Conference proceedings
15th International Scientific Conference

"Law in Business of Selected Member States of the European Union"

October 25–27, 2023, Prague, Czech Republic

Nicole Grmelová
(editor)

NAKLADATELSTVÍ OECONOMICA

Prague University of Economics and Business
Faculty of International Relations
Department of Business and European Law

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Foreword

Dear Ladies, Dear Gentlemen,

These conference proceedings constitute a selection of 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 between 25 and 27 October 2023. The conference hosted participants from all across Europe (Germany, Poland, Turkey, Slovakia, Spain, Hungary, Latvia, Lithuania, Belgium, and the Czech Republic). The conference was held in a hybrid format, being streamed online for those who could not join the conference venue in person and to reach a wider audience. All papers passed double blind peer review and were checked for their originality using the iThenticate software developed by Turnitin kindly provided by the Prague University of Economics and Business. Unlike the conference events held in the past years, this conference has grown much more sustainable. Plastic water bottles were replaced by glass packaging; hence no plastic was produced during the entire conference event.

The conference has been supported by the Internal Grant Agency Project No. 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.

The conference organizers will be happy to welcome both international academics and practitioners to the 16th conference to be held in 2025 in Prague. For more information on the call for papers for the upcoming conference please check the conference webpage at https://lawinbusiness.vse.cz/.

On behalf of the Scientific and Organizational Committee of the conference I would like to wish you an enjoyable read and inspiration for your own research.

Nicole Grmelová

Chair of the Scientific Committee of the Conference

Comparative study of the Czech and Maltese SICAV structure

JUDr. Ing. Jana Brodani, Ph.D. LL.M. (Lon)

Abstract: *Investments funds' sector is strongly regulated on the European level. There are some European laws, which may be considered as a success even on a global scale, which allowed the European open-ended mutual funds to be recognized as a brand worldwide. However, most of the local success stories are brought by the local developments. In many countries it is the local rules that play the key role in shaping the competitiveness of the local market. Most obvious success story of the SICAV introduction may be seen in Luxembourg, which became one of the global financial centres mainly based on the favourable regulation of investment funds, including the availability of SICAV structure. However, there are also other jurisdictions, where SICAV made a significant contribution to the development of the local market. Amongst these jurisdictions, there are also Malta and the Czech Republic. This article examines how the basic features of SICAVs are incorporated in the local laws. Basic features of SICAV legislation were chosen and compared in the Czech Republic and Malta. Most similarities are a result of a structuring of SICAVs as investment entities for investors, such as redemptions, capital raising and SICAV structuring. Some differences are on the way how SICAVs are incorporated in the company law or in the special investment law. The use of abbreviation from a French language "SICAV" is enabled in both countries. There are also some specific features in each regulation adapting the local regulation to the needs of the use of their investors.*

Keywords: *SICAV, joint-stock company with variable capital, taxation, investment fund, capital market, investments, competitiveness*

INTRODUCTION

Investments funds' sector is strongly regulated on the European level. There are some European laws, which may be considered as a success even on a global scale, such as UCITS Directive (The Undertakings for Collective Investment in Transferable Securities Directive)[1], which brought common European regulation for the open-ended mutual funds and which allowed the European open-ended mutual funds to be recognized as an UCITS brand worldwide. Despite this type of regulation, most of the local success stories are brought by the local developments. In many countries it is the local rules that play the key role in shaping the competitiveness of the local market.

Most obvious success story of the SICAV introduction may be seen in Luxembourg, which became one of the global financial centres mainly based on the favourable regulation of investment funds, including the availability of SICAV structure. As one of the key legal practitioners in the global fund jurisdiction of Luxembourg notes: *"Investment funds soon became an integral part of Luxembourg´s investment scene, helped by a flexible and robust*

[1] Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities ("UCITS Directive")

legal and regulatory environment, attractive tax treatment, and the steadily growing expertise of local providers." [2]

One of the examples of the local developments are the types of the structures available as the legal form of an investment fund. Amongst these, the prominent role in Europe belongs to so-called SICAV (joint-stock company with variable capital). This article examines two jurisdictions, where SICAV structure plays an important role: Malta and Czech Republic, bringing an international perspective based on the consideration of the Maltese and Czech laws on SICAV.

In order to provide this comparison, the concept of SICAV is introduced, followed by defining the main regulatory features to be compared in both jurisdictions and analysing these features in detail based on the Maltese and Czech regulations. The analysis brings a practical insight into practical functioning of SICAV as an investment structure in Malta and Czech Republic.

1. DEFINING THE SICAV

In legal theory, as the structure of a SICAV is considered an open-ended type of investment structure. The abbreviation SICAV is based on the French name "*société d'investissement à capital variable*". The widespread use of this structure in Luxembourg as a global investment fund centre, where investment funds from all over Europe and the world are domiciled, contributed to the expansion of this abbreviation and its wider use in a number of jurisdiction, even the non-French speaking countries such as Czech Republic and Malta.

The name itself indicates three basic conceptual features of SICAV:

- Legal personality ("société")
- Investment vehicle (d'investissement)
- Variable capital ("à capital variable")

"JSCVC is a joint stock company in which the capital and shares vary by new entrance or withdrawals of stockholders or by lapse of time through changing sharing proportions because of changes in shares' durations. Amount of nominal capital of the company at any point of time is calculated by summing up the nominal values of the shares of shareholders at that time, but company's yields are distributed by time-duration weighted of the shares."[3]

"In the most general sense, a SICAV can be understood as a legal entity used for investments, whose capital is variable. Variability of capital is a condition for easy raising of capital for investment, as well as for simple redemption of securities issued by the fund from investors. Legal personality is important for setting the mutual rights of an investor and a professional manager, but especially for a clear definition of its tax status".[4]

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[2] KREMER, Claude. *Collective investment schemes in Luxembourg: Law and practice*. Oxford: Oxford University Press, 2009, p.6, ISBN 9780199559763.

[3] BIDABAD, Bijan. "Joint stock company with variable capital (JSCVC)." *In: International Journal of Law and Management* 56 (2014): 302–310.

[4] BRODANI, Jana. Comparative Study of the Basic Features of the Czech Legal Regulation of a Joint-Stock Company with Variable Registered Capital (SICAV) with Foreign Regulation of the SICAV Structure in Slovakia. *In: Obchodněprávní revue* 13(3) (2021), 171–174. ISSN 1803-6554.

2. FEATURES OF SICAVS COMPARED IN MALTA AND CZECH REPUBLIC

Even though the three common features of SICAVs are repeating in various jurisdiction, the key for success is usually hidden in the details of the regulation and in their settings which offer the benefits to investors and fund managers. When examining different approach to SICAV regulations in different jurisdictions, it is important to establish comparative factors that will allow comparison of individual modifications based on the isolation of the essential attributes of individual legal forms in the examined legal systems. The scope of this article does not provide sufficient space for a detailed examination of private law in the jurisdictions under review, nor would such detailed examination bring significant benefits to this article.

For the comparison, the following criteria were set and defined on the basis of a detailed examination of the advantages and disadvantages of an investment fund in a form of regular joint-stock company with a legal personality and a mutual fund as a sum of assets without legal personality. These features were examined in detail in an individual academic paper based on the experience with previous Czech legislation (which did not contain the SICAV structure[5]. These features were subsequently investigated in selected jurisdiction and are shortly described below:

- Legal personality of the entity
- Flexible procedures for raising new capital through the issuance of securities
- Enabling the redemption of securities
- Flexibility in structuring the fund to meet the different requirements of different investors, for example by introducing compartments or different ways of dealing with the fund's returns through different types of securities.
- Manager – investor set-up enabling the setting of the fund to be determined in such a way that the investor, as a person having primarily property rights to purchase, to share in the proceeds and, if applicable, in the liquidation balance of the fund.[6] "The attractiveness of investing through investment funds lies in the fact that this type of business effectively combines the element of risk distribution of the investor with the expertise of the manager of his investments."[7]
- Together with these basic features, for the purposes of this paper, there are added also other issues to be shortly examined in the jurisdictions compared, especially a short introduction of the legal framework for investment funds, and rules which constitute the legal form of SICAVs. Mentions are also done with regards to some particular or specific characteristics in the jurisdiction.
- There is one specific aspect of local regulation, which has been omitted, and it is the taxation, which has a key impact on the use or no use of a specific type of investment entity in the local jurisdiction. "*Taxation is a factor that has a key impact on the economic efficiency of any type of entity, including investment funds. Exclusivity of the use of a joint-stock company with variable registered capital only for investment*

[5] BRODANI, Jana. Zavedení struktury SICAV do českého právního řádu. In: *Právo v podnikání vybraných členských států Evropské Unie – sborník příspěvků k VIII. ročníku mezinárodní vědecké konference*. Prague: TROAS, 2016, pp. 147–157. ISBN 978-80-88055-01-3.

