which consumer's consent, as insured party, is validly formed. The negotiated character of the clause refers to the active involvement of the consumer in the formulating of the clause, and the proof of this active role played by the consumer rests with the professional who affirms that the unbalanced terms have been subject to negotiation; should the insurer fail to prove the negotiability of the unfair clause, the latter becomes eligible for judicial removal, since it has been found contrary to the good faith and the transparency exigences, and it has significantly unbalanced the contractual position of the parties.

Seen through the lens of the scope of the analysis of unfair clauses, the 'effective negotiation' of the disputed clauses requests supplementary efforts on 'deciphering' for the consumer of the ambiguous terms, during the discussions carried out between the protagonists of the insurance contract since the deciphering of certain legal aspects to the potential consumer does not automatically equal to the possibility of influencing the content of the unbalanced terms.

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Retail investment strategy proposal – overcoming cross-border business challenges through legislative process

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Abstract: *This article provides a comparative analysis of the changes brought forward by the Retail Investment Strategy (RIS) proposal within the European Union and a critical discussion of its potential impacts. Given the limited scope of this article, the authors intend to deal mostly with cross-border business relations. The purpose of our research was to assess the impact of the current wording of the RIS proposal on existing legislative framework (MiFID, IDD, PRIIPs, and others) and to highlight potentially problematic or even counterproductive provisions. The RIS proposal impacts a wide spectrum of financial products and represents a further stage of so-called "Mifidization process". Talking about a strategy that will result in a framework amending several areas of financial services, one would reasonably expect to see unification and simplification tendencies, e.g. in information disclosure requirements. Last but not least it is rational to assume compatibility with existing legal framework, e.g. Rome I Regulation. But is this really the case? And will it lead to higher consumer protection and financial literacy standards? As we see it, the European Commission's proposal raises many hidden challenges that may prove problematic in practice and should therefore be further considered by the European Parliament and Council as a part of the upcoming European legislative process.*

Keywords: *Financial Regulation, IDD, Choice of Law, MiFID II, Mifidization, Retail Investment Strategy, RIS.*

INTRODUCTION

On 24 May 2023, the European Commission (EC) published its Retail Investment Strategy (RIS). In fact, rather than a document of strategic nature, it is a packaged legislative proposal covering all retail investment products, includ-

ing insurance-based ones. It contains legislative proposals for an Omnibus directive[1] and a Regulation[2] amending PRIIPs.[3] Omnibus is an amending directive, aiming to modify MiFID II[4], IDD[5], Solvency II[6] (SII), AIFMD[7], and UCITS[8]. It is therefore divided into five main sections. The amendment to PRIIPs, a directly applicable regulation, takes place outside the Omnibus framework.

The objective of RIS is to achieve uniform retail investor protection throughout the EU and across all investment products and distribution channels by enacting consistent and sometimes uniform requirements for all relevant sectors. This legislative package responds to the key objective of the Capital Markets Union Action Plan[9] – making the EU an even safer place for citizens to invest in the long term.

Firstly, it aims to provide retail investors with adequate protection matching their risk profile, helping them to make fully informed financial decisions by modifying existing and introducing new information obligations.

Secondly, the proposal should allow retail investors to benefit from the extensive EU capital market by mitigating potential conflicts of interest and preventing misleading marketing. This is intended to promote safe cross-border distribution.

1. MIFIDIZATION

The RIS does not fully reflect the goals indicated above. First of all, proposals have been developed with MiFID products and distributors in mind and

[1] Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Directives (EU) 2009/65/EC, 2009/138/EC, 2011/61/EU, 2014/65/EU and (EU) 2016/97 as regards the Union retail investor protection rules.

[2] Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Regulation (EU) No 1286/2014 as regards the modernisation of the key information document.

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do not adequately address the sector-specific features of insurance-based investment products (IBIPs), such as potential risk coverage, financial guarantees, and the variety of insurance distribution channels.

The unification of regulation across all financial services sectors is also referred to as "despecialization."[10] The level of imitation by the Solvency II directive[11] of Basel II[12] is also very high. The reason could lie in the fact that the EU legislator lacks expertise in the complex and highly technical matter of insurance.[13] This over-generalised result is inappropriate; changes proposed to MiFID may not simply be extended to the Insurance Distribution Directive (IDD).

Furthermore, the RIS imposes multiple bans on inducements, thereby hindering access to investment. It introduces new inappropriate requirements for non-independent advised sales and establishes value for money benchmarks with a risk of price control. It also mandates new disclosures, contributing to information overload negatively perceived by the customers,[14] and adds additional steps to the already lengthy suitability and appropriateness tests.

Nevertheless, the price of a product is not the only determinant, as it may lead to a counterproductive decision by consumers to choose the cheapest option, rather than the best products, which reflect sustainability, risk preferences, etc. It is worth mentioning that the increased customer protection can slow down innovation and product development.[15]

Given the limited scope of the article, we will mainly focus on the contentious elements and shortcomings associated with the choice of law in cross-border business that need to be highlighted and adjusted in the upcoming European legislative process.

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[15] TOMIC, Katica. Product Intervention of Supervisory Authorities in Financial Services. In: GRIMA, Simon and MARANO, Pierpaolo (eds.) Governance and Regulations' Contemporary Issues (Contemporary Studies in Economic and Financial Analysis, Vol. 99), Bingley: Emerald Publishing Limited. s. 229-255. [online]. 2023-09-25 [viewed 2023-09-29]. Available from: https://doi.org/10.1108/S1569-375920180000099011.

2. MIFID II FRAMEWORK

Draft Article 35a MiFID II is one of those proposed to enable the cross-border provision of financial services. However, de facto, it may pose an obstacle. The providers of investment services should report the set of information described below annually to the competent authority (CA) of the particular Member State when they provide services to more than 50 clients on a cross-border basis:

a) the list of host Member States in which the investment firm is active through the Freedom to Provide Services (FOS) and activities following notification (art. 34(2));

b) the type, scope, and scale of services and activities in each host Member State, through the FOS;

c) the total number and the categories of clients corresponding to the services provided during the relevant period, and a breakdown between professional and non-professional clients;

d) the number of complaints (art. 75) in each host Member State;

e) the type of marketing communications used in each host Member State.

A newly formulated Art. 86(1) MiFID II modifies the corrective and reporting measures to be taken by the host Member State in cases of cross-border activities (both through its branch and under the FOS). The CA of the host Member State (initiating authority) shall refer its findings to the home Member State authority if it believes that an investment firm infringes MiFID obligations within the competence of the home Member State authority and is newly obliged to inform European Securities and Market Authority (ESMA) about it. The CA of the home Member State shall newly take the necessary measures or commence the corresponding administrative process at the latest 30 working days after the referral. ESMA shall also transmit such information to the CA of all host Member States where the investment firm is active. The CA of the home Member State shall communicate the implemented measures to the host Member State (as well as to ESMA and to the CA of all Member State affected). If, despite the measures taken by the home CA the investment firm persists in such actions, the CA of the host Member State will be entitled to prevent it from initiating any further transactions within their territories.

This provision is interwoven with the mutual information obligations of the home and host CA and to inform both ESMA and the EC. The host Member State may also propose ESMA to prohibit the undesirable practices. Any other host Member State may adopt similar or identical measures without first referring findings to the home CA, but shall inform the home CA at least five working days before taking such precautionary measures.

The proposed wording is overcomplicated and does not enable the host CA to immediately protect customers in their market without asking the home CA for intervention. Based on art. 87a MiFID II, ESMA should be entitled to set

up a collaboration platform between the involved CAs. Instead, it would be worthwhile to directly introduce a platform streamlining the various combinations of information exchange between all the home and host CAs, ESMA, and the EC.

3. IDD FRAMEWORK

Even the IDD appears to be associated with over-regulation in some areas.[16] The RIS further reinforces this trend and introduces more complex administrative procedures (rather than strengthened customer protection) associated with the IDD framework, e.g., product oversight and governance requirements.

Starting with the proposed Art. 5 IDD, in cases of breaches of duties associated with cross-border distribution, the information obligations related to remedies are similar to those in MiFID. However, the rule that any other host Member State may adopt similar or identical measures in case of similar or identical infringements is missing. The narrative about the cooperation platform is different (and more complicated). The European Insurance and Occupational Pensions Authority (EIOPA) may set it up in cases where, within 12 months, two or more CAs of host Member States have taken remediation with respect to one or more insurance, reinsurance, or ancillary insurance intermediaries having the same home Member State, or if a home Member State disagrees with the findings of a host Member State. In our view, there are no specific reasons to formulate the cross-border cooperation and reporting duties differently compared to MiFID. The current standardized insurance product information document (IPID) in the non-life insurance segment is now proposed to be extended to the life insurance segment as well while IBIPs remain part of the PRIIPs KID framework. As a result, the information on choice of law is to be provided for all insurance products except IBIPs.[17]

Reporting of cross-border activities pursuant to the newly inserted Art. 9a IDD is, at first glance, similar to those in MiFID, but upon closer looking, there are differences. Member States shall require that insurance distributors to report the following information annually in the same situations as in MiFID:

a) the list of host Member States in which the insurance distributor is operating under the FOS or the freedom of establishment;[18]

b) the scale and scope of the insurance distribution activities conducted in each host Member State;[19]

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[16] KÖHNE, Thomas, Christoph BRÖMMELMEYER. *The New Insurance Distribution Regulation in the EU—A Critical Assessment from a Legal and Economic Perspective.* Geneva Papers on Risk and Insurance: Issues and Practice, Volume 43, Issue 4, Pages 704–739 [online] 2018-10-01 [viewed 2023-10-01] Available from: https://doi.org/10.1057/s41288-018-0089-0.

[17] Article 20 – new paragraph 8a letter (o).

[18] MiFID lacks a list of countries where the activity is carried out on the basis of FoS.

[19] Only under the FOS in MiFID.

c) the type of insurance products distributed in each host Member State;[20]

d) for each host Member State, the total number of customers for the relevant period ending on 31 December;[21]

e) the number of complaints in each host Member State.[22]

The type of marketing communications used in host Member State (to be reported under MiFID), is absent in the proposed amendment of IDD. However, in our opinion, this should be synchronized.

According to the amended wording of Art. 20(8) IDD, the IPID for retail customers should contain the added letter (j).[23] This new rule signifies that customers will be explicitly alerted to the choice of law, which they might not typically notice in insurance terms and conditions. This introduction poses a significant challenge to cross-border sales.

The Rome I Regulation[24] contains specific limitations on the choice of law for insurance services concerning risks situated within the EU.[25] For risks situated outside the Member States, the general rules for consumer contractual relations under Art. 6 will apply – if the professional pursues their commercial activities in the country of consumer´s residence or directs such activities to that country, the legal regime will be governed by the law of the consumer's habitual residence.[26] The same rule is applicable for MiFID regulated services but also inside Member States. In the CJEU´s Verein für Konsumenteninformation v. Amazon EU Sa`rl case[27], the trader targeted consumers with habitual residence in Austria by means of a website in German. As a result, Austrian law should have applied. Thus, in this situation, the connecting factor in article 6(1) Rome II Regulation corresponds to the one in Article 6(2) Rome I.[28] The concept of 'directing activities' was firstly explained in Pammer and Alpenhof case[29], where it was interpreted in the sense of offering services not only through active distribution but

[20] In MiFID, this is combined with the previous point.

[21] In MiFID, categories of clients – i.e., professional or non-professional – are also included.

[22] The same as in MiFID.

[23] "The law applicable to the contract where the parties do not have a choice of law or, where the parties can choose the law applicable to the contract, the law that the insurance undertaking proposes to choose, and the competent jurisdiction."

[24] Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I).

[25] Rome I, Art. 7.

[26] Rome I, recital 26, Art. 6.