[6] BRODANI, Jana. Zavedení struktury SICAV do českého právního řádu. In: *Právo v podnikání vybraných členských států Evropské Unie – sborník příspěvků k VIII. ročníku mezinárodní vědecké konference*. Prague: TROAS, 2016, pp. 147–157. ISBN 978-80-88055-01-3.

[7] ŠOVAR, Jan. *Zákon o investičních společnostech a investičních fondech, komentář.* Aleš KRÁLÍK, Jiří BERAN, and Daniela DOLEŽALOVÁ. Prague: Wolters Kluwer, 2015. ISBN 978-80-7478-783-6.

purposes. The funds also require taking into account several key factors for its taxation, whether it is a legal form of a joint-stock company, i.e. an entity with a legal personalities, but also the specific regulation of the taxation of investment funds, as well as the taking into account of European tax rules or the impact of the specifics of taxation on investors."[8] Details on taxation are not described in detail in this text, however the cited article provides for a comprehensive analysis of SICAV taxation in the Czech Republic.

3. SICAVS IN MALTA

Malta is not one of the traditional established fund centres, but since its accession to the European Union, its financial sector has shown significant growth, from a total of 5 funds in 1995 to 545 funds in 2023[9], the vast majority of which are foreign funds domiciled in Malta. The biggest momentum for Malta was the implementation of the AIFMD[10]. *"The changes brought about by the AIFMD and the policy decisions made by Maltese authorities during the transposition process and beyond have strengthened the regulatory framework for investor protection and financial integrity in Malta."*[11]

Regulatory landscape represents one of the main reasons for establishing investment funds in Malta. "regulatory and supervisory regime in Malta applicable to fund structures have indeed played a pivotal role in establishing Malta as a centre for the registration of funds and their service providers."[12] This is a comprehensive summary of the reasons of Maltese fund sector success.

3.1 Legal framework for investment funds

Fund environment in Malta is based on three pillars. The regulatory pillar consists mainly of fund specific regulation – such as Chapter 370 of the Investment services act (ISA) and the different legal forms are generally regulated in the legislation governing the different Maltese legal forms in general, i.e. corporations are regulated in the so-called Companies Act[13] or trusts in the so-called Trusts and Trustees Act (TTA)[14], complemented with subsidiary regulation Focusing on specific structures, such as SICAV Reg.[15]

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[8] BRODANI, Jana. Key aspects of taxation of SICAV in the Czech Republic. Socio-Economic and Humanities Studies. 2021, (2), 87–103.

9 EFAMA [online]. [no date] [viewed 8 October 2023]. Available from: https://www.efama.org/sites/default/files/files/Quarterly%20Statistical%20Release%20Q1%202023.pdf

10 EU, Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers

11 BUTTIGIEG, Christopher P. The Implementation of the Alternative Investment Fund Managers Directive in Malta. In: The Implementation and Enforcement of European Union Law in Small Member States [online]. Cham: Springer International Publishing, 2021, pp. 175–203 [viewed 8 October 2023]. Available from: doi:10.1007/978-3-030-66115-1_8

12 BUTTIGIEG, Christopher P., and Martha CHETCUTI. Regulation of funds in Malta: the challenges ahead. Journal of Financial Regulation and Compliance [online]. 2013, 21(2), 121–135 [viewed 6 October 2023]. ISSN 1358-1988. Available from: doi:10.1108/13581981311315541

13 MALTA, Companies Act, Cap.386 of the Laws of Malta

[14] MALTA, Trusts and Trustees Act, Cap. 331 of the Laws of Malta

[15] MALTA, Subsidiary legislation, Companies Act, Cap.386.02, (Investment companies with variable share capital Regulations) of the Laws of Malta

Second administrative and supervisory pillar is based on the activities of the Malta Financial Services Authority (MFSA), who is the regulator of the financial sector in Malta. The MFSA provides for services which are important for fund operations in Malta, and therefore numerous administrative bodies, such as International Tax Unit (ITU) or Registrar of Companies.

Third pillar complementing the regulatory environment is complemented by the so-called Legal Notices issued by the Ministry of Finance and the so-called Investment Services Rules issued by the MFSA.

3.2 Legal personality of SICAV

A SICAV is defined in section 84 of the Companies Act as a company that meets the following 3 conditions[16] :

- the company's capital is divided into an unspecified number of shares without par value
- the capital is equal to a lot of the company's assets and the company is obliged to buy back shares from shareholders at their request
- it is only a collective investment undertaking or pension fund

SICAV as a corporation has legal personality under Maltese law.[17] Article 70 of the Companies Act directly allows the use of the abbreviation SICAV for variable capital investment companies, even though this abbreviation does not correspond to the name of the company in Maltese or English.

3.3 Flexible procedures for raising new capital through the issuance of securities

Article 2 of ISA defines collective investment schemes (as a condition for a company to be incorporated as a SICAV) as any collective investment scheme, that spreads risk, pools contributions, redeems units and periodically issues new ones.

It is clear, that offer of fund securities and compulsory redemption do not represent some kind of an exemption from a general corporate rules, but a basic feature of SICAV, without which this entity could not be formed as SICAV. Further, the CA also defines the value of a share or interest in a SICAV solely as NAV. [18]

3.4 Enabling redemption of securities

Article 2 of the ISA directly defines the obligation for a "collective investment scheme", which a SICAV must be, to redeem its securities from investors on their request. In general, redemption is regulated in the ISA, and redemption as such is already allowed through the Companies Act.[19] Flexibility in structuring the fund to meet the different requirements of

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[16] MALTA, Investment Services Act, Cap. 370 of the Laws of Malta

[17] MALTA, Companies Act, Cap.386 of the Laws of Malta

[18] MALTA, Companies Act, Cap.386 of the Laws of Malta: Any reference in this Act to the nominal value of an issued or allotted share in, or of the issued or allotted share capital of, a company shall be construed, in the case of an investment company with variable share capital, as a reference to the net asset value

[19] MALTA, Companies Act, Cap.386 of the Laws of Malta, Art. 84 (5): The purchase by an investment company with variable share capital of its own shares shall be on such terms and in such manner as may be provided by its articles.

different investors, for example by introducing compartments or different ways of dealing with the fund's returns through different types of securities.

3.5 Flexibility in fund structuring

Both the Companies Act and the SICAV Reg provide for the possibility of SICAVs to issue different classes of units or to be constituted as a "multi class company". However, in this case, the different classes do not form separate sub-funds. Separate sub-funds are also made possible by allowing a SICAV to be set up as a so-called multi fund company, i.e. a company whose capital is divided into different securities, each class of those securities constituting a separate sub-fund.[20] Provisions are made for the assets and liabilities of each sub-fund to be segregated from each other.[21] Any common costs are then allocated to the sub-funds on the basis of the rules laid down in the statutes, and the capital and NAV are calculated separately for each sub-fund.

There is one special feature of SICAV available in the Maltese law, so-called "cell company" arrangement, which pushes the boundaries of fund structuring even further. In addition to the very typical features of SICAVs, namely the variability of capital and its subdivision into sub-funds, this also allows such sub-funds to act on their own. However, with regards to the limited space in the academic paper, this feature has not been analyzed in detail.