[27] Judgment of the Court of Justice of 28 July 2016, Verein für Konsumenteninformation v. Amazon EU Sa`rl. Case C-191/15 [online]. In EUR-Lex. [accessed on 2023-10-18]. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A62015CJ0191.

[28] RUTGERS, Jacobien. Judicial Decisions on Private International Law. *Neth Int Law Rev* 64, pp. 163–175 (2017). [online] 2017-04-06 [viewed 2023-10-19] Available from: https://doi.org/10.1007/s40802-017-0084-3.

[29] Judgment of the Court (Grand Chamber) of 7 December 2010 in Joined Cases C-585/08 a C-144/09 Peter Pammer v Reederei Karl Schlüter GmbH & Co. KG (C-585/08) and Hotel Alpenhof GesmbH v Oliver Heller (C-144/09) [online]. In EUR-Lex. [accessed on 2023-10-18]. Available

also through country-specific advertising or even language versions of the presentation, here in relation to a choice of forum based in Brussels I Regulation (recast).[30]

In case of life insurance products, only the law of the nationality of the policyholder can be chosen pursuant to Rome I Regulation, Art. 7 (3) c). If no law is chosen, the contract is governed by the law of the state where the risk is located, [31] i.e., according to the policyholder's habitual residence. This is apparent from Rome I Regulation, Article 7(3)(c) and (3) last sentence in conjunction with Solvency II, Article 13(13)(d) regardless it is an IBIP product or not.

Pursuant to Rome I Regulation, Article 7(3), Member States may grant a greater freedom in the choice of applicable law in the cases referred to in Article 7(3)(a), (b) or (e). This allows, inter alia, a derogation from the option linked to the place where the risk is situated at the time of concluding the contract and from the option associated with the place of habitual residence of the policyholder. This flexibility is not possible for life insurance (letter (c)). If the insurance contract covers risks both inside and outside the EU, the requirements of both Art. 6 and 7 of Rome I Regulation must be considered.

4. CONCLUSION

The legislative proposals are set to be debated by the European Parliament and the Council. It is necessary to draw attention to complicated and confusing provisions, as hasty decisions made before the upcoming elections may prove to be insufficient.

The reasoning also remains unclear as to why the amended MiFID and IDD rules require additional informational materials for customers, rather than concise and clear contractual terms and conditions. Reflecting the relevant provisions of Rome I Regulation would show that choice of law is in fact not possible for life insurance products and the protection of domestic law always benefits consumers in the case of MiFID products. The intricate system of information transfer among regulators should be substituted with a common online platform for all the European Supervisory Authorities (ESAs) and national regulators.

Cross-border distribution also requires defining the target market and assessing the appropriateness of contractual terms and conditions. This raises the question whether it is feasible to successfully test and subsequently launch a product when the validity of the choice of law remains unresolved.

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from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A62008CJ0585.

[30] 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 of the original Regulation No 44/2001 of 22 December 2001) - the so-called Brussels I Regulation recast.

[31] LOWRY, John. *Insurance Law: Doctrines and principles.* Oxford: Bloomsbury Publishing PLC, 3rd edition, 2012, ISBN 978-1-84946-201-3, pp. 388-389.

The determination of the target market may also incentivize data profiling of consumers by financial service providers (also with regard to the possible use of geo-blocking). Consequently, we can observe the competing interests of consumer protection regarding the provision of appropriate financial products on one hand, and the use of consumers' data in digital profiling on the other.[32]

Efforts to harmonize the regulation of insurance and investment products stem from concerns about the absence of comparable consumer protection and the perceived need for a consistent approach to providing information on costs, risks, and remuneration.[33] In contrast, the application of national law is inevitable in the case of directed activities. Consequently, unless the choice of law is liberalized, facilitating the cross-border provision of services effectively remains a challenge.[34]

For instance, Mariani criticizes the ineffectiveness of efforts to unify fragmented national markets.[35] An empirical study by Buryk[36] reveals that the unification of insurance market regulation under Solvency II and IDD resulted in diverging approaches across Member States. Notably, the number of national laws adopted is higher in Member States where the insurance market is less developed, as measured by total premiums paid.

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[2] 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.

[3] Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution.

[4] Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance.

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[7] Regulation (EC) No. 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations.

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[1] Judgment of the Court of Justice of 28 July 2016, Verein für Konsumenteninformation v. Amazon EU Sa`rl. Case C-191/15 [online]. In EUR-Lex. [accessed on 2023-10-18]. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A62015CJ0191.

[2] Judgment of the Court (Grand Chamber) of 7 December 2010 in Joined Cases C-585/08 a C-144/09 Peter Pammer v Reederei Karl Schlüter GmbH & Co. KG (C-585/08) and Hotel Alpenhof GesmbH v Oliver Heller (C-144/09) [online]. In EUR-Lex. [accessed on 2023-10-18]. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A62008CJ0585.

Selected aspects of the transposition of the new EU regulatory framework for credit purchasers into the Czech law

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Abstract: *Following the relatively comprehensive regulatory framework of the prudential regulation after the financial crisis and the banking crisis that hit the European Union in the past, the EU legislation has in recent years become more specific in setting rules in sub-fields such as non-performing loans. In particular, regulatory efforts have been being driven by the aim of developing the secondary market for non-performing loans on the one hand and harmonising the rules for the participants in that market and for trading on it on the other. One of the cornerstones of such regulation is the Directive (EU) 2021/2167 of the European Parliament and of the Council of 24 November 2021 on credit servicers and credit purchasers and amending Directives 2008/48/EC and 2014/17/EU. The article discusses the new EU regulatory framework for credit purchasers as one of the participants in the secondary market for non-performing loans. At first, the new EU regulatory provisions harmonising the rules applicable to credit purchasers are reviewed. Subsequently, the article compares the new EU regulatory scheme with the current Czech regulatory framework regulating the activities of credit purchasers and analyses the intended transposition of the EU provisions harmonising the conduct of business of credit purchasers into the Czech law. Finally, conclusions regarding the possible impact of such transposition are reached.*

Keywords: *non-performing loan, credit purchaser, credit servicer, secondary market, European Union.*

INTRODUCTION

The accumulation of non-performing loans (NPLs) in bank portfolios entails numerous negative consequences including a reduced ability of credit institutions to continue funding the economy which affects the entire real economy.[1] Another problematic aspect of NPLs is that their peak is delayed since the outbreak of economic crises.[2] The negative effects of NPLs have been particularly

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evident in the EU in the aftermath of the 2008 financial crisis.[3, 4]

The article focuses on the new EU regulatory framework for the secondary market for NPLs (NPL secondary market), with the aim of answering the research question "*What regulatory harmonisation standards does the new EU regulatory framework for credit purchasers entail and does the setting of the new EU regulatory framework for credit purchasers and its proposed transposition into the Czech law show any deficits in terms of the prospective implementation?"* analyses new rules for credit purchasers and, based on a comparison with the proposed transposition of this new EU regulatory framework into the Czech law, concludes the impact which the transposed regulation may bring.[5]

1. CURRENT EU REGULATION OF NON-PERFORMING LOANS

1.1. Differentiation of regulation of NPLs

A significant part of the regulation of NPLs falls within the area of the prudential regulation which specifies a range of provisions, from the definitional harmonisation of terms related to NPLs, over the coverage of systemic risks associated with NPLs, to the setting of the supervisory mechanism.[6] At the level of international regulation, standards[7] supplemented by guidelines are crucial.[8] Further, the accounting regulation such as the IFRS 9 implementing the forward-

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[3] MILERIS, Ricardas. MACROECONOMIC FACTORS OF NON-PERFORMING LOANS IN COMMERCIAL BANKS. *Ekonomika* [online]. Vilnius: Vilniaus Universiteto Leidykla, 2014, 93(1), 22-39, ISSN 1392-1258, DOI https://doi.org/10.1016/j.jbankfin.2021.106140 [viewed 3 September 2023]. Available from: https://www.researchgate.net/publication/330518139_MACROECONOMIC_FACTORS_OF_NON-PERFORMING_LOANS_IN_COMMERCIAL_BANKS, p. 26-28, 37-38.

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[5] The article focuses, in the ambit of legal research, on the regulation of the NPL secondary market with intra-state aspects, therefore it is abstracted from studying effects of the NPL secondary market regulation regarding specifics of cross-border activities of credit purchasers, whether across EU Member States or in relation to third countries.

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[7] See The Basel Framework [online]. The Basel Committee on Banking Supervision. Available from: https://www.bis.org/basel_framework/, (see in particular points 20.104 et seq., 30.68 et seq.).

[8] e.g. Guidelines, Prudential treatment of problem assets – definitions of non-performing exposures and forbearance [online]. The Basel Committee on Banking Supervision. Available from: https://www.bis.org/bcbs/publ/d403.htm.

looking approach in relation to NPLs can also be distinguished.[9] At the EU level, the prudential regulation of NPLs includes the secondary legislation, in particular the CRR[10] which, amended in the form of a prudential backstop, governs the capital coverage of risks associated with NPLs,[11] and further non-legislative acts[12] as well as various guidelines.[13] Conversely, purchasing NPLs from creditors, reselling them and recovering such NPLs, as well as the impact of these activities on NPL market participants (financial or non-financial)[14] have not been such comprehensively regulatorily addressed at the EU level. Despite that recovery practices in relation to consumer NPLs are, under certain conditions, governed by the EU consumer protection regulation[15] the regulation of NPL recovery practices has been being varied across EU.[16] Moreover, it is important to note that the consumer regulation governs only a selected group of credit relationships.

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[13] E.g. Guidelines on the application of the definition of default under Article 178 of Regulation (EU) No 575/2013 (EBA/GL/2016/07), 18/01/2017 [online]. European Banking Authority. Available from https://www.eba.europa.eu/regulation-and-policy/credit-risk/guidelines-on-the-application-of-the-definition-of-default.

[14] HARVARD LAW REVIEW. IMPROVING RELIEF FROM ABUSIVE DEBT COLLECTION PRACTICES. Online. *Harvard law review* [online]. 2014, 127(5), 1447-1468. ISSN 0017-811X. [viewed 10 September 2023]. Available from: https://heinonline.org/HOL/P?h=hein.journals/hlr127&i=1472, p. 1447-1452.

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[16] STĂNESCU, C.-G. Regulation of Abusive Debt Collection Practices in the EU Member States: An Empirical Account. *Journal of consumer policy* [online]. New York: Springer US, 2021, 44(2), 179-216. ISSN 0168-7034 [viewed 14 September 2023]. Available from: https://doi.org/10.1007/s10603-020-09476-8, p. 187-191.

1.2. What is actually NPL and the regulatory concept for the NPL market

The term non-performing loan is only a generic one. The EU prudential regulation distinguishes between a "default of an obligor" and a "non-performing exposure". The default of an obligor under Article 178 of the CRR means primarily a situation where the obligor is more than 90 days past due on any material credit obligation to the credit institution or an unlikeliness to pay has been considered. The non-performing exposure is a more extensive term. It includes, according to Article 47a of the CRR, a wider range of defaulted instruments as well as a wider variation of default events.

The need to regulate the EU market environment for NPLs has gained a momentum in recent years. The NPL Action Plan 2020 was adopted to ensure among others the convergence of insolvency regimes, setting of rules for asset management companies and finally to ensure the development of the NPL secondary market and of the harmonized mechanism of the extrajudicial collateral enforcement.[17, 18]

2. NEW EU REGULATORY FRAMEWORK FOR CREDIT PURCHASERS

2.1. Scope of the Non-performing Loans Directive

One of regulatory pillars for the development of the NPL secondary market should be the so-called Non-performing Loans Directive (NPLD).[19] The NPLD lays down requirements related to transferring NPLs from credit institutions to credit purchasers, or to reselling NPLs between credit purchasers, as well as to the indirect service of NPLs.[20] According to the NPLD, NPLs are those originally granted by the credit institution in the form of a deferred payment, a loan or other similar financial accommodation.[21] The NPLD classifies the transfer

[17] BUSCH, Danny. The Future of EU Financial Law. *Capital markets law journal* [online]. Oxford, England: Oxford University Press, 2022, **17**(1), 52-94. [viewed 16 September 2023] ISSN 1750-7219. Available from: https://doi.org/10.1093/cmlj/kmab038, p. 82-86.

[18] EUROPEAN COMMISSION. COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL AND THE EUROPEAN CENTRAL BANK Tackling non-performing loans in the aftermath of the COVID-19 pandemic, COM/2020/822 final. In: *Eur-Lex* [online]. Brussels: European Commission, 16.12.2020, [viewed 16 September 2023]. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52020DC0822, p. 6-17.

[19] Directive (EU) 2021/2167 of the European Parliament and of the Council of 24 November 2021 on credit servicers and credit purchasers and amending Directives 2008/48/EC and 2014/17/EU [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/eli/dir/2021/2167.

[20] See Article. 1 and Article 20 of the NPLD.

[21] See Article. 1 and Article. 3 points (1) (4) and (13) of the NPLD.

of a NPL not only as a transfer of creditor's rights, but also as a transfer of the NPL credit agreement itself or of a NPL portfolio.[22] The default is defined in a wider meaning with reference to Article 47a of the CRR as a non-performing exposure.[23] Although the NPLD states in Article 2(1) that it applies primarily to credit servicers and credit purchasers, who are specified as follows:[24]

a) credit purchaser as "any natural or legal person, other than a credit institution, that purchases a creditor's rights under a non-performing credit agreement, or the non-performing credit agreement itself, in the course of its trade, business or profession, in accordance with applicable Union and national law;"

b) credit servicer as "a legal person that, in the course of its business, manages and enforces the rights and obligations related to a creditor's rights under a non-performing credit agreement, or to the non-performing credit agreement itself, on behalf of a credit purchaser…," and, pursuant to Article 11 of the NPLD, on the basis of a written credit servicing agreement specifying mutual rights and obligations and the scope of the indirect NPL service, carries out such indirect credit service;

The personal scope of the NPLD should be understood more broadly. The NPLD also sets requirements in relation to credit institutions, to supervisory authorities and to NPL borrowers, although the NPLD explicitly excludes from its personal scope entities that may already carry out the service of NPLs under another regulation, i.e. credit institutions or non-credit institutions handling consumer credits (the credit servicer, the credit institution and the non-credit institution handling consumer credits hereinafter collectively referred to as the person authorised to service a NPL (PAS-NPL)), or other entities that carry out a specific credit service.[25]

2.2. Rights and obligations for credit purchasers under the NPLD

At first, the NPLD does not in any way affect the principles of the national Civil Law or the protection set by the consumer protection legislation.[26] The NPLD introduces a four-way differentiation of rights and obligations applicable to credit purchasers.

2.2.1 Rights and obligations between credit purchasers and credit institutions

An important aim of the NPLD is to mitigate the information asymmetry

[22] See Recital 37 and Article. 1 and 3 point (6) of the NPLD.
[23] See Article 3 point (13) of the NPLD.
[24] See Article 3 points (6) and (8) of the NPLD.
[25] See Article 2(5) and (6) of the NPLD.
[26] See Article 2(2) of the NPLD.

regarding offered NPLs. Therefore, specialised templates for the provision of appropriate information regarding NPLs transferred from credit institutions to credit purchasers for a viable assessment of such NPLs by credit purchasers should be used.[27] The proposed concept appears to be beneficial for credit purchasers. On the other hand, it imposes obligations on credit institutions. A problematic factor seems to be that these templates should be mandatorily used only by credit institutions not by credit purchasers. This could retain the information asymmetry among credit purchasers in case of reselling NPLs. Also, the so-called NPL data-hub is to be used in the future for publishing of the data on transactions on the NPL secondary market in an anonymised manner.[28] Anyway, the data-hub remains only in the form of a conception.

2.2.2. Rights and obligations between credit purchasers and supervisory authorities

In general, the principle of non-imposing excessive requirements on credit purchasers in order not to reduce their demand for NPLs can be observed.[29, 30] Thus, it can be deduced that a credit purchaser should not, in principle, be subject to the authorisation under the NPLD. However, in accordance with Article 18 and 20 of the NPLD credit purchasers are obliged to perform reporting obligations *vis-à-vis* the supervisory authority. In the case of the indirect NPL service, it could be relatively deduced, that these requirements could be performed by the PAS-NPL on behalf of the credit purchaser.[31] Credit purchasers thus become a sort of a quasi-regulated financial market entity.

2.2.3 Rights and obligations between credit purchasers and borrowers

The development of the NPL secondary market is complemented by the

[27] See Article 15(1) and 16 of the NPLD; according to Article 16(7) of the NPLD "The data templates shall be used for transactions relating to credits issued on or after 1 July 2018 that become non-performing after 28 December 2021..."

[28] KASINGER, Johannes, KRAHNEN, Jan Pieter, ONGENA, Steven et al. Non-performing loans - new risks and policies? NPL resolution after COVID-19: Main differences to previous crises. *IDEAS Working Paper Series from RePEc* [online]. St. Louis: Federal Reserve Bank of St Louis, 2021. [viewed 17 September 2023]. Available from: https://www.econstor.eu/handle/10419/232027, p. 22-23.

[29] See Recital 40 and Article. 17(2) of the NPLD.

[30] See paragraph 2.1. of the Opinion of the European Central Bank of 20 November 2018 on a proposal for a directive on credit servicers, credit purchasers and the recovery of collateral (CON/2018/54) [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52018AB0054.

[31] See Article 17(5) of the NPLD.

requirement to ensure the protection of all borrowers of NPLs traded on it.[32] Obligations imposed on credit purchasers in relation to borrowers can be divided into representable information obligations, which should be during the indirect NPL service performed on behalf of a credit purchaser by a PAS-NPL, and non-representable obligations mainly regarding the conduct *vis-à-vis* borrowers, which should apply to credit purchasers ceaselessly regardless of the type of NPL service.[33]

2.2.4 Rights and obligations between credit purchasers and credit servicers

First of all, credit purchasers should be ultimately responsible for the performance of credit service activities performed on their behalf by the credit servicer.[34] The NPLD frames the rules for two basic concepts of the indirect NPL service, namely the indirect service of consumer NPLs and of non-consumer NPLs.

a) **The indirect service of the consumer NPL**. Generally, the NPLD sets that Member States shall ensure that, where a credit purchaser purchases from a credit institution an NPL whose borrower is a consumer, credit purchasers entrusts the service of such NPL to a PAS-NPL,[35] with the apparent purpose to link the recovery of consumer NPLs to a higher level of supervision of PAS-NPLs. The issue is whether a credit purchaser can opt for the direct service of consumer NPLs and manage them individually. Wording of Article 17 point (a) of the NPLD would not indicate such practice. However, Recital 44 of the NPLD allows the direct service of consumer NPLs, but then the credit purchaser should be considered a credit servicer and therefore should fulfil conditions including also the authorisation imposed on credit servicers. The insufficient explicit wording in articles of the NPLD may cause issues with the transposition of the NPLD and its future implementation.

b) **The indirect service of the non-consumer NPL.** Entrusting of the management of non-consumer NPLs should be a facultative option for credit purchasers. The NPLD suggests that the direct service should be possible in these cases. The question is, whether an authorisation to act as a credit servicer should be also required for the direct service of non-consumer NPLs. The principle of non-imposing excessive requirements in conjunction with the wording of recital 46 of the NPLD would rather indicate that the obligation for credit purchasers to be authorised as a credit servicer is not applicable for the direct service of non-consumer NPLs. Yet, this conclusion cannot be explicitly supported e.g. by the

[32] See Recital 9 of the NPLD.
[33] See Article 10 of the NPLD.
[34] Recital 32 of the NPLD.
[35] See Article 17(1) point (a) of the NPLD.

historical interpretation method since the European Commission itself envisaged some regulation of the direct NPL service in its proposal for the NPLD.[36] The European Parliament's certain attitude to the NPLD proposal was rather that entrusting of the NPL service to a credit servicer should be compulsory for all types of NPLs.[37] Conversely, the European Central Bank (ECB) stressed that excessive obligations imposed on credit purchasers could disrupt the development of the NPL secondary market.[38]

3. SELECTED ASPECTS OF THE CZECH PROPOSED NPLD TRANSPOSITION

3.1. Proposed transposition of the NPLD

The Czech Republic is one of the countries where the sectoral specific regulation on the NPL secondary market has been absent so far.[39] Thus, the issue has been being primarily regulated by rules of the Civil Code[40] and the trade law.[41] The Czech legislator transposes the NPLD primarily by the Act on the Non-Performing Loans Market (NPLA)[42] which is, at the time of this research, being discussed as a proposal in the legislative process. The NPLA specifies the PAS-NPL[43] and systematically reflects that the NPLD sets certain obligations for entities which are *per se* not credit servicers. The Czech transposition also foresees the exclusion of legal professions and investment fund managers from the scope

[36] See Article 18 of the Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on credit servicers, credit purchasers and the recovery of collateral, COM/ 2018/0135 final - 2018/063 (COD), [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX%3A52018PC0135 (proposal for the NPLD).

[37] See point 218 of the NPLs: Proposal for a Directive of the European Parliament and of the Council on credit services and credit purchasers - Three-column table to commence trilogues, Interinstitutional File: 2018/0063A (COD), [online]. General Secretariat of the Council. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CONSIL:ST_6047_2021_INIT.

[38] See paragraph 2.1. of the Opinion of the European Central Bank of 20 November 2018 on a proposal for a directive on credit servicers, credit purchasers and the recovery of collateral (CON/2018/54) [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52018AB0054.

[39] STĂNESCU, C.-G. Regulation of Abusive Debt Collection Practices in the EU Member States: An Empirical Account. *Journal of consumer policy* [online]. New York: Springer US, 2021, 44(2), 179-216. ISSN 0168-7034 [viewed 23 September 2023]. Available from: https://doi.org/10.1007/s10603-020-09476-8, p. 187-190.

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

[41] Point 1 of the general part of the Explanatory report to the Government bill on the Non-Performing Loans Market, parliamentary file 472 (472/0) (9. term of office) [online]. The Government of the Czech Republic.

[42] The research was conducted on the basis of the text of the Government bill on the Non-Performing Loans Market, parliamentary file 472 (472/0) (9. term of office) [online].

[43] Section 4 of the NPLA.

of the NPLA. In relation to PAS-NPLs, that are not credit servicers, the applicability of NPLA obligations not included in other sectoral regulation is envisaged.[44]

The NPLA foresees also the option of the indirect repayment of NPLs, as anticipated in Article 6 of the NPLD, via a credit servicer, provided that the credit servicer is authorised to do so and fulfils conditions laid down in other relevant legislation governing, for example, payment services, if applicable.[45,46]

Conversely, the option of entrusting the management of NPLs to a natural person, given to Member States in Article 17(4) of the NPLD, is not transposed into the NPLA. Additionally, the Czech legislator does not reflect the problem regarding the possible obligation for a credit purchaser to obtain a credit servicer authorisation for the direct NPL service, which may cause difficulties during the implementation. On the basis of an analysis of the NPLA text, it could be also concluded that Article 17(5) first subparagraph of the NPLD is relatively insufficiently transposed. The provision of the NPLD in question states: "Member States shall ensure that the appointed credit servicer, or entity referred to in Article 2(5), point (a)(i) or (iii) [PAS-NPL], complies, on behalf of the credit purchaser, with the obligations imposed on the credit purchaser pursuant to paragraph 2 of this Article and Articles 18 and 20 [obligations in relation to the supervisory authority]. In cases where no credit servicer or entity referred to in Article 2(5), point (a)(i) or (iii) [PAS-NPL], is appointed, the credit purchaser or its representative shall remain subject to those obligations."