3.6 Manager – investor set-up

The professional manager is responsible for the activities and operation of the fund and the investor in the fund acts as a person having primarily property rights to redemption, to a share in the proceeds and, if applicable, to the liquidation balance of the fund. From the investors' point of view, the investors' right to redeem securities issued by the fund is thus primarily defined in the Companies Act

4. SICAV IN THE CZECH REPUBLIC

In the Czech Republic, the investment funds sector was strongly influenced by the voucher privatization. "The Czech voucher privatization was a method of giving out state property to the population, mobilizing the majority of citizens, but also giving incentives for the founding of investment funds, which commissioned unprecedented marketing campaigns to divert shares from individuals, somewhat overshadowing the first efforts of the state to make everyone an investor."[22] The consequences of massive frauds via non-regulated entities called "investment funds" resulted in loss of trust towards the investment sector. It has taken many years for the Czech market to recover from this gloomy period of 1990s, but eventually investment funds enjoy a good reputation from the perspective of investors. This results in an increase in fund investments as well as number of investment funds domiciled in the Czech Republic. Based on

[20] Art. 5. SICAV Reg

[21] Art. 9. SICAV Reg

[22] BABIČKA, Martin. "The future is in your hands": temporality and the neoliberal self in the czech voucher privatization. *Journal of Contemporary Central and Eastern Europe* [online]. 2022, 1–17 [viewed 8 October 2023]. ISSN 2573-9646. Available from: doi:10.1080/25739638.2022.2044616

the data of the Czech Capital Market Association[23], the total volume of investments into funds in 2001 were only 66 bn Czech compared to 1 200 bn Czech crowns in 2023. One of the success stories has also been the introduction of the SICAV structure, which has obtained a vast popularity especially in the sector of qualified investors funds since their introduction in the legal system in 2014, reaching the number of 270 Czech SICAVs in 2023.

4.1 Legal framework for investment funds

In general, the investment funds regulatory environment is governed in the Czech legal system by Act No. 240/2013 Coll., on Investment Companies and Funds (so called "ZISIF")[24], which also introduced the SICAV structure in the Czech law as of 2014. The legislative regulation of SICAVs in the ZISIF is exclusive, ie. it is regulated only in the act regulating the investment funds sector.

However, as SICAV is being considered as a specific type of a joint-stock company, also general rules (if not regulated differently in the ZISIF) of the company law apply to them. Thus, the SICAV is subject to the general regulation of joint-stock companies in Act No. 90/2012 Coll., on Business Corporations (so-called ZOK), as well as the regulation applicable to joint-stock companies in other laws, such as accounting regulations, tax regulations, or the investment rules for investment funds and also the supervision of the Czech National Bank and its Benchmarks and other types of considerations.

4.2 Legal personality of SICAV

The ZISIF makes it clear that a company limited by shares with variable share capital (SICAV) is a joint-stock company[25] , and as such has legal personality. In addition, business name includes the designation 'variable capital investment fund', which may be replaced by the abbreviation "SICAV".[26]

4.3 Flexible procedures for raising new capital through the issuance of securities

An important difference of a SICAV compared to a standard joint-stock company is the regulation of Section 155 of the ZISIF, which defines the share capital of a joint-stock company with variable capital, which means fund capital.[27] The share capital of a joint stock company, as defined in the ZOK, is then registered share capital in accordance with Section 155 of the ZISIF.

4.4 Enabling redemption of securities

The SICAV issues shares with a shareholder's right to redeem them on behalf of the company. Sections 154 et seq. of the ZISIF regulate the structure of SICAVs within the framework of the general legal regulation of investment funds, thus makes it clear that a SICAV issues shares which carry a shareholder's right of redemption on behalf of the company.

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[23] AKAT, [online]. [no date] [viewed 8 October 2023]. Available from: www.akatcr.cz

[24] CZECH REPUBLIC Act No. 240/2013 Coll., on Investment Companies and Funds [zákon č. 240/2013 Sb., o investičních společnostech a fondech]

[25] Section 154(1) of the ZISIF Act

[26] Section 154 of the ZISIF Act

[27] Section 16(5) of the ZISIF Act

4.5 Flexibility in fund structuring

Based on Section 156(2) (and other provisions) of the ZISIF, it can be inferred that the SICAV may, but need not, create sub-funds. However, each sub-fund must be defined in the SICAV's statutes. The ZISIF defines a sub-fund as an accounting and asset segregated part of the assets of the SICAV.[28] The asset segregation is to be underlined by the obligation of the SICAV to keep accounts in such a way as to enable the preparation of financial statements for each individual sub-fund. If the SICAV creates a sub-fund, it is obliged to segregate all investment activity into a sub-fund: *"public limited company with variable share capital shall include in the sub-fund or sub-funds the assets and debts of its investment activities."*[29] Classes of share in SICAV and its sub-funds are available as well.

4.6 Manager – investor set-up

ZISIF regulates the differences between SICAV shares – so-called founder shares and investment shares. It is based on a different concept, where founders are understood as trustees rather than investors – owners of investment shares, who do not have a status comparable to a shareholder, do not have an influence on the actual operation of the investment fund and do not have a fundamental influence on the management of the company.

5. COMPARISON OF MAIN FEATURES OF SICAV IN THE CZECH REPUBLIC AND IN MALTA

Based on detailed analysis of the chosen features of SICAV in the Czech Republic and Malta it is clear, that their general regulation is very similar. This is a result of their characteristics as an investment funds, which are heavily regulated on the European level and their regulation has undergone a long history aiming at the maximum protection of (especially) retail investors.

Thanks to the common EU regulation, most similarities in the Czech and maltese SICAV are based on their purpose as a fund vehicle.

As being investment entities, the key features, which define the SICAV as an investment structure, such as flexible procedures for raising new capital through the issuance of securities, enabling redemption of securities and fund structuring enabling creation of sub-funds are very similar in both jurisdictions.

On the other hand, there are also some key differences in the main legislation incorporating the SICAV in the local law. The main incorporation of SICAV regulation in both jurisdictions are also very similar, mainly the mix of company law governing the corporations in general and special investment laws regulating the investment aspects, even though the regulatory concept has been chosen differently. In Malta, the basic rules for SICAV are incorporated in the company law, whereas in the Czech Republic, the basic regulation is in the specific investment regulation.

One of the interesting points is the use of the SICAV abbreviation. In both jurisdictions, the use of abbreviation "SICAV" from the French language is available, which makes the sense especially with regards to the popularity of SICAV structure (mostly made popular by Luxembourg as a global fund centre). Again, there is a slight difference, where in the Maltese law, the SICAV abbreviation is widely used in the local law, whereas in the Czech law SICAV

[28] Section 165(1) of the ZISIF Act

[29] Section 165(2) of the ZISIF Act

is referred as the a joint-stock company with variable capital and only making the SICAV abbreviation available to use in a fund name.

There are also some features specific in each jurisdiction. One of the most distinctive regulatory features however may be the possibility of having two types of shares in the Czech SICAV – so called "managerial" or "founders" shares and "investment" shares, which represent the main investment activity of the SICAV. There is a specialty in the Maltese regulation consisting in enabling so-called cell companies which has not been examined in detail.

There is also one aspect, that deserves the detailed analysis, and it is the taxation issues, however this paper does not allow for a detailed overview as the tax systems in both countries are very different.

CONCLUSION

In both jurisdiction SICAV represents a success story with regards to the number of funds and the share of SICAV structure on the total volume. The regulation has contributed significantly to this fact, as both countries show similarities in their SICAV regulation. Most similarities are a result of a structuring of SICAVs as investment entities for investors, such as redemptions, capital raising and SICAV structuring. Some differences are on the way how SICAVs are incorporated in the company law, in Malta being the basic rules in the general company law, in the Czech Republic in the special investment law. The use of abbreviation from a French language "SICAV" is enabled in both countries, even though it being in a wider use in the Maltese regulation. Two types of SICAV shares – founders´ and investors´ shares in the Czech law make the most distinction in the structuring of SICAVs in both jurisdictions, whereas in Malta the special regulation of cell-companies represents a distinctive feature.

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[6] MALTA, Subsidiary legislation, Companies Act, Cap.386.02, (Investment companies with variable share capital Regulations) of the Laws of Malta

[7] MALTA, Investment Services Act, Cap. 370 of the Laws of Malta

[8] CZECH REPUBLIC Act No. 240/2013 Coll., on Investment Companies and Funds [zákon č. 240/2013 Sb., o investičních společnostech a fondech]

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Liability of non-state healthcare providers for damages caused by nosocomial infections

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Abstract: *Nosocomial infections occur frequently in medical care facilities and cannot be completely eliminated. This raises the issue of liability of healthcare service providers for damages caused by such infections. This paper examines the conditions of liability and the scope of liability for nosocomial infections using the method of analysis. The author concludes that as a rule it is impossible to obtain compensation for damages caused by nosocomial infections under the Czech legal system because the conditions for bearing the burden of proof are too strict.*

Keywords: *burden of proof, consumer protection, damages, liability, nosocomial infections*

INTRODUCTION

This paper is based on the hypothesis that a patient was infected with a virus (such as the covid-19 virus) during hospitalisation. This is therefore a case of a so-called nosocomial infection[30]. Nosocomial infections are infectious diseases that occur following the admission of patients to hospital. These diseases exclude illnesses for which the patient was admitted to hospital. Hospital-acquired infections have a negative impact on healthcare, leading to prolonged hospital stays, increased treatment costs and higher mortality. It is therefore imperative that all healthcare professionals know how to prevent and communicate[31] the risk of these infections[32].

In the Czech Republic, nosocomial infections are dealt with in the Public Health Protection Act[33]. In particular, it defines the obligation for healthcare service providers to take hygiene and epidemic control measures to prevent the occurrence and spread of nosocomial infections. These measures are defined in the healthcare provider's operating rules. If a disease is detected, the provider is then required to take immediate anti-epidemic measures to identify the source of the disease, the means of its spread, to prevent its spread and to treat infected and suspected persons. It must also keep a register of all nosocomial infections and provide information to the relevant public health authority on request.

[30] KOLLEF Marin H. *et al.* Nosocomial Infection. *Critical Care Medicine* [online]. 2021, Vol. 49, n. 2, pp. 169–187. DOI: 10.1097/CCM.0000000000004783. Available from: https://pubmed.ncbi.nlm.nih.gov/33438970/

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[32] MAĎAR Rastislav *et al. Prevence nozokomiálních nákaz v klinické praxi*. Praha: Grada, 2006. ISBN 9788024716732.

[33] CZECH REPUBLIC Act No. 258/2000 Coll. on the protection of public health [zákon č. 258/2000 Sb. o ochraně veřejného zdraví a o změně některých souvisejících zákonů].

In the case of nosocomial infections, the healthcare provider is exonerated from all liability if they can prove that they took all precautions reasonably required and implemented and consistently applied a system of hygiene and epidemic control measures designed to minimise the risk of infection[34]. Therefore, the strict liability does not apply[35].

Unfortunately, healthcare-associated infections cannot be completely prevented. However, by taking a series of measures at central level and in each hospital, it is possible to reduce their number by up to 50 per cent. Although some of these measures are being implemented in the Czech Republic, there are significant gaps in many of them. These include hand hygiene, the low number of infection prevention and control specialists in hospitals, and the minimum number of isolation rooms[36]. According to a one-off prevalence study carried out in 2017 in 45 Czech hospitals, the incidence of hospital-acquired infections is 6.7 per cent, which is very close to the European average of 6.5 per cent. Compared with other countries, a large proportion of critically ill patients in intensive care, who are at much higher risk of contracting a nosocomial infection, were included in the study[37]. Hand hygiene is an essential preventive measure against hospital-acquired infections. While the World Health Organisation recommends an absolute minimum of 20 litres of hand disinfectant per 1,000 days of treatment[38], in the Czech Republic this consumption was 14.7 litres in 2018. And looking at the number of rooms for the isolation of airborne transmission, the Czech Republic finds itself, along with Croatia and Serbia, in the worst category with fewer than two per thousand beds[39].

From the point of view of consumer protection the objective of this paper is to examine the conditions for compesating damages suffered by patients due to having contracted a nosocomial infection. To this end, the paper will set out defining the legal requirements for holding the health care provider liable for damages. Subsequently, the paper will compare litigation to alternative dispute resolution mechanisms in terms of their possible success to recover damages. The paper shall use analysis to explore the current regulatory framework for compensating damages caused by healthcare providers in case of nosocomial diseases. Also, comparison shall be employed while addressing the use of litiagation as opposed to alternative dispute resolution.

1. THE LIABILITY OF PRIVATE HEALTH CARE PROVIDERS

In the Czech legal system, the liability of public and private healthcare providers is identical, hence there is no difference in terms of the extent of liability depending on whether the infection occurred in a private or public healthcare establishment. In 1992, the law on

[34] ŠUSTEK Petr *et al*. *Zdravotnické právo*. Praha: Wolters Kluwer ČR, 2016: 307. ISBN 978-80-7552-321-1.

[35] However, legal scholarship argues in favor of no-fault liablity in relation to the introduction of artificial intelligence in the field of providing health care services. For details see: HOLM, Soren et al. A New Argument for No-Fault Compensation in Health Care: The Introduction of Artificial Intelligence Systems. *Health Care Analysis* [online], 2011, 29, 171–188. Available from: https://link.springer.com/article/10.1007/s10728-021-00430-4

[36] KOUBOVÁ, Michaela. Nemocniční infekce? Na zanedbávání preventivních opatření může díky trestní odpovědnosti právnických osob doplatit i vedení nemocnic. Zdravotnický deník [online]. 2019 [viewed 9 August 2023]. Available from: www.zdravotnickydenik.cz/2019/10/nemocnicni-infekce-zanedbavanipreventivnich-opatreni-muze-diky-trestni-odpovednosti-pravnickych-osob-doplatit-i-vedeni-nemocnic/

[37] Ibidem.

[38] WORLD HEALTH ORGANIZATION. Guidelines on hand hygiene in health care. WHO/IER/PSP/2009/01. 15 January 2009. Available from www.who.int/publications/i/item/9789241597906

[39] KOUBOVÁ, Michaela, *op. cit.*

healthcare in non-state healthcare establishments was passed[40], which also regulated compulsory insurance for these healthcare providers in the following way:

Civil liability insurance
Article 15
If the operator of a non-State healthcare establishment employs at least one employee, they shall be obliged to take out contractual liability insurance for damage suffered by their employees in the performance of their duties or in direct connection therewith, and for which the operator is liable. The operator of a non-State establishment must always take out contractual insurance so that the insurance contract takes effect on the date of the employment relationship.

Article 16
The operator of a non-State facility is obliged to conclude a contract with an insurance company operating on the territory of the Czech Republic for insurance against liability for damage caused to citizens in the course of providing healthcare before commencing operations. This insurance must last for the entire period during which the operator of the non-state establishment provides healthcare.

This Act was repealed with effect from 1 April 2012 and replaced by the Health Services and Conditions for Providing Health Care Act (Health Services Act)[41]. The Health Services Act defines a health services provider as a natural or legal person authorised to provide health services under the Act. The decision to grant authorisation to provide health services is taken by the regional authority in whose administrative district the health facility in which the health services are to be provided is located[42].

Article 16 of the Health Services Act defines the conditions for granting authorisation to provide health services, Article 17 defines the obstacles to granting authorisation to provide health services, Article 18 contains a list of data that must be included in the application for authorisation to provide health services and Article 19 specifies the procedure for the decision to grant authorisation to provide health services. The competent administrative authority shall suspend or withdraw the authorisation to provide health services if the provider is not insured against liability for damage caused in the course of providing health services[43].

In the Czech legal system[44], liability for personal injury is governed by the Civil Code[45]. In the case of personal injury, the injured party is entitled to both compensation for material damage and compensation for non-material damage. With regard to compensation for material damage, the Czech legal system is based on compensation for damage and lost profits. As regards compensation for non-material damages, it compensates for pain and suffering, loss of social status and other non-pecuniary damages.

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[40] CZECH REPUBLIC Act No. 160/1992 Coll. on health care by non-state health service providers [Zákon č. 160/1992 Sb. Zákon České národní rady o zdravotní péči v nestátních zdravotnických zařízeních].

[41] CZECH REPUBLIC Act No. 372/2011 Coll. on health care services [Zákon č. 372/2011 Sb. Zákon o zdravotních službách a podmínkách jejich poskytování (zákon o zdravotních službách)].

[42] Article 15 of the above Act.

[43] Article 24 of the above Act.

[44] CAMARGO, Viviana Galán. La pandemia Covid-19 y los retos frente a la responsabilidad civil de los profesionales de la salud. *Revista DIXI* [online]. 2023, vol. 25, n. 1, pp. 1–20. ISSN 2357-5891. Available from: https://revistas.ucc.edu.co/index.php/di/article/view/4509/3380

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

1.1 Preconditions for Liability for Damages

The precondition for the obligation to pay damages is the wrongful act of the offender, which consists of the breach of a legal obligation, the occurrence of damage that has a causal link with the wrongful act and, finally, the presence of fault.

A breach of a legal obligation in the healthcare sector occurs when the treatment procedure does not comply with current medical science. In other words, it is a procedure carried out by a doctor or the medical services that is qualified as *non lege artis*. In the case of a patient contracting covid-19 during hospitalisation, this would be the case, for example, when medical staff do not use the prescribed masks or disinfection. The appropriate professional level of healthcare is also defined in the Health Services Act, which defines the concept of *lege artis medicinae*, that is the obligation to provide care at the level of available knowledge and procedures offered by medical science at a given time[46].