It can be inferred that the EU legislator rather intended to transfer the performance of obligations in relation to the supervisory authority to credit servicers on behalf of credit purchasers in the case of the indirect NPL service, although Recital 47 of the NPLD slightly disrupts such interpretation. As for the NPLA, it keeps in section 20 and section 22 these obligations associated only with credit purchasers.

The Czech National Bank (CNB) should be the authority supervising both PAS-NPLs and credit purchasers.[47] It can be inferred that the off-site surveillance,[48] mainly in the form of reporting obligations, is envisaged especially in relation to credit purchasers.[49] As for PAS-NPLs, it can be deduced that the NPLA foresees primarily the on-site supervision and the supervision through the authorisation process.[50] Despite the absence of the detailed regulation of the on-

[44] See Section 3 of the NPLA and re Section 4, the special part of the Explanatory report to the NPLA.
[45] See Section 10 of the NPLA.
[46] Re Section 2, the special part of the Explanatory report to the NPLA.
[47] See Section 30(1) of the NPLA.
[48] As for the off-site surveillance and the on-site supervision of the CNB see CZECH NATIONAL BANK. Supervisory methods. In: *cnb.cz* [online]. Prague: The Czech National Bank, Undated [viewed 28 October 2023].
[49] See Sections 20(1) and (2), 22(1), 38(3) point a) and d) of the NPLA.
[50] See Sections 6 et seq., 33(2), 37(1) and 38(1) of the NPLA. Eventually through the authorisation

site supervision in the NPLA, the on-site supervision of PAS-NPLs can be inferred indirectly from Section 33(2) of the NPLA regulating an on-site inspection carried out by the CNB following a request from another Member State.[51] Some PAS-NPLs may also be subject to supervisory mechanisms under other relevant regulation. Although the on-site supervision is not particularly foreseen by the NPLA in relation to credit purchasers, generally they should be entities supervised by the CNB and, therefore, situations in which the CNB could perform an on-site inspection based on the legislation of CNB's general on-site inspection powers cannot be excluded.[52]

3.2. Issues of transfer and passage in relation to the NPL

Basically, the Czech law differentiates between the transfer and the passage of rights and obligations.

a) **NPLs and the transfer of rights and obligations**. According to Section 2 point (c) of the NPLA, a transfer of a NPL means the transfer of a non-performing loan or the assignment of rights and obligations arising therefrom. Since the NPLA does not explicitly define means of NPL transferring, it should primarily result in the subsidiary use of the Civil Code taking into account the special provisions of the NPLA. Legal institutes of the Civil Code regarding the transfer of NPLs are mainly the assignment of a claim, the assignment of a set of claims and the assignment of a contract.[53,54] But, the term transfer of a NPL under the NPLA is understood broadly and is intended to include also e.g. the transfer of an enterprise.[55] This mean of transfer is limited in the case of an initial transfer of NPLs from a bank, as the enterprise of a bank can only be acquired by another bank with the consent of the CNB.[56] In the case of credit unions, the transfer of the enterprise also requires the approval of the supervisory authority.[57] However,

process of a PAS-NPL regulated by another relevant regulation.

[51] Deduced also from the special part of the Explanatory report to the NPLA, re Section 33.

[52] See Sections 44(1) point g) and 45(1) of CZECH REPUBLIC Act No. 6/1993 Coll., on the Czech National Bank [zákon č. 6/1993 Sb. České národní rady o České národní bance]; further CZECH REPUBLIC Act No 255/2012 Coll. on inspection (Inspection Code) [zákon č. 255/2012 Sb. o kontrole (kontrolní řád)].

[53] See Sections 1879 et seq., 1887 and 1895 et seq. of the Civil Code.

[54] Translation extracted from: Ministry of Justice of the Czech Republic. Act No. 89/2012 Coll., the Civil Code (translation). In: *Nový občanský zákoník* [online]. Prague: Ministry of Justice of the Czech Republic, Undated [viewed 25 September 2023]. Available from: http://obcanskyzakonik.justice.cz/index.php/home/zakony-a-stanoviska/preklady/english.

[55] Re Section 2, the special part of the Explanatory report to the NPLA.

[56] See Section 16(1) point a) and (4) of the CZECH REPUBLIC Act No. 21/1992 on Banks [zákon č. 21/1992 Sb., o bankách] (Act on Banks).

[57] See Section 1(7) of the CZECH REPUBLIC Act No. 87/1995 Coll., on Credit Unions [zákon č. 87/1995 Sb., o spořitelních a úvěrních družstvech a některých opatřeních s tím souvisejících a o doplnění zákona České národní rady č. 586/1992 Sb., o daních z příjmů, ve znění pozdějších předpisů] (Act on Credit Unions).

the extensive definition of the transfer of the NPL has its role for the resale of NPLs between credit purchasers.

b) NPLs and the passage of rights and obligations. While the transfer of rights and obligations is related to a disposal volitional act of a person, a passage covers when rights and obligations are passed by virtue of another legal fact.[58] The passage also happens upon a de-merger by spin-off by acquisition,[59] *"as a result of which a company or a cooperative being demerged is not terminated and part of its assets is passed to one or more existing companies or cooperatives...."*[60] For the legal research, it seems appropriate to focus on the issue of a possible passage of NPLs upon the de-merger by spin-off by acquisition. The NPLA regulates *stricto sensu* legal facts related to the transfer. Extensive, widely euroconform,[61] interpretation of the transfer of NPLs including the passage of NPLs upon de-merger by spin-off by acquisition which, however, would be materially an alienation of NPLs in the course of business, could result in a distortion of the legal certainty.

As credit institutions can undertake demergers upon the approval of the CNB, this type of conversion would still be subject to the supervision.[62] Yet, in the case of the potential passage of NPLs between credit purchasers, the lack of regulation of this legal institute within the transposed regulation for the NPL secondary market may cause implementation problems. However, it is necessary to consider that a de-merger by spin-off by acquisition, which, however, would be materially only an alienation of NPLs in the course of business, could manifest features of the circumvention of the regulation set in the NPLA, misuse of law or contravention of law or legal principles which would not enjoy legal protection with all consequences arising therefrom.

CONCLUSION

The article discussed a new regulation governing the activities of credit

[58] PELIKÁNOVÁ, Irena. Problém převodu a přechodu práv. *Právní rozhledy* [online], 2001, (4), 141-151, ISSN 1210-6410 [viewed 29 September 2023]. Available from: https://www-beck-online-cz.ezproxy.is.cuni.cz/bo/chapterview-document.seam?documentId=nrptembqgfpxa4s7grpxgxzrgqyq&groupIndex=1&rowIndex=0&refSource=search-facets.

[59] DVOŘÁK, Tomáš. Dvě otázky právního nástupnictví při fúzi, rozdělení a převodu jmění společníka po 1. 1. 2012. *Právní rozhledy* [online], 2012, (15-16), 558-560, ISSN 1210-6410 [viewed 29 September 2023]. Available from: https://www-beck-online-cz.ezproxy.is.cuni.cz/.

[60] See Section 243(1) point (b) point 2. of the CZECH REPUBLIC. Act No. 125/2008 Coll., on the conversion of commercial companies and cooperatives [Zákon č. 125/2008 Sb. o přeměnách obchodních společností a družstev] (Conversion Act). Author's translation based on the translation of Section 179 of the Civil Code extracted from the source cited in the footnote 54.

[61] In line with Articles 135, 136(1) and 159 of the Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law (codification) [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CEL EX%3A02017L1132-20220812.

[62] See Section 16(1) point c) of the Act on Banks and Section 13(4) of the Act on Credit Unions.

purchasers, which has not been sufficiently studied in the field of law so far. NPLs can pose an economic systemic problem therefore setting a prudential, consumer and secondary market regulatory framework for NPLs is essential to prevent negative consequences that NPLs may generate. Answering the defined research question, as for regulatory harmonisation standards entailed by the NPLD, it has been researched that new rules should, throughout the EU, regulate credit purchasers to the non-excessive extent and reduce the information asymmetry, increase the demand for NPLs by credit purchasers, protect all borrowers of NPLs, set harmonised parameters for the service of consumer and non-consumer NPLs and establish a supervisory mechanism of the NPL secondary market. Yet, particularly in the area of the direct NPL service or the performance of reporting obligations to a supervisory authority, the NPLD shows some regulatory deficits which may cause disruptive effects during the transposition, as well as the implementation of the NPLD. Beyond that, the NPLD *per se* probably may not be a single sufficient tool for developing the NPL secondary market. The NPLD needs to be complemented by a sound harmonisation of insolvency regimes, the implementation of institutes such as the NPL data-hub and the convergence of rules for asset management companies or the out-of-court recovery of collateral. The proposed transposition of the NPLD into the Czech law systematically well reflects harmonised activities of participants in the NPL secondary market. Conversely, problematic aspects, stemming from the NPLD itself as well as from some Czech legal specificities of the differentiation between the transfer and passage of rights and obligations and of the de-merger by spin-off by acquisition as a legal institute of the Czech conversion law, are rather not sufficiently addressed in the NPLA and may prospectively distort the implementation process of the NPLD.

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De Lege Ferenda Considerations on Potential Institutes Increasing Participation in Supplementary Pension Savings

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Abstract: *Supplementary pension savings represent one of the results of the diversification of the pension system in the Slovak Republic. For the majority of the population, with the exception of selected types of professions, participation in supplementary pension savings is voluntary. In order to ensure and improve the standard of living of individuals in the post-productive age, the legislator has introduced in the legal order regulations that should motivate to participation in supplementary pension savings, such as the possibility to inherit the value of a personal account, tax benefits or employer contributions. The paper contains a set of proposals and reflections of the authors on what other possible mechanisms should be introduced in order to increase interest in saving the so-caller third pillar both on the part of the participant and on the part of their employer.*

Keywords: *participant, supplementary pension savings, supplementary pension savings asset, Management Company.*

1. INTRODUCTION

A reform of the pension system has been performed in Slovakia.[1] The "legacy" of the social security systems did not meet the needs of the transition to a market economy.[2] The mass of employer-sponsored social benefits in a state-controlled economy could not be transferred to the private market economy without a significant impact on its economic performance.[3] The Resolution of the Government of the Slovak Republic No. 257 of 2 April 2003 approved the Concept of Pension Reform in the Slovak Republic, which is also valid in the current

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[2] TOMEŠ, Igor. *Sociální polilitika, teorie a mezinárodní zkušenost.*2nd Edition. Praha: Socioklub, 2001, 205, 80-86484-00-9.
[3] Ibid.

period.[4] The pension reform in the Slovak Republic consisted primarily of:

- the introduction of a contributory defined-contribution compulsory old-age pension savings system;
- rebuilding the pay-as-you-go system based on its modified philosophy;
- increasing the importance of voluntary pension schemes.[5]

The Slovak pension system is based predominantly on mandatory pay-as-you-go scheme.[6] The reform in question identified the main problem of the Slovak pension system as the extent of pay-as-you-go financing of pensions, which it described as unsustainable in the light of demographic and economic developments.[7]

The optimal saving strategies connected with life-cycle strategies have been studied by Mešťan et al.[8] Mesťan et al. have studied projections pension benefits from the third pillar in Slovak Republic.[9]

From a substantive perspective, we consider that de lege ferenda considerations should involve a number of procedural and substantive steps that are logically interrelated. First of all, there is the identification of the problem followed by an analysis. The analytical part should then be consulted with the professional public and stakeholders who may have or have an interest in the outcome. This is followed by the formulation of the proposal, the implementation of the legislative process, the approval, and the actual implementation.