To define the breach of a legal obligation, the definition of *lege artis* has so far been based mostly on case law, literature and legal scholarship. According to the judgment of the Supreme Court of the Czech Republic[47], the assessment of *lege artis* must also take into account the temporal context and the conditions in which the medical practice took place, as well as the risks incurred. The doctor's conduct must be assessed *ex ante*, that is on the basis of the information and options available to the doctor at the time of their decision[48].

Causality requires that the unlawful act be the causal factor (the cause) of the deterioration in health, i.e. that the deterioration in health would not have occurred without the cause (medical malpractice). It is so difficult for the injured party to prove the causal link that case law tends to relax this very strict requirement. The Constitutional Court of the Czech Republic has described the requirement of one hundred percent proof of an objective causal link as unrealistic, as it is impracticable and unsustainable[49]. Proving that it is the omission that creates an unbroken link with the harmful consequence is essentially impossible. The concept of a causal link is not defined in any way in Czech law.

This allows the courts to reconsider the requirement of a one hundred percent proven causal link and the adoption of a more appropriate and realistic interpretation of "causing damage" that would compensate for the weaker position of victims[50].

In medical practice, it is quite common for several relevant causes to act simultaneously. For example, it is highly unlikely that an otherwise healthy person would die solely from covid-19. In such a case, the extent of the influence of the individual causes and the immediacy of their action in relation to the outcome in question must be taken into account. In this context, the term "gradation of causation" is used[51].

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[46] SVEJKOVSKÝ, Jaroslav *et al*. *Zdravotnictví a právo*. Praha: C.H. Beck, 2016: 317. ISBN 978-80-7400-619-7.

[47] Decision of the Supreme Court of the Czech Republic of 31 October 2013, File n° NS 25 Cdo 2221/2011, C13633 [online]. Available from http://kraken.slv.cz/25Cdo2221/2011

[48] Decision of the Supreme Court of the Czech Republic of 22 March 2005. File n° NS 7 Tdo 219/2005, T784 [online]. Available from http://kraken.slv.cz/7Tdo219/2005.

[49] Decision of the Constitutional Court of the Czech Republic of 12 August 2008. File n° I.ÚS 1919/08, Case Reports ÚS 10/2008. Available from https://nalus.usoud.cz/Search/GetText.aspx?sz=1-1919-08_1.

[50] SVEJKOVSKÝ, Jaroslav, *op. cit.*, at p. 323.

[51] ŠVESTKA Jiří *et al*. *Občanský zákoník. Komentář*. I. a II. svazek. 2. vydání. Praha: C. H. Beck, 2009: 1206. ISBN 978-80-7598-412-8.

Material damage is compensated in money (known as relutive restitution). The amount of compensation is defined in article 2952 of the Civil Code. Actual damage (*damnum emergens*) is defined as a reduction in the property of the injured party compared with the state prior to the damaging event, which requires the expenditure of assets to restore the property to its previous state.

The loss of profit (*lucrum cessans*) is the damage consisting in the fact that the injured party's assets do not increase as a result of the harmful event, whereas this could have been expected in the normal course of events. Thus, the loss of profit is not manifested by a reduction in the injured party's assets, but by a loss of the expected benefit and by the fact that the assets do not increase, whereas they should have done so in the normal course of events.

In the case of material damage, the typical pecuniary claim is for loss of income, the cost of medical care and, in the event of the victim's death, the cost of maintaining the survivors and the cost of the funeral.

As far as loss of earnings is concerned, a distinction is made between loss of earnings during the incapacity to work, when the injured person is no longer involved in their previous work, and after the end of the incapacity to work, when there may be a reduction in working capacity caused by health effects and the resulting impact on possible future work. In both cases, the loss of income is covered by a cash pension.

For the purposes of calculating loss of earnings, income from employment prior to the incapacity for work is expressed in terms of what is known as average income under employment law. The right to compensation for loss of earnings is also available to people who are preparing to take up paid employment (studies, schooling, other forms of vocational training).

In addition to the pecuniary damages mentioned above, the victim is also entitled to compensation for non-pecuniary damages.

Under article 2958 of the Civil Code, in the event of bodily injury, the injured party must be compensated with a sum of money that fully offsets the pain and suffering and other non-pecuniary damages. If the deterioration in health has caused an obstacle to a better future for the injured party, the latter must also compensate them for reduced social mobility. The Civil Code therefore distinguishes three types of claim for non-pecuniary damages, namely

(i) pain

(ii) reduced social mobility, and

(iii) other non-pecuniary damages.

These three claims are directly linked to the injured person and are therefore extinguished on their death. These claims are only subject to inheritance if they have been recognised as a debt or if they have been claimed before a court[52]. From a procedural point of view, a court decision on *pretium doloris* does not constitute *lis pendens* or *res iudicata* for a court decision on reduced social mobility.

[52] See Decision of the Supreme Court of the Czech Republic of 27 April 2017. File No. NS 25 Cdo 3556/2016. Available from https://www.zakonyprolidi.cz/judikat/nscr/25-cdo-3556-2016. See also HRÁDEK Jiří. Občanský zákoník: Komentář, Svazek VI. Commentary on Article 2894. ASPI legal database, 2021.

With respect to pain, the function of this claim is to compensate for physical pain. The amount of compensation for pain must be adapted to the specific circumstances of the injured party and to the established case law of the courts, in accordance with Article 10 of the Civil Code.

Compensation for reduced social mobility represents a certain limitation on the victim's opportunities to develop in the sphere of family, cultural, social or sporting life. It compensates for the fact that the ill person's life is less satisfactory following the illness than it was before the illness. It is an assessment of the impediment to a better future. The assessment should be carried out once the patient's state of health has relatively stabilised. This period is generally one year, but longer periods, such as two years, may be considered (there are documented cases of "long covid" during which the victim's state of health has changed). The victim's age must also be taken into account.

Other non-pecuniary damages are sometimes referred to as mental anguish. Other non-pecuniary damages are used to compensate for psychological damage in accordance with Article 2956 of the Civil Code. The purpose of compensating other non-pecuniary damages is to make up for what could not be covered by compensation for pain and suffering or reduced social mobility. Examples of specific mental distress associated with personal injury include fear of dying, anxiety during treatment (about the future course of treatment, fear of complications or of further surgery), worry about the future, shock caused by the injury, separation from family during a long stay in hospital etc[53].

1.2 Determining the amount of compensation

The aim of monetary compensation is not to obtain reparation, but compensation. In determining monetary compensation, courts may rely on the methodology developed by the Supreme Court of the Czech Republic in cooperation with the Czech Society for Medical Law. The methodology was recommended to judges by the Civil and Commercial Collegium of the Supreme Court of the Czech Republic on 12 March 2014. The importance of the methodology was reinforced by its publication in the Collection of Decisions and Opinions of the Court (although it is not a court decision or unifying opinion of the Court) under the file number Rc 6302014. The methodology applies to the calculation of pain and suffering and the determination of the amount of compensation for reduced social mobility. The methodology therefore does not apply to the determination of the compensation for other moral damages. The methodology consists of four parts: the preamble (introduction, general explanation), the overview of pain (pain scores), activity and participation (from 1 November 2016 three-level International Classification of Functional Abilities, Disability and Health) and the technical part (preparation of assessments and qualification of experts).[54]

With regard to the calculation of pain and suffering, the methodology assigns a score (from one point to 2,400 points) to each personal injury. The value of the point is calculated on the basis of one per cent of the gross monthly wage per capita in the national economy for the calendar year preceding the year in which the claim for compensation was made, i.e. pain. The value of the point in 2022 was CZK 378.39 (equivalent to approximately EUR 8).

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[53] JANDOVÁ, Hana Tečka nebo otazník za dvoukolejnou právní úpravou náhrady nemajetkové újmy na zdraví v českém právním řádu. In: DUREC KAHOUNOVÁ Michaela and Silvia SENKOVÁ. Zborník z mezinárodnej vedeckej konferencie Bratislava: Bratislavské právnické fórum, Bratislava, 2022, 8–19. ISBN 978-80-7160-664-2.

[54] SVEJKOVSKÝ, Jaroslav, *op. cit.*, at pp. 366–367.

The amount of compensation may be adjusted by the assessing doctor according to the complication of the state of health if the basic assessment does not correctly reflect the seriousness of the damage. A distinction is made between the following levels of complication: 1. mild complication (up to 5 %) requiring short-term treatment, not prolonging the treatment of the underlying diagnosis. 2. moderate complication (up to 10 %) requiring long-term treatment and further surgery. 3. Severe complication (up to 15 %) requiring intensive treatment and multiple re-operations, and 4. Severe complication (up to 20 %) seriously life-threatening (e.g. organ failure)[55].

The method for calculating compensation for reduced social mobility is based on the World Health Organisation's International Classification of Functioning Capacities, Disability and Health. This classification is publicly available on the website of the Ministry of Labour and Social Affairs of the Czech Republic[56]. According to this classification, impairments are not assessed on the basis of a diagnosis, but according to physical structures and functions and their impact on a given individual's normal life activities. This means that two people with the same diagnosis may have different functional limitations. The calculation of disability compensation is therefore not based on a score but on a percentage loss of life opportunities (better future) ranging from zero to 100 per cent for each individual item in nine areas of social life (learning and application of knowledge, general tasks and requirements, communication, mobility, personal care, home life, behaviour and interpersonal relationships, main areas of life and community, social and civic life). Each item represents 11.1 %. Applying the methodology to children is very problematic, as their current state may not be relevant and some vital factors cannot be assessed at all (e.g. economic self-sufficiency).

Some authors suggest a revision of the methodology in the form of tests carried out in a laboratory environment which would assess individual physical components, the FCE (Functional Capacity Evaluation). This would make it possible to examine work capacity in the activities that are the most frequent components of physical work (lifting, standing, walking, etc.). These activities would then be assessed against prescribed tasks in accordance with well-established biomechanical criteria[57].

2. JURISDICTION OF THE COURT

If an individual who has suffered harm due to contracting a nosocomial infection wishes to recover their damages, they can opt either for litigation or for an alternative dispute resolution mechanism. Should the consumer opt for litigation the district court has jurisdition to hear the claim in the first instance. In the Czech judicial system, the district court is the lowest possible level of general courts. The system of ordinary courts is based on the following four pillars: district courts, regional courts, superior courts and the Supreme Court and the Supreme Administrative Court[58].

In case of litigation, the defendant is generally a healthcare provider. The concepts of doctor and healthcare provider may be confused (for example, in the case of a sole practitioner). However, if the operator of the healthcare facility is a person other than the doctor themselves, that person, i.e., for example, a company, is liable to the patient for any wrongdoing related to

[55] *Ibidem*, at p. 368

[56] In Czech: Ministerstvo práce a sociálních věcí. www.mpsv.cz

[57] JANDOVÁ, Hana, *op.cit*, at p. 17.

[58] EUROPEAN COMMISSION. European Judicial Network. https://e-justice.europa.eu/

having provided healthcare. An individual healthcare professional who has an employment relationship with the operator of the healthcare facility may be liable to their employer under employment law if their conduct has substantially exceeded the scope of their standard duties[59].

The claim for compensation must be made before the limitation period expires. The Civil Code sets the general limitation period at three years[60]. As regards compensation for pecuniary and non-pecuniary damage, the limitation period is subjective and begins when the injured party becomes aware of the harm. The starting point of the limitation period differs depending on whether the harm is non-material or material. In case of pain and suffering, the limitation period begins to run when the pain is felt. In case of a reduction in social mobility, the limitation period begins to run when the permanent consequences of the injury can be objectively assessed, i.e. when the injured party's state of health has stabilised.

The Civil Code also provides for a different contractual limitation period[61]. In the case of reduced social mobility, this period cannot be shorter than the general limitation period of three years. The defendant decides on the exception to the limitation period. The court does not take the limitation period into account *ex officio*. If the defendant does not raise a plea of prescription, the judge will allow the action and grant the plaintiff the right they are asserting. If the defendant raises an exception of prescription, the claim becomes inapplicable and the court cannot grant the claim to the plaintiff. Consequently, the claim is dismissed[62].

Limitation periods are suspended in the event of out-of-court negotiations between the creditor and the debtor, in accordance with the provisions of Article 647 of the Civil Code. The limitation period begins to run after the creditor or debtor have expressly refused to continue these negotiations. If the limitation period has already begun to run, it does not run during the out-of-court negotiations.

3. OUT-OF-COURT SETTLEMENT OF COMPENSATION DISPUTES

Since out-of-court dispute settlement is less public than litigation, it may be the preferred option for healthcare service providers against whom a claim is asserted. The private nature of out-of-court settlement implies that there are no public statistics on the extent of out-of-court compensation in the healthcare sector, but the existence of the Supreme Court's methodology used to calculate the amount of compensation for pain and suffering creates conditions conducive to its use in the area of negotiating out-of-court compensation. For most healthcare establishments, litigation is a solution of last resort[63]. Mediation in civil disputes involving compensation is governed by the provisions of the Mediation Act[64], which transposed Directive 2008/52/EC of the European Parliament and of the Council of 21 May 2008 on certain aspects of mediation in civil and commercial matters[65]. In the Czech Republic, the mediation

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[59] ŠUSTEK, Petr *et al*., *op.cit*., at p. 298.

[60] Article 629 Civil Code.

[61] Article 630 Civil Code.

[62] HURDÍK, Jan *et al*. *Občanské právo hmotné. Obecná část. Absolutní majetková práva*. Plzeň: Aleš Čeněk, 2013: 188–189. ISBN 978-80-7380-718-4.

[63] PASEKOVÁ, Eva. Náhrada za újmu na zdraví se k soudu dostává častěji, částky při odškodnění stoupají. Portál česká justice. 2021. Available from https://www.ceska-justice.cz/2021/03/nahrada-za-ujmu-na-zdravi-se-k-soudu-dostava-casteji-castky-pri-odskodneni-stoupaji/.

[64] CZECH REPUBLIC Act No. 202/2012 Coll. on mediation [Zákon č. 202/2012 Sb. o mediaci a o změně některých zákonů (zákon o mediaci)].

[65] OJ L 165, 18.6.2013, p. 63.

agreement cannot be directely enforeced. To make it an enforceable instrument, it needs to be approved by a law court as a settlement or included in a notarial deed bearing a clause of direct enforceability. However, even in the absence of their self-executing power, agreements reached in mediation tend to be implemented on a volunatary basis in most cases.

CONCLUSION

In practice, it will be very difficult for people who have contracted a nosocomial disease during hospitalisation to bear the burden of proving that a health care facility has breached their legal obligations. This will be virtually impossible in the case of short hospital stays, where the victim may already have been infected before being admitted for treatment of another disease, but where the infection has not yet manifested itself through a diagnostic test. Since the unsuccessful party bears the costs of litigation and the legal fees of the successful party, a large number of claims for compensating harm suffered dut to nosocomial infections cannot be expected.

The legal policy regarding the difficult conditions for obtaining compensation for a nosocomial infection is based on the fact that this type of infection cannot be completely avoided. If compensation for hospital-acquired infections were easy to obtain, there would be a risk that healthcare providers would not have sufficient resources to provide primary healthcare as an important public service once compensation had been paid. Thus, the low probability of obtaining compensation for a nosocomial infection represents the state's interest in ensuring that healthcare providers remain motivated to provide their services and are not forced to stop doing so for economic reasons.

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[3] CZECH REPUBLIC Act No. 258/2000 Coll. on the protection of public health [zákon č. 258/2000 Sb. o ochraně veřejného zdraví a o změně některých souvisejících zákonů].

[4] Decision of the Constitutional Court of the Czech Republic of 12 August 2008. File n° I.ÚS 1919/08, Case Reports ÚS 10/2008. Available from https://nalus.usoud.cz/Search/GetText.aspx?sz=1-1919-08_1.

[5] Decision of the Supreme Court of the Czech Republic of 31 October 2013, File n° NS 25 Cdo 2221/2011, C13633 [online]. Available from http://kraken.slv.cz/25Cdo2221/2011

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The formal principle in bank guarantees in the Czech Republic

Mgr. Ing. Veronika Hejná

Abstract: *In international and domestic trade, the formal principle governing independent guarantees holds a pivotal role. This paper examines the formal principle and its challenges to the creditor – the beneficiary of bank guarantee. Firstly, the analysis of the legal nature of independent guarantees and the formal principle, well known as the "strict compliance principle" in international trade practice, will be performed. Then, the level of formal compliance of demand under ICC Rules URDG758 and Czech law will be introduced. The final part of the paper will point out the challenges of the formal principle for the creditor.*

Keywords: *demand guarantee, independent guarantee, bank guarantee, formal principle, autonomy*

INTRODUCTION

When conducting cross-border trade, the contracting parties require independent guarantees issued in their favour securing the obligations of counterparty to mitigate the transaction risk. The main reason is that the enforcement of law across borders is much more difficult[66] than domestically. Not only cross-border trade carries risks; with some types of domestic projects, considerable risk exposure can be encountered.