Considering the complexity of the issues covered by the system of voluntary savings for retirement represented by the supplementary pension savings product, the authors have the ambition to make de lege ferenda considerations in this area to the extent of problem identification and partial analysis. The scope does not allow the authors to go into a comprehensive analysis, because its implementation generates a complex of information, social, demographic, labour and labour law, fiscal-budgetary and regulatory issues. We consider that the very identification of the problem and the basic analysis contributes in this area to fulfill the task of de lege ferenda considerations, which is to adapt the legal system to the changing needs of society and its values, thus effectively endowing,

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[4] POLONSKÝ, Dušan, PLACHÁ, Jana. *Sociálne poistenie v systéme sociálneho zabezpečenia na Slovensku od roku 1990 po súčasnosť.* Trnava: Univerzita sv. Cyrila a Metoda v Trnave, Fakulta sociálnych vied, 2017, 67, 978-80-8105-876-9.

[5] RIEVAJOVÁ, Eva et al., *Sociálne zabezpečenie*. 2nd Edition. Bratislava: Vydavateľstvo EKONÓM, 2017, 143, 978-80-225-4396-5.

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[8] MEŠŤAN, Michal et al.Impact of Different Life-Cycle Saving Strategies and Unemployment on Individual Savings in Defined Contribution Pension Scheme in Slovakia.E & M Ekonomie a Manažment. 2021, 24(3), pp. 124-128.

[9] MEŠŤAN, Michal et al. *Projections of pension benefits in supplementary pension saving scheme in Slovakia.* Central European Journal of Operations Research. 2021, 29(2), pp. 687-712.

but also stimulating socio-economic development.

In the article, not only the method of analysis, but also synthesis is being used. The authors synthesize the acquired information and form them into de lege ferenda considerations and proposals.

1. CURRENT STATUS OF PARTICIPATION IN THE THIRD PILLAR

The relevant regulation entered into force on 1 January 2005.[10] The purpose of the Act No. 650/2004 Coll. on Supplementary Pension Savings and on Amendments and Supplements to Certain Acts, as amended (hereinafter referred to as "Supplementary Pension Savings Act") is mainly, but not exclusively, to provide for social care for a natural person who ceases to be economically active and enters post-productive age. By regulating the social relations arising in the field of supplementary pension savings, the legislator pursues the interest in compensating for the loss of income of a natural person in old age (in the case of sensitive professions exhaustively defined in the Supplementary Pension Savings Act, also in the event of termination of employment), through supplementary pension savings benefits. Supplementary pension savings are based on the capitalisation of individual savings and represent a defined contribution scheme, i.e. the amount of the individual's contributions is predetermined, but the pension from this scheme is not predetermined (not known in advance) and depends on a number of factors (length of savings, amount of contributions, etc.).[11] The third pillar is also referred to as the employee pillar because employers use it as a form of employee benefit for their employees.[12]

Supplementary pension savings represent one of the legal instruments to educate and motivate individuals to take responsibility for their income in post-productive age. Despite this fact, the table below, published on the website of the Ministry of Labour, Social Affairs and Family of the Slovak Republic, shows that the supplementary pension savings sector cannot be considered to be saturated with participants.

Tab. 1. Number of Participants in the 3rd pillar: Status as of September 30, 2023

Supplementary Pension Asset Management Company	Number of Participants	Share in %
DDS Tatra banky d.d.s., a.s.	297 442	30,3 %
NN Tatry-Sympatia, d.d.s., a.s.	424 660	43,3 %

[10] SLEZÁKOVÁ, Andrea. Komparácia zákonných podmienok pre distribúciu doplnkového dôchodkového sporenia v SR a doplnkového penzijného sporenia v ČR. STUDIA IURIDICA *Cassoviensia*. 2021, 9(1), pp. 85-94, p. 86.

[11] MEŠŤAN, Michal, PINTÉR, Ľubomír. *Kolektívne investovanie a sporenie na dôchodok*. Banská Bystrica: BELIANUM, 2022, 85, 978-80-557-1947-4.

[12] Ibid.

Supplementary Pension Asset Management Company	Number of Participants	Share in %
Stabilita, d.d.s., a.s.	127 541	13,0 %
UNIQA d.d.s., a.s.	130 660	13,4 %
Total amount	980 303	100%

Source: webpage www.adds.sk

We consider that in practice there is still potential for further increasing the participation in supplementary pension savings and "making" the third pillar more attractive. In the light of the above, we would like to draw your attention to a set of *de lege fereda* proposals.

2. DE LEGE FERENDA CONSIDERATIONS ON THE MATERIAL SCOPE OF SUPPLEMENTARY PENSION SAVINGS

The fifth part of the Supplementary Pension Savings Act regulates the conditions of activity of the supplementary pension asset management company. The legal definition of the term supplementary pension asset management company had been enshrined by the legislator in Article 22(1) of the Supplementary Pension Savings Act. This entity is a joint-stock company with its registered office in the territory of the Slovak Republic, the subject of activity of which is the creation and administration of supplementary pension funds for the purpose of supplementary pension savings, on the basis of a license for the establishment and operation of a supplementary pension asset management company granted by the National Bank of Slovakia. On the business activities of the supplementary pension asset management company the Act No. 513/1991 Coll., the Commercial Code, as amended (hereinafter referred to as "Commercial Code") applies and the rule *lex specialis derogat lex generalis* is being applied at the same time. It follows that where a more special legal regulation (the Supplementary Pension Savings Act) provides otherwise than the more general one (the Commercial Code), the more special one, i.e. the Supplementary Pension Savings Act, will apply (e.g. the Supplementary Pension Savings Act provides for a minimum number of three members of the board of directors as compared to the Commercial Code).

A supplementary pension asset management company is a *sui generis* joint stock company. This is for three reasons. Access to the business is linked to the obligation to obtain a relevant license, so the registration principle does not apply, but the authorisation principle is being applied for entry into the business. This also means that the party to the proceedings (the applicant for the license for the establishment and operation of a supplementary pension asset management company) is obliged to prove that the conditions laid down by law have been met. Another reason is the legal institute of the prior approval of the National Bank of

Slovakia. The legislator defines exhaustively in the Supplementary Pension Savings Act a range of acts whose execution is subject to prior approval of the National Bank of Slovakia. This legal institute constitutes a consensual expression of the will of the supervisory authority, the National Bank of Slovakia, to carry out a certain act, which is expressed in an individual administrative act, a decision of the National Bank of Slovakia. The last reason consists in interference in the form of an on-site or off-site supervision carried out in accordance with Act No 747/2004 Coll. on Financial Market Supervision and on Supplements and Additions to Certain Acts, as amended.

A supplementary pension asset management company carries out a specific object of business, the creation and management of supplementary pension funds for the purpose of carrying out supplementary pension savings, the change of which is *ex lege* prohibited. At the same time, it is clear from the ideas mentioned above, that where the legislator in the currently valid legislation speaks about the purpose in the form of performing supplementary pension savings, it expresses the specific mission of the commercial company.

We can therefore conclude that, in addition to making a profit, this joint stock company will also fulfil another purpose. Namely, raising the standard of living of individuals entitled to benefits. Therefore, we consider that the performing of this object of business is linked not only to commercial and financial law, but also to social security law.

Social security represents a set of legal, financial and organisational instruments and measures designed to compensate for or prevent the adverse financial and social consequences of various life circumstances and events that threaten recognised social rights.[13]It consists of social insurance, social support and social assistance.[14]

Ulrich Becker defines social security law as the branch of law that deals with the solution of social problems.[15]

Social security law is a branch of law that belongs to the structural unit of public law, but it also has private law elements. One of these is represented by supplementary pension saving.

In accordance with Article 15 of the Supplementary Pension Savings Act, the following benefits are paid from the supplementary pension savings under the conditions laid down in the normative legal act in question:

a) a supplementary old-age pension, in the form of
   1. lifetime supplementary old-age pension,
   2. a temporary supplementary old-age pension,

b) a supplementary retirement pension, in the form of

[13] GAJDOŠÍKOVÁ, Ľudmila.Charakteristika súčasného systému práva sociálneho zabezpečenia. Právny obzor 1997, 80 (4), pp. 453-461, p. 453.
[14] Ibid.
[15] RULAND, Franz, BECKER, Ulrich, AXER, Peter. *Sozialrechtshandbuch.* 7. Auflage. Baden-Baden: Nomos, 2022, 53, 978-3-8487-8638-1.

1. a supplementary retirement pension for life,
2. a temporary supplementary retirement pension,

c) a lump-sum payment,

d) a nearly withdrawal.

The ageing of the population is putting and will continue to put pressure on the financial sustainability of public pension schemes, regardless of the form of funding. Benefits from mandatory pension schemes will not be sufficient to maintain the living standards of pensioners. The need to financially stabilise public pension schemes will require their consistent universality and uniformity. This will mean, in addition to lower benefits, longer stays in the system. For some professions, this will be unaffordable or even impossible in the public interest. It can thus be said that we are moving towards a situation where public pension schemes are unable to finance the needs of specific job categories and are not flexible to the needs of the self-employed, and the number of people so affected is expanding enormously, with the constant development of hybrid working models, particularly in the post-covid phase.

From the above, then, we can derive four key meanings of a supplementary pension scheme:

a) Providing additional resources to finance the maintenance of an adequate standard of living for pensioners. The state needs to divest itself of its responsibility for the living standards of pensioners and transfer this to the future pensioners themselves and their employers.

b) Creating the possibility to individualise the pension scheme. The opportunity to be employed and perform a job in old age is individual. The pension system needs an element to allow early retirement or partial retirement and to cover cash shortfalls in phases until a 'basic scheme' solution is available for a particular individual. At the same time, this element, once the overall basic scheme is in place, should provide for even a partial increase in the pensioner's standard of living over and above the scope of the basic scheme benefits in the long term.

c) Exposure to harmful factors of work and the working environment limits the duration of certain occupations. The maintenance of the standard of living beyond this period has been transferred from the basic scheme to the supplementary scheme through compulsory employer contributions. However, it is questionable what contribution is sufficient (currently 2 % under the valid legislation).

d) The self-employed need a flexible instrument for building up pension savings, so that they can build them up according to the current economic situation.

In view of the abovementioned description of the current situation and the identified risks that we are already facing today and will only face more and more in the future in view of the negative demographic development, it is necessary to ensure the improvement of the system of supplementary pension savings

in Slovakia, which should take place, inter alia, through the following proposals for adjustments.

First of all, it is appropriate to talk about the extension of higher-level collective agreements. The basic motivating factor for an employee's participation in supplementary pension savings is the existence of an employer's contract and the employer's contribution, both in the current and in the expected setting. In order to extend the possibility of obtaining an employer's contribution to as many employees as possible, it would be advisable to make use of higher-level collective agreements, where an obligation on the part of employers to conclude employers' agreements for the entire sector for which the relevant higher-level collective agreement applies would be adopted.

This measure would have a significantly greater impact if it were possible to extend this collective agreement to all employers in the sector. This is a very effective solution that would ensure sectoral involvement of employers and their employees. This solution may also remove the limiting factor of low financial literacy in Slovakia, which reduces the penetration of voluntary retirement savings products in view of the lack of knowledge of pension law. Among other things, this regulation would be a logical continuation of the European Union's expectation of the continued development of[16] social dialogue[17] between employers and employee representatives (bipartite) and, where appropriate, the government (tripartite). De iure, it is primarily a modification of the legislation dealing with the institution of collective bargaining. Secondarily, however, it is also necessary to address the product-law implications in the legislation on supplementary pension savings, since the individual employee does not enter into a legal relationship by concluding a contract in accordance with the general rules of civil law, but by a decision of a third party - the representatives of the employer and the representatives of the employees' representatives. This solution thus also has implications for public law, particularly from the point of view of consumer protection, which raises the question of how the suitability and appropriateness of the choice of a particular pension fund for an individual employee will be dealt with.