The independent bank guarantee payable upon first demand without any proof of default plays an important role. As previous studies have shown, the effects of particular guarantee instruments supply shocks are stronger during times of financial distress[67,68].

The Czech Civil Code enables the issue of autonomous guarantees to any issuer, not only the bank, yet the bank guarantees remain prevailing. In case of bankruptcy of the contractor, the creditor can satisfy their claim from bank guarantee regardless of the ongoing insolvency proceedings[69]. For this reason, this paper focuses on bank guarantees exclusively.

[66] NIEPMANN, Friederike, and SCHMIDT-EISENLOHR, Tim. No guarantees, no trade: How banks affect export patterns. Journal of International Economics. 2017, 108, p. 339. Similarly BLAU, Werner, and Joachim JEDZIG. Bank guarantees to pay upon first written demand in German courts. The International Lawyer[online]. 1989, 23(3), p. 726, available from: https://www.jstor.org/stable/40706312.

[67] Ibid, p. 339.

[68] "An increase in the riskiness of destination coutries generates the shift in the use of letters of credit observed during the 2007/2008 financial crisis." NIEPMANN, Friederike, and SCHMIDT-EISENLOHR, Tim. *International trade, risk and the role of banks.* Journal of International Economics. 2017, 107, p. 112.

[69] ZOUBEK, Hynek. Finanční záruka. In: *Občanský zákoník: komentář.* Praha: C. H. Beck, 2017, ISBN 978-80-7400-653-1, p. 2055.

The legal nature of autonomous guarantees has been examined by Liška[70], Lukeš[71] and Plíva[72]. Commentaries to Civil Code focusing on financial (bank) guarantees have been written, e.g. by Zoubek[73], Richter[74] and Kindl[75].

This article examines the formal principle established by the Czech Supreme Court in the context of risk allocation between the creditor (beneficiary) and the debtor (principal). Moreover, the paper introduces the application challenges that may arise when conditions for payment under the bank guarantee do not align with the terms of the underlying contract.

The formal principle as follows from the autonomy of demand guarantees ensures that the banks are entitled to examine only whether or not the formal conditions of the guarantee have been met.

Firstly, the analysis of the legal nature of independent guarantees and the formal principle will be performed. Then, the level of formal compliance of demand under ICC Rules and Czech law will be introduced. The final part of the paper shall point out the challenges of the formal principle for the creditor.

1. LEGAL NATURE OF INDEPENDENT BANK GUARANTEES AND THE FORMAL PRINCIPLE

Although independent guarantees share some similarities with suretyships and sometimes are even considered a type of surety[76], the essential features distinguish them. The key difference between a demand (independent) guarantee and a suretyship[77] as the debt security instrument is that demand guarantees are non-accessory and non-subsidiary[78] to the obligation from the underlying contract.

Independent bank guarantees can secure any type of debt (both pecuniary and non-pecuniary). The legal concept of autonomous guarantees came to the European continent from the Anglo-American law[79]. These instruments are considered to be relatively new[80], emerging spontaneously in response to the practical needs of international trade in the middle 1960s[81].

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[70] LIŠKA, Petr. *Bank guarantees in the Czech Republic*. Archives of Business Research[online]. 2023, **11**(1) [viewed 16 August 2023]. ISSN 2054-7404. Available from: doi:10.14738/abr.111.13696.

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[73] ZOUBEK, Hynek. Finanční záruka. In: *Občanský zákoník: komentář.* Praha: C. H. Beck, 2017, pp. 2053–2063.

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[75] KINDL, Tomáš. Finanční záruka. In: *Občanský zákoník*: komentář. Praha: Wolters Kluwer, 2014, pp. 562–572. ISBN 978-80-7478-369-2.

[76] LIŠKA, Petr. *Bank guarantees in the Czech Republic*. Archives of Business Research[online]. 2023, **11**(1) [viewed 16 August 2023]. ISSN 2054-7404. Available from: doi:10.14738/abr.111.13696, p. 1, similarly LUKEŠ, Jan. *Bankovní záruka.* Právní rozhledy. 2001, **9**(1), p. 5.

[77] RABAN, Přemysl. Občanské právo hmotné: relativní majetková práva. Brno: Václav Klemm, 2013. ISBN 978-80-87713-10-5, p. 76.

[78] KOPÁČ, Ludvík. *Obchodní kontrakty*. Praha: Prospectum, 1993. ISBN 8085431750., p. 180.

[79] PLÍVA, Stanislav. *Bankovní obchody.* Praha: ASPI, 2009. ISBN 978-80-7357-433-8, p. 75.

[80] LIŠKA, Petr. *Vývojové trendy právní úpravy bankovní záruky*. In: Pocta Ireně Pelikánové. Praha: Wolters Kluwer ČR, 2019, p. 556. ISBN 978-80-7598-427-2, p. 417.

[81] BERTRAMS, Roealand F. *Bank guarantees in international trade.* Netherlands: Kluwer Law International, 2013. ISBN 978-92-842-0185-3, p. 1.

However, independent guarantee contracts may have a longer tradition than generally acknowledged and they date back to classical Roman law.[82]

The bank's obligation under a bank guarantee according to Czech Civil Code is established when the bank issues a *"guarantee deed"* in written form[83]. The essence of a bank guarantee lies in the bank statement that the bank will satisfy the creditor according to the conditions of the guarantee deed up to a specified monetary amount if the debtor fails to fulfill their obligation or if other conditions specified in the guarantee deed occur[84]. The guarantee deed must be issued in writing, either in paper form or electronic form[85].

Under Section 2035 (1) of the Civil Code, if the conditions stated in the guarantee deed are met, the issuer shall perform the obligation under the guarantee upon receiving a written request from the creditor.

The issuance of a guarantee is not an isolated activity; rather, it consists of a network of relationships. The guarantee operation is considered to be a complex operation[86] and comprises (at least) three relationships – the underlying contract, the mandate agreement between the bank and the instructing party, and the guarantee deed itself. The three contract relationships are legally independent of each other, still interconnected economically[87].

The doctrine concluded that two types of bank guarantees can be recognized – unconditional and conditional guarantees[88]. The first type widely used in international trade transactions is usually paid under "first demand and without any objections". In the latter one, either the principle of an accessory or the principle of subsidiarity (or both) is incorporated[89]. If payment depends upon the submission of certain documents, the guarantee is called a "documentary guarantee"; Czech legal doctrine includes documentary guarantees within the framework of the conditional ones[90]. However, even an unconditional (autonomous) guarantee contains certain conditions: at least written demand is required, submitted as prescribed in guarantee deed[91], and during the validity period of the bank guarantee.

The true essence of the autonomous demand guarantees lies in their documentary nature[92]. The conditions for payment depend only on the terms stipulated in the guarantee deed[93]; the payment obligation of the issuing bank is triggered by presenting the conforming demand

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[82] RODRÍGUEZ GONZÁLEZ, Anna M. *La accesoriedad de las garantías en el derecho romano. ¿son las actuales garantías independientes figuras de nuevo cuño?* Revista de estudios histórico-jurídicos[online]. 2018, **40**, 47–69 [viewed 9 August 2023]. Available from: doi:10.4067/S0716-54552018000100047, p. 57.

[83] LIŠKA, Petr. *Bank guarantees in the Czech Republic*, op.cit., p. 5 – "guarantee deed" translates as "záruční listina".

[84] Section 2035 (1) of Civil Code.

[85] "An electronic bank guarantee is, therefore, a bank guarantee in electronic form (e.g. in the PDF format) with recognized electronic signatures attached on behalf of the bank" in LIŠKA, Petr. *Bank guarantees in the Czech Republic*, op.cit, p. 5.

[86] MASIÁ, Enrique Fernández. *Las garantías bancarias en el comercio internacional.* Boletín Mexicano de Derecho Comparado[online]. 2014, **47**(139), 101–144. ISSN 0041-8633. Available from: doi:10.1016/S0041-8633(14)70502-2p., p. 125.

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[88] KOPÁČ, Ludvík. *Obchodní kontrakty*, op.cit., p. 180.

[89] Ibid, p. 180.

[90] Ibid, p. 183.

[91] Judgment of the Supreme Court 29 Cdo 3950/2018 dated March 31st, 2020.

[92] KELLY-LOUW, Michelle. The Documentary Nature of Demand Guarantees and the Doctrine of Strict Compliance (Part 1 and Part 2). 2009, **21**, 306; 470. Part One, p. 311.

[93] LUPTON, Cayle. Demand guarantees in the construction industry: recent developments in the law relating to the fraud exception to the independence principle. South African law journal. 2019, **31**, p. 402.

(accompanied by other documents if required)[94] rather than the proof of claim[95] and reference to the underlying relationship is made only for identification purposes[96].

The "formal principle" has been derived from the jurisprudence of the Czech Supreme Court. In foreign doctrine, this principle is called "the strict compliance principle." As a consequence of the autonomy of the guarantee, the banks review only the documents tendered, not the underlying relationship.

2. THE FORMAL PRINCIPLE IN URDG758 AND CZECH CASE LAW

The Czech Civil Code does not specify the degree of compliance the demand must meet; the formal principle was derived from jurisprudence. Submitting the formally compliant demand for payment under the guarantee is crucial for the creditor. The guarantee may also require the statement of breach (the mere statement or the statement of breach particularised[97]). To which extent the risk is transferred from the creditor to the debtor depends on the nature of the documents required.

If a guarantee deed requires a court decision regarding the validity of the creditor's claim, it does not necessarily establish the accessory of the guarantee. Although the requirement for a court decision or an arbitral award required by the URCG (ICC Pub. No.325) was "technically" of a documentary nature (the judgment or arbitral award would be accepted by the issuer even if given without jurisdiction), the consequences for the beneficiaries were almost the same as with the surety guarantee [98].

2.1 Formal (strict compliance) principle in ICC Rules

A bank guarantee is governed by ICC Rules only if expressly incorporated. According to Article 19 of the Uniform Rules for Demand Guarantees (ICC Pub. No. 758), the guarantor shall determine whether the presentation (demand and accompanying documents) appears on its face as complying. However, complying presentation does not require literal compliance.

If the terms used in *"presentation appear on their face to convey the same meaning as the required in the guarantee,"*[99] the presentation may comply. Merely in case the guarantee deed

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[94] GOODE, Roy. *Abstract payment undertakings in international transactions*. Brooklyn Journal of International Law[online]. 1996, 22(1), 1–20 [viewed 1 August 2023]. Available from: https://brooklynworks.brooklaw.edu/cgi/viewcontent.cgi?article=1696&context=bjil, p. 4 and CHIVIZHE, Tinaye. A comparative analysis of the approach to the conformity of a supporting statement calling for payment under demand guarantees. Potchefstroom Electronic Law Journal (PELJ)[online]. 2022, 25, 1–21 [viewed 24 August 2023]. ISSN 1727-3781. Available from: https://www.academia.edu/92346645/A_Comparative_Analysis_of_the_Approach_to_the_Conformity_of_a_Supporting_Statement_Calling_for_Payment_Under_Demand_Guarantees, p. 4.

[95] HSU, Chung-Hsin. The independence of demand guarantees, performance bonds and standby letters of credit, op. cit., p. 4.

[96] LIPARTIA, Nino. *Analysis of legal nature of bank guarantees in the light of the principles of autonomy and strict compliance*. Journal of Law[online]. 2017, (2) [viewed 16 August 2023]. Available from: https://jlaw.tsu.ge/index.php/JLaw/article/view/2378, p. 31

[97] CHIVIZHE, Tinaye, (op.cit), p. 4.

[98] AFFAKI, Georges, and Roy GOODE. *Guide to ICC uniform rules for demand guarantees*. Paris: ICC, 2011. ISBN 978-92-842-0078-8., p. 19.

[99] ICC. Mezinárodní standardní praxe pro záruky vyplatitelné na požádání podléhající URDG 758 (ISDGP). Praha: ICC ČR, 2022. ISBN 978-80-904651-4-5, Art.142, p. 167.

requires the use of specific terms by quoting them by using quotation marks or by referring to the form attached the creditor must use the exact words in their demand.

2.2 Formal principle in the Supreme Court decisions

According to the Superior Court in Prague, the use of imperfect verb forms instead of perfect form does not make the demand non-complying. However, there is a substantial difference between the terms "payment obligations" and "due payment obligations"[100], the Supreme Court ruled. Noting that the bank was not authorized to examine the related legal relationship or to raise objections regarding this relationship but its obligation to pay was tied to the first demand containing the creditor's declaration that the debtor had not fulfilled their "due payment obligations" the Supreme Court concluded the creditor was obliged to adhere to the text of the statement.

In the decision[101] from April 2011 the Supreme Court stated that the issuing bank is not entitled to scrutinize the submitted document on a substantive basis but solely from a formal standpoint. The bank guarantee deed required the creditor to submit a statement that the buyer had not fulfilled their payment obligations and a copy of the unpaid invoices. Some of the invoices submitted were not yet due. The Supreme Court reminded that the guarantee deed issued "without objections" determines the bank is not authorized to review the specific legal relationship. Hence, the distinction between invoices before or after the due date is immaterial.

3. CHALLENGES ARISING FROM THE FORMAL PRINCIPLE

As the three relationships forming the guarantee operation are independent, aligning the terms of all three is crucial. The banks, with the aim of safeguarding their clients from the misuse of these abstract instruments, incorporate standardized clauses into guarantee deed wordings. Those standard wordings may not align with the condition of the underlying contracts.

3.1 Formal compliance of declaration of non-performance

The bank guarantee deed may stipulate the payment conditions more broadly than the underlying contract. This is particularly the case when the guarantee is payable on first demand, without objections or need to declare any counterparty's non-performance. This type of guarantee favours the creditor and leads to complete risk redistribution up to the amount of the bank guarantee. The bank is not entitled to refuse the payment of the bank guarantee based on conforming demand, even if it knows from the debtor that the creditor (based on the conditions of the underlying contract) may not be entitled to payment[102].

Provided the creditor receives the payment upon their demand in compliance with the terms of the guarantee deed, although this demand is not substantiated according to the underlying contract, it is the debtor's right to challenge the legitimacy of the drawing in a subsequent legal dispute.

However, if the underlying contract stipulates the right to claim under the bank guarantee on several occasions, and, on the contrary, the guarantee requires exact wording of a narrowly

[100] Judgment of the Supreme Court of the Czech Republic of August 31, 2016. 32 Cdo 4752/2014.

[101] Judgment of the Supreme Court of the Czech Republic of April 27, 2011. 23 Cdo 3042/2009.

[102] Judgment of the Superior Court in Prague of September 19, 2006. 5 Cmo 265/2006.

specified declaration of non-performance that does not cover all the claims arising from the contract, this situation brings potential disputes.

The contract may allow the creditor to satisfy the claims not yet due from the guarantee, while the guarantee deed requires the declaration that the debtor had not fulfilled their *"due payment obligation"*. In another scenario the contract entitles the creditor to draw from the bank guarantee to settle all the claims in connection with the contract (e.g., contractual penalty, compensation for actual damages, and unjust enrichment). Issues appear when the demand must be accompanied by the declaration that the debtor had not fulfilled their *"obligation related to proper and timely execution of the work,"* and the damage arose only after the proper and timely delivery of the work.

The creditors confront a dilemma when they need to claim the bank guarantee. Due to the formal principle, if the declaration does not comply, the bank will reject the demand. If the creditor risks submitting an incorrect (even false) statement, this act might have subsequent legal consequences.[103]

3.2 Formal principle and the conditions of effectiveness

As the Czech Supreme Court established, the formal principle in bank guarantees applies not only to the demand itself but also to assessing whether or not the conditions for effectiveness have been met.

Issuing banks incorporate suspensive conditions to protect their clients against unlawful claims under guarantee in the following manner: *"This guarantee shall come into effect upon receipt of payment identified by/with a variable symbol of/referring to the number of this guarantee"*. As the formal principle must also apply when examining whether the guarantee even became effective[104], such a suspensive condition brings challenges for the beneficiary.

The advance payment invoice usually contains different variable symbol based on accounting software numbering; the creditor is then instructed to use two different variable symbols – the invoice and the guarantee number. While a payment can be identified later for bookkeeping purposes, failure to provide a number for the purpose of guarantee coming into effect is due to the formal principle irreparable.

If the payment is not correctly identified in compliance with the suspensive condition in the guarantee deed, the Supreme Court stated that this mistake cannot be corrected subsequently, e