A further extension of the product, and a related de lege ferenda consideration, arises from the specific approach to types of employment. In the case of so-called risk-based jobs, under current legislation the employer is obliged to provide an employer contribution of at least 2 % of the employee's assessment base. The condition is that the employee has concluded a contract with a supplementary pension asset management. It is clear that, despite the legal obligation on the part

[16] European Comission. Council Recommendationon Strengthening Social Dialogue in the European Union. [online]. 2023. [viewed 21 October2023]. Available from: https://ec.europa.eu/social/ BlobServlet?docId=26557&langId=en.

[17] Parliamentary Assembly. [online]. 2023. [viewed 21 October2023]. Available from: https://assembly.coe.int/nw/xml/XRef/Xref-XML2HTML-en.asp?fileid=23231&lang=en.

of the employer, which increases the social protection of specific groups of employees (so-called risk-takers, or persons who perform work in an employment relationship that is classified as third or fourth category of work difficulty in accordance with the provisions of Act No. 355/2007 Coll. on the protection, promotion and development of public health and on amendment and supplementation of certain acts, as amended).The employer's obligation to contribute to the employee is directly correlated to the employee's obligation to enter into a participation contract. However, this obligation is not explicitly stated and, even if some legal opinions claim otherwise, is not effectively legally enforceable. The authors are not aware of any decision of a governmental or public authority effectively imposing such an obligation on an individual in an employee position or imposing a sanction on such an individual for failure to conclude a participation contract. Again, in line with the previous proposal, the solution in this case would be to provide for automatic entry of such employees (risk-takers) into the system of supplementary pension savings. Also, here it is worth noting that the law needs to solve the application problems related to the replacement of the expression of will, but this process is already outlined in the legislative solution to the reform of the old-age pension savings system effective from May 1, 2023.

While the previous considerations were directed towards the intervention of the legislator in the process of clients' entry into the system, in view of the gradually increasing awareness of the need for individual pension provision, fully linked to merit, the authors find it necessary to share also the consideration of the extension of the system on the basis of voluntary entry into the system. However, this is determined by the motivation (preferably provided or mediated by the state) that the client receives for joining or, more precisely, entering and staying in the supplementary pension savings scheme. The state currently provides participants of supplementary pension savings with a tax relief of EUR 180 per year, which means that the contributions paid by the participant to the third pillar can be deducted from the tax base and the participant can save up to EUR 34.20 per year on tax. This option applies only to those participants who joined the scheme after 2014 or switched to the new terms and conditions. This extent of support also determines the choice and willingness of the citizen to enter the scheme and voluntarily give up part of their net income (after contributions and tax) for a period of time after retirement age. For comparison, the authors present recalculated[18] data of two philosophically and socio-economically comparable schemes in correlation to their support by, the state. The Czech Republic has, more than 70 % of the population enrolled while the cost to the state to support the system was approximately €220 million per year in 2016. Support for supplementary pension savings in Slovakia is approximately EUR 23 million per year (2016 cal-

[18] NEMEC, Michal.*Doplnkové dôchodkové sporenie neobrúsený diamant slovenskej dôchodkovej schémy*. Conference „Quo vadis 3. pilier“, Bratislava, status of October 18,2016.

culation) with approximately 30 % of potential participants. Another consideration following the identification of the problem is to change the logic of the state's provision of support to the system. This proposal significantly determines the impact of the proposed legislation on the state budget and therefore its most effective solution is subject to macro and microeconomic analyses and impact studies. However, two forms of support are evident in priority - direct, namely the state's contribution to the participant's paid contribution, and indirect in the form of tax relief. Both forms have been encountered in Slovakia; direct support has long been used for developing savings products, while indirect support has been used for other savings products (and is currently also used in supplementary pension savings). This modification is feasible with regard to the choice of a solution directly in the special regulation on retirement savings or in the regulation on taxation if it is an indirect support. In this context, it is also necessary to deal with situations where, through no fault or fault of the consumer, the product is terminated early before the pension entitlement. It is not appropriate and effective to elaborate on the details of the solution at this stage of the reasoning, as it will always be tied to the final chosen type of system support and the situation in which the solution needs to be applied (culpability, non-culpability, etc.). In direct connection with the previous consideration, a comprehensive assessment of the support system (and here also direct or indirect) and the implementation of further suggestions for improvement is appropriate. In particular, the abolition of the obligation to include the employer's contributions paid into the supplementary pension savings scheme in the income tax base of individuals (participants), the abolition of the tax burden on the payment of benefits and the abolition of the obligation to pay health insurance contributions on the contributions paid into the supplementary pension savings scheme. All of these proposals, as part of de lege ferenda considerations, are directly linked to the fiscal incentives of the employee and their employer. However, even with these incentive measures, it is necessary to ensure, whether in product regulation or through tax regulation and social security law, that they are applied in a way that is correlated with the fulfilment of the product's purpose, i.e. to cover the consumer's needs during their retirement. On the contrary, it is appropriate and even necessary to penalise abuse in order to protect the system itself and the principles on which it is based and which it represents.

In our de lege ferenda considerations, we also focus on extending the material scope of supplementary pension savings in order to introduce new types of benefits.

The first benefit is the so-called pre-retirement pension. The currently debated topic is the determination of the retirement age limit. In recent years, legislation has alternated between anchoring the retirement age in a precise number (fixed age) and linking it by a formula to life expectancy, which is gradually increasing, which inevitably means an increase in the retirement age. On the other hand, however, there are natural factors limiting the retirement age, namely the

state of health linked to physical or mental wear and tear at the long end, determined by disability. In order to avoid unwanted excessive wear and tear on the human body or mind in this context, we propose, as part of de lege ferenda considerations, to consider the introduction of the institution of a pre-retirement pension.

The pre-retirement pension should be a benefit covering the social risk of pre-retirement unemployment or gradual retirement. It is therefore intended for persons of pre-retirement age who can no longer, or cannot be employed in the labour market, but also for participants who voluntarily and on the basis of subjective reasons decide to leave the labour market before the moment of reaching retirement age. The pre-retirement pension is therefore intended to help participants who, for various reasons, in particular health reasons, cannot work full-time and who, in the period up to the retirement age required to qualify for an old-age pension or early retirement pension, are no longer able to benefit from other institutions of social security law (such as unemployment benefits). The proposal for the pre-retirement pension benefit is based on a proposal[19] already introduced in the 2016-2020 electoral period, according to which a participant could start receiving the pre-retirement pension no earlier than five years before the retirement age, while at the time of application the monthly pre-retirement pension payment must be at least 136% of the minimum subsistence level, while at the same time it cannot be higher than the maximum amount of the unemployment benefit. However, a further economic prerequisite is that the amount saved must be sufficiently high to enable the participant to continue receiving the pre-retirement pension until retirement age or, as the case may be, until the participant reaches the age required to qualify for an early retirement pension.

The second benefit is the supplementary allowance for spa care. In a broader sense, the primary purpose of supplementary pension savings is primarily to increase income at a time when an individual ceases to be economically active. In particular, the supplementary old-age pension benefit, by its very nature, represents a kind of "remediation" of a loss of income. Its aim is to raise the standard of living. In this context, it seems appropriate to point out that an increase in the standard of living can be viewed not only through the prism of disposable income, but also the health status of the individual. How "fit" an individual is at the time of entitlement to benefits is also an essential aspect of the individual's quality of life. The approach to health protection should respect several principles:

- the principle of equality for all, transparency (reducing social inequalities in the provision of health care, information on health measures must be clear, simple and understandable for all citizens),

[19] Government of the Slovak Republic. Meetings of the Government of the Slovak Republic.Draft Act amending Act No. 650/2004 Coll. On Supplementary Pension Savings and Amending and Supplementing Certain Acts, as amended, and by which certain acts are being amended and supplemented [online]. 2017. [viewed 21 October2023]. Available from: https://hsr.rokovania.sk/1717 92017%E2%80%93m_opva/?csrt=17176178771473135320.

- principle of cross-cutting across all policies and integrity (public health actions should be organised and developed within an integrated health system concept),
- also, the principle of safety and precaution (public health measures will be implemented after they have been verified as safe from a health point of view.[20]

Health care, among other things, contributes to this. Health care is also provided pursuant to Act No. 577/2004 Coll. on the Scope of Health Care Reimbursed under Public Health Insurance and on Reimbursement for Services Related to the Provision of Health Care, as amended (hereinafter referred to as "Health Care Scope Act"). Health care is a set of professional processes carried out by a health care provider, primarily through the activities of health care professionals, which is composed of individual health care interventions, the indication and implementation of which are decided on behalf of the provider by the attending health care professional.[21] In accordance with Article 7 of the Health Care Scope Act, spa care is fully or partially reimbursed under public health insurance if it follows on from previous outpatient health care or inpatient health care. Spa care is health care provided in natural health spas and health resorts.

Pursuant to Article 7(4) of the Health Care Scope Act, the provision of spa care is approved by the relevant health insurance company on the proposal of a medical doctor and on grounds of individual indications which are specified in a list pursuant to Article 7(3) of the Health Care Scope Act. Pursuant to Article 7 (3) of the Health Care Scope Act, the diseases for which spa care is fully or partially reimbursed by public health insurance, the indication conditions and the length of the treatment stay are specified in the Indication List for Spa Care, which forms Annex 6 to the Health Care Scope Act.

In general, spa care represents a set of specific infrastructure and human resource activities focusing on techniques and procedures to remedy various somatic, psychosomatic and psychological problems.[22]

In our opinion the entitlement to the benefit (supplementary allowance for spa care) should be a combination of two conditions, namely a minimum number of years in which the individual has been a participant in supplementary pension savings and the approval of the spa treatment in group B by the health insurance company.

Spa care, which, as the above definition implies, is the removal or reduction of various somatic or psychosomatic complaints. A participant should be en-

[20] ŠEVCOVÁ, Katarína.Zákon o zdravotnej starostlivosti, službách súvisiacich s poskytovaním zdravotnej starostlivosti. Komentár. Žilina: EUROKÓDEX, 2019, 3, 978-80-8155-088-1.
[21] HUMENÍK, Ivan, KOVÁČ, Peter et al.*Zákon o zdravotnej starostlivosti. Komentár*. 2. vydanie. Bratislava: C. H. Beck, 2023, 13, 978-80-8232-027-8.
[22] KEREKEŠ, Juraj. *Kúpeľníctvo a jeho význam v turizme.* Bratislava: Weltprint, 2018, 32, 978-80-973035-1-8.

titled for this category of benefit in the medium term, i.e., after having participated for a minimum of five years. During the period of time in question, sufficient funds will have been accumulated and appreciated for the benefit in question to provide the participant with the level of care required and necessary.

Another condition that cumulatively adds to the minimum number of years in which an individual has been a participant in a supplementary pension savings plan is the approval of spa care in group B. The health insurance company of an insured person who will go for spa treatment in group B covers exclusively medical care in a spa. The costs of accommodation, meals must be paid by the insured person. Accommodation and boarding costs are reimbursed by the insurer only in the case of spa treatment in group A. This implies that the individual must accumulate funds to some extent before receiving spa treatment. The fact that the health insurance company has approved the "group B - spa treatment" demonstrates that the medical condition requires this type of stay. In practice, a situation could potentially arise in which an individual lacks the available assets for accommodation and food. This will result in a subjective inability to participate in a stay in which spa care should have been provided. In this connection, we would point out that the existence of a supplementary allowance for spa care would constitute a set of legal rules regulating the provision of funds. A new incentive for participation in the third pillar would be created for individuals who have not yet concluded a supplementary pension savings contract. This is because they would be able to view participation in supplementary pension savings as a form of saving for spa care that they will possibly need in the future.

A benefit in the form of a supplementary allowance for spa care, which would result in an extension of the material scope of supplementary pension savings, would improve the quality of life of the individual. The benefit in question is, by its very nature, consistent with the purpose of supplementary pension savings, which is to provide supplementary income. In this case, it would be supplementary income with the aim of improving the health of the participant in the supplementary pension savings scheme.

In this context, it seems appropriate to state why we abstract from the age requirement and do not mention it in the *de lege ferenda* considerations. Each individual's state of health is different. It is not possible for an individual to define, at what age he or she will need spa health care. If the contribution from the supplementary pension scheme to cover the costs of spa care is to act as a reason for entering into a participation contract, the introduction of an age limit would, in our view, constitute an obstacle to motivation.

Another condition that cumulatively adds to the minimum number of years in which an individual has been a participant in a supplementary pension savings plan is the approval of spa care in group B. The health insurance company reimburses the insured person who goes for spa care in group B exclusively for medical care in. The costs associated with accommodation and meals are borne by the insured person. Reimbursement of accommodation and boarding costs is

reimbursed by the health insurance company only in the case of spa care in group A. This implies that the individual must accumulate funds to some extent before receiving spa care. Similarly, the fact that the health insurance company has approved group B spa care demonstrates that the medical condition requires this type of stay. In practice, a situation could potentially arise in which an individual lacks the available assets to pay for board and lodging. This will result in a subjective inability to participate in a stay in which spa care should have been provided. A new incentive for participation in the third pillar would be created for individuals who have not yet concluded a participation contract. This is because they would be able to view participation in supplementary pension savings as a form of saving for spa care.

The benefit in question is, by its very nature, consistent with the purpose of supplementary pension savings, which is to provide supplementary income. In this case, it would be supplementary income with the aim of improving the health of the participant in the supplementary pension savings scheme. This will enable them to be in better health at the time of entitlement to further benefits from supplementary pension savings.[23]

In this context, it seems appropriate to state why we abstract from the age requirement and do not mention it in the de lege ferenda considerations. Each individual's state of health is different. It is not possible for an individual to define, even by guesswork, at what age they will require health care at a spa. If the contribution from the supplementary pension savings to cover the costs of spa care is to act as a reason for entering into a participation contract, the introduction of an age limit would, in our view, constitute an obstacle to motivation.

In relation to the method of calculating the amount of the supplementary allowance for spa care, we believe that a provision should be incorporated into the legislation stipulating that the supplementary allowance for spa care will be provided in the amount of the actual proven costs of stay and food during the provision of spa care in group B, but not more than EUR 1 000. We are also in favour of making it possible to apply for the supplementary allowance for spa care for the first time after five years have elapsed from the date of first participation in supplementary pension savings, as already mentioned. Any further requests contribution could be claimed after five years from the date of entry into group B spa care. This is justified by the fact that the primary and key purpose of supplementary pension savings is to provide supplementary income in old age, which is essential for long-term asset appreciation. This could not be achieved by

[23] Although in thiscasetherewouldbe a linkbetweentheprovision of a financial and a non-financialservice, wecannotspeak of a so-calledtying of products. For more detailsseeWINKLER, M.: LegalRegulation of Cross-Selling of Financial and Non-FinancialProducts. In.: Červenka, P., Hlavatý, I., Škvarčeková, O. (eds.) *Trends and Challenges in theEuropean Business Environment: Trade, International Business and Tourism [elektronický zdroj] : Proceedings of the 6th International Scientific Conference, October 17 - 18, 2019 (Mojmírovce, Slovak Republic)*, EKONÓM, 2019, p. 467-476.

continuously drawing funds from a personal pension account.

A final consideration related to the improvement of the voluntary pension savings scheme is the modification of the participation of self-employed persons in the scheme. In general, in social security law, a self-employed person is both an employer and an employee. The consequence, then, is a levy structure that covers both substantively and fiscally both positions of such a person. However, this so-called duality is not subsequently reflected in the other spectrum of legislation, here specifically in the voluntary pension savings scheme. The question is then whether such a system, on the one hand imposing obligations on both the employee and the employer but, on the other hand, providing only the benefits of one of them, is not direct discrimination. The de lege ferenda consideration is thus to adjust the set-up of the system (not only on the product side, but also on the tax and levy side) so that a self-employed person can benefit from both types of relationships if they are already at the other end of an obligation similar again to both types of relationships. The regulation itself would be legislatively simple, as we would create a legal definition of a self-employed person for the purposes of the special regulation by combining the existing definitions of employee (participant) and employer.

CONCLUSION

The Supplementary Pension Savings Act represents one of the results of the pension reform in the Slovak Republic. Since its entry into force, the normative legal act in question has been amended relatively frequently. Despite the legislator's efforts to motivate people to participate in supplementary pension savings, there is still potential to increase the number of clients of supplementary pension asset management companies.

The authors present a set of de lege ferenda proposals focusing on regulatory changes that could potentially increase participation in supplementary pension savings.

First of all, it is appropriate to talk about the extension of higher-level collective agreements. The basic motivating factor for an employee's participation in supplementary pension saving is, in today's and in the future, the existence of an employer's contract and the contribution of their employer. In order to extend the possibility of obtaining an employer's contribution to as many employees as possible, it would be advisable to make use of higher-level collective agreements, where an obligation on the part of employers to conclude employers' agreements for the entire sector for which the relevant higher-level collective agreement applies would be adopted.

Secondly, an extension of the material scope of supplementary pension savings could be introduced. This could take the form of two new benefits, the pre-retirement pension and the supplementary allowance for spa care. The pre-retirement pension should be a benefit covering the social risk of pre-retirement

unemployment or phased retirement. It is therefore intended for persons of pre-retirement age who are no longer able or unable to participate in the labour market, but also for participants who voluntarily and on the basis of subjective reasons decide to leave the labour market before the moment of reaching retirement age.

The inclination of the spa industry towards health care or tourism is not unambiguous, therefore it should be seen as an intersection of both fields of economic activities within health tourism, however, it is possible to express the hypothesis that with the continuous limitation of health insurance funds for spa medical care, the Slovak spa industry will show a higher inclination towards spa tourism, which is also the direction of the current European spa industry.[24] In this context, we note that the reduction of the funds spent by health insurers could also create an opportunity to extend the material scope of supplementary pension savings to a new type of benefit (the supplementary allowance for spa care).

Another consideration de lege ferenda has introduced a solution how to provide forthe increase in the number of clients of supplementary pension asset management companies. It is the automatic entry of employees perfoming risk-based jobs into the supplementary pension saving scheme.

An impressive incentive can also be seen in the abolition of the obligation to include the employer's contributions paid into the supplementary pension savings scheme in the income tax base of individuals (participants), in the abolition of the tax burden on the payment of benefits and in the abolition of the obligation to pay health insurance contributions on the contributions paid into the supplementary pension savings scheme. A final consideration related to the improvement of the voluntary pension savings scheme is the modification of the participation of self-employed persons in the scheme.

A common feature of all de lege ferenda considerations and proposals is the fact that the responsibility for increasing income in post-productive age is to be transferred from the state to the individual. To this end, systematic education and raising the financial literacy of the population is necessary so that people come to realise that they can still influence and increase their income in retirement while they are still economically active, by participating in supplementary pension savings.

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Modernising payment services and enhancing open banking: a comparison of recent EU proposals of payment services directive 3 (PSD3) and payment services regulation (PSR) with current PSD2

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Abstract: *The article provides a comparative analysis of the fundamental developments of the recently published EU Financial Data Access and Payments Package. It focuses on the comparison of the proposal of the Payment Services Directive 3 (PSD 3) and a new Payment Services Regulation (PSR) with the current PSD2. Among the main features, the European Commission promises improvements mainly in the protection of Payment Services Users and also in the area of competitiveness in the financial sector. Besides PSD3, the new PSR, which will be directly applicable in the whole EU, will tackle forum shopping by increasing the harmonisation in different Member States. Regarding competitiveness, the proposed framework aims to increase competitiveness by further enhancing open banking with a dedicated interface (API) for exchanging information between market players and providing users with dashboards to monitor and manage their consent with data sharing easily. However, the proposed framework repeals some PSD2 exceptions and imposes unnecessary administrative burden on specific types of businesses, such as foreign exchange services or limited networks, or fails to include sufficient temporary provisions allowing for uninterrupted operations. The article presents a critical discussion of proposed changes and their potential impact on practice. The new framework is just at the beginning of the legislative process, and the finally approved PSD3 and PSR are expected to be applicable in 2026 at the earliest.*

Keywords: *consumer protection, open banking, open finance, payment services, PSD3, PSR.*

INTRODUCTION

The European Commission published on 28 June 2023, a package of legislative proposals[1] with the aim of modernising the payment services, ensuring a more robust protection of Payment Services Users and increasing the competitiveness between the various market players. This Financial Data Access and Payments Package consists of three files. First, a proposal for a Regulation on a

[1] EUROPEAN COMMISSION. Financial data access and payments package. *European Commission*[online]. 2023 [viewed 7 October 2023]. Available from: https://finance.ec.europa.eu/publications/financial-data-access-and-payments-package_en.

framework for Financial Data Access (FIDA Regulation)[2] brings a new framework for managing the sharing of financial data for boosting financial innovation and enabling new services for clients, such as a single dashboard with all the financial data of the customer. Second, a draft of the Payment Services Directive 3 (PSD3)[3] brings significant enhancement, especially in stronger consumer protection or fairer competition between banks and non-banks. Finally, the new Payment Services Regulation (PSR)[4], which aims to tackle the different status of reinforcement of the obligations arising from the current Payment Services Directive 2 (PSD2)[5] in different Member States, and to set a harmonised playing field in whole the EU. The last two proposals jointly form a new regulatory framework for payment services, and thus, this article cannot omit either of them.

The research question of this article reads as follows: "How do PSD3 and PSR compare to PSD2 in modernising EU payment services, promoting open banking and addressing emerging challenges, and what are the implications of this new regulatory framework for stakeholders?"

The article builds on the comparative legal analysis and focuses on the comparison of two recent EU legislative proposals with the current regulatory framework governing payment services since 2018.

1. PROPOSAL OF PAYMENT SERVICES DIRECTIVE

According to the research, the national differences related to the implementation of PSD2 mean a problem in the common EU market, and some authors called for the revision of the PSD2 to tackle these national differences in a very connected payment services market.[6] Also, the European Commission has recently published a report on the application of PSD2, where it found such national

[2] EUROPEAN COMMISSION. Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on a framework for Financial Data Access and amending Regulations (EU) No 1093/2010, (EU) No 1094/2010, (EU) No 1095/2010 and (EU) 2022/2554. European Commission [online]. 2023 [viewed 7 October 2023]. Available from: https://eur-lex.europa. eu/legal-content/EN/TXT/?uri=CELEX:52023PC0360.

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[6] STEENNOT, Reinhard, and Maria Raquel GUIMARÃES. Allocation of Liability in Case of Payment Fraud: Who Bears the Risk of Innovation? A Comparison of Belgian and Portuguese Law

inconsistencies in the application of PSD2 provisions and uneven playfield for banks and non-banks.[7] Therefore, the Commission has decided to move the rules directly applicable to Payment Services Providers (PSPs) in all Member States from the current PSD2 and incorporate them into a new directly applicable PSR Regulation to enhance the harmonisation. The major changes are as follows:

1.1. Merge of Electronic Money Institutions (EMIs) with Payment Institutions and re-authorisation of current market PSPs and EMIs

According to the proposal of PSD3, the regulation of Electronic Money Institutions[8], as well as Payment Institutions, will be merged into the new PSD3 and the current Electronic Money Directive (EMD2)[9] will be repealed. According to PSD3, only Payment Institutions will be allowed to issue electronic money.

The proposal of PSD3 states that the current PSPs and EMIs need to undergo a re-authorisation, which might be granted by national regulators to the current PSPs automatically, given that the PSD3 requirements are met. The applicants for authorisation will have to provide various documents to the regulator, including increased capital requirements or winding-up plans (Art. 3 of PSD3). The author does not find it efficient and necessary to force new re-authorisation of all institutions licenced under PSD2 and suggests including more favourable temporary provisions for existing market players, allowing for uninterrupted operations, given they comply with PSD3 obligations.

1.2. Direct access to payment systems for PSPs

In response to the complaints of market players and following the result of its own study, the European Commission concluded that the unequal position between banks and non-banks in the market also persists in the area of access to payment systems. Therefore, the European Commission addressed it by introducing the right for PSPs to use direct access to payment systems instead of indirect access (Art. 46 of PSD3, which modifies the Settlement Finality Directive

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(SFD),[10] and Art. 31 of PSR). The European Commission claims it needs to solve the uneven playfield, so it includes only 6 months for national transpositions (Art. 49 of PSD3). According to the author, this time frame is extremely short and insufficient in practice, given the length of legislative processes in various Member States.

1.3. Changes in safeguarding of client funds

Aligned with the fundamental principles of (prudential) financial regulation, PSD3 tries to eliminate the still possible high concentration risk by stipulating that PSPs shall avoid concentration risk from depositing all client funds into a single bank and forcing them to diversify (Art. 9(2) of PSD3). Unlike under the current PSD2, the new framework also allows the companies to hold safeguarded funds at a central bank or permits these funds to be invested in specific low-risk assets according to the decision of the national regulator.[11] The framework also allows the safeguarding of client funds by using a guarantee or insurance policy. Despite the fact that PSD3 offers multiple methods of protection of client funds, the new requirement on usage of multiple safeguarding methods seems quite challenging, according to the author, as it is questionable whether payment institutions will be able to open accounts with multiple credit institution (given that guarantees or insurance policies are not widely offered in all Member States).

2. PROPOSAL OF PAYMENT SERVICES REGULATION

As discussed above, the European Commission aimed at a stronger harmonisation of the rules governing the payment services, which are currently regulated by the PSD2 Directive, and prepared a directly applicable legal instrument – PSR Regulation, where such provisions of PSD2, which are directly applicable on PSPs, were shifted. However, the main substantive changes in the PSR regulatory framework are as follows:

2.1. Enhancement of Strong Customer Authentication (SCA)

As already suggested during the assessment of the PSD2 application, some technical and organisational improvements related to SCA were desirable.[12]

[10] Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems.

[11] RANK, Pim, and Matheus TOMÉ. PSD2 and the safeguarding of clients' funds: a comparative analysis with respect to funds of payment service users in the Netherlands and Brazil. Journal of International Banking and Financial Law [online]. 2020, 2020(October) [viewed 3 October 2023]. ISSN 0269-2694. Available from: https://scholarlypublications.universiteitleiden.nl/.

[12] KOTÁB, Petr, Jiří MORAVEC, and Jan ŠKRABKA. TRANSPOSITION OF PSD2 INTO CZECH LAW. In: Gabriella GIMIGLIANO and Marta BOŽINA BEROŠ, eds. The Payment

The PSR proposal mandates the Account Information Service Providers (AISPs) to conduct their own initial SCA and subsequent SCAs at least every 180 days (Art. 86 of PSR). Moreover, PSR also aims to effectively enable SCA also for clients with disabilities or other vulnerable clients without access to digital channels. Some of the rules included in regulatory technical standards (RTS) related to SCA, which are currently issued by EBA, were also moved directly into PSR; however, the European Banking Authority (EBA) is obliged to issue new RTS on various technical details of the PSR proposal, including on SCA (Art. 89 of PSR).

2.2. Increased protection of customers

Some authors describe the relationship between the current payment services regulatory framework (PSD2) and data protection (GDPR) as poor coordination with legal loopholes or even as a *Gordian legal knot*.[13] However, this situation changes with the proposed framework, where PSR solves these data protection issues to keep the client's data safe.

The proposal of PSR not only supports Third-Party Payment Providers (TPPs) but also extends the current obligation to provide users with permission dashboards, where they can easily monitor and manage their data-sharing options easily. In order to simplify the process for clients, changes to their data-sharing settings will have to be handled with TPPs by PSPs (Art. 43 of PSR).

Similar to the proposed revision of the Regulation as regards instant credit transfers in euro,[14] PSR introduces mandatory IBAN-Name checks to enhance the security of clients and their payments.

Unlike the PSD2, which forbids surcharges (checkout fees in case of a specific type of payment) for card payments in any currency but only for direct debits or credit transfers in euro (e.g. SEPA payment),[15] the PSR proposal bans this practice altogether for any currency (Art. 28 of PSR).

Services Directive II [online]. Edward Elgar Publishing, 2021, pp. 282–303 [viewed 8 October 2023]. ISBN 978-1-83910-567-8. Available from: doi:10.4337/9781839105685.00029.

[13] FERRETTI, Federico. Open Banking: Gordian Legal Knots in the Uncomfortable Cohabitation between the PSD2 and the GDPR. European Review of Private Law [online]. 2022, 30(Issue 1), 73–102 [viewed 7 October 2023]. ISSN 0928-9801. Available from: doi:10.54648/erpl2022004.

[14] EUROPEAN COMMISSION. Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Regulations (EU) No 260/2012 and (EU) 2021/1230 as regards instant credit transfers in euro. *European Commission*[online]. 2022 [viewed 7 October 2023]. Available from: https://eur-lex.europa.eu/legal-content/EN/.

[15] GIMIGLIANO, Gabriella. TITLE IV, 'RIGHTS AND OBLIGATIONS IN RELATION TO THE PROVISION AND USE OF PAYMENT SERVICES', CHAPTER 2 'AUTHORISATION OF PAYMENT TRANSACTIONS' (ARTS 64-77). In: Gabriella GIMIGLIANO and Marta BOŽINA BEROŠ, eds. The Payment Services Directive II [online]. Edward Elgar Publishing, 2021, pp. 145–161 [viewed 5 October 2023]. ISBN 978-1-83910-567-8. Available from: doi:10.4337/97818391 05685.00019.

Finally, PSR aims to significantly limit the risk of fraud by improving the current transaction monitoring by mandatory fraud data exchanges between PSPs (Art. 83 of PSR). Statistical data on frauds will have to be reported to national regulators, and PSPs will have to inform their users of new trends in fraud, fraud prevention and appropriate countermeasures (Art. 84 of PSR).

2.3. Measures for increasing the competition in the market and supporting Open Finance

In order to establish more equal conditions and enhance Open Finance, the PSR draft aims to simplify data exchange by introducing a new obligation for PSPs to offer a dedicated interface for open banking data access, which can be helpful, especially for FinTech players offering innovative data-driven services (in general for TPPs) (Art. 35 of PSR). Some specialised PSPs will be offered an exemption from this general rule under the conditions specified by EBA in the future. On the other hand, the current obligation of PSPs on a mandatory fallback interface is removed, which can also help to reduce the security concerns associated with it.[16] Finally, the existing obligation not to discriminate against financial institutions (FIs) in the opening of their bank accounts or access to payment systems is extended to FIs in the licensing process and to the offboarding process of FIs and also holds on payment institution's agents and distributors. This does not mean that FIs cannot be refused the opening of accounts, but such refusal must always be substantiated with specific, compelling reasons and provided in writing (Art. 31 of PSR). However, the practical impact of this provision is rather unclear. Even under current regulation, banks cannot discriminate regarding access to payment accounts, and yet, in practice, many FinTech companies face significant problems with opening bank accounts.[17]

3. CHALLENGES OF THE PROPOSED PSD3 AND PSR FRAMEWORK AND THE NEXT STEPS

Despite the aforementioned significant changes, the European Commission labels published Financial Data Access and Payments Package as an evolution, but not a revolution;[18] it indeed aims to address some of the main challenges

[16] WOLTERS, P. T. J., and B. P. F. JACOBS. The security of access to accounts under the PSD2. Computer Law & Security Review [online]. 2019, 35(1), 29–41 [viewed 7 October 2023]. ISSN 0267-3649. Available from: doi: 10.1016/j.clsr.2018.10.005.

[17] BORGOGNO, Oscar, and Giuseppe COLANGELO. Data, Innovation and Competition in Finance: The Case of the Access to Account Rule. European Business Law Review [online]. 2020, 31 (Issue 4), 573–610 [viewed 7 October 2023]. ISSN 0959-6941. Available from: doi:10.54648/eulr2020023.

[18] DOMBROVSKIS, Valdis. Remarks by Executive Vice-President Dombrovskis and Commissioner McGuinness on financial data access and payments. European Commission [online]. 2023 [viewed 7 October 2023].

of the current payment services regulatory framework. However, there are still certain problematic areas which are not solved by the upcoming PSD3 and PSR framework.

First, as we learnt from the significantly delayed publication of the RTS in connection to PSD2, the delay caused a decrease in security because PSPs had to comply with strict security measures on strong customer authentication only after the publication of the RTS (Art. 115 of PSD2).[19] Therefore, timely preparation of regulatory technical standards by EBA is also crucial in the case of a new regulatory framework (e.g. Art 30 of PSD3 or Art. 89 of PSR).

Second, a necessary preparation of all relevant stakeholders, especially financial institutions, for the implementation of the new regulatory framework will be a rather costly process. Significant compliance costs are mainly related to the changes in IT or processes. Moreover, the proposals impose an unnecessary administrative burden and reporting obligations on some market players, such as on limited networks or foreign exchange services.

Third, the recital of PSD3 states that "*buy now pay later" service (BNPL)* is not a payment service, but the legislative text does not include this explicit exception. However, the author suggests providing rather a narrow exception in the legislative text of PSD3 only for one-time BNPL, which does not provide users with payment accounts or payment cards.

Regarding the next steps of the Financial Data Access and Payments package, the European legislative process of the proposed directives and regulations will likely bring some amendments. This new regulatory framework is expected to be completed by the end of 2024, provided that the European Parliament elections in 2024 do not delay the process. Once the legislative package is approved, Member States will have 18 months for the transposition; thus, the new framework will be applicable in 2026 at the earliest.

CONCLUSION

This article critically analyses the recent proposal of the EU Financial Data Access and Payments Package, comprising both PSD3 and PSR, which will be applicable no earlier than 2026.

Despite that the European Commission labels the EU Financial Data Access and Payments Package as an evolution but not a revolution, the paper has proven that PSD3 and PSR bring a significant number of improvements compared to PSD2, which are beneficial not only for clients but also mainly for FinTech companies or generally non-bank players. According to the research, the adoption of PSD2 unlocked the market potential and caused a rapid surge of new

[19] WOLTERS, P. T. J., and B. P. F. JACOBS. The security of access to accounts under the PSD2. Computer Law & Security Review [online]. 2019, 35(1), 29–41 [viewed 7 October 2023]. ISSN 0267-3649. Available from: doi: 10.1016/j.clsr.2018.10.005.

FinTech companies, especially when it was accompanied by offering regulatory sandboxes.[20] According to the author, this trend will continue as the new regulatory framework in the EU Financial Data Access and Payments Package will also likely bring a number of new innovative market players.

The analysis revealed that the majority of proposed modifications in PSD3 and PSR only elaborate on the existing legal institutes used in PSD2 and broaden their scope, simplify and improve the functioning of payment services for customers, or enhance the regulatory environment to allow more equitable competition between banks and non-banks. However, the proposals also impose unnecessary administrative requirements on some market players or require a mandatory re-authorisation of payment institutions, which are not the necessary steps, according to the author.

This article analyses the published proposals of PSD3 and PSR, which are likely to change during the EU legislative process. Once the final versions of PSD3 and PSR are approved, a detailed study of the new regulatory framework and the impact of the changes on the payment services and all stakeholders will be essential.

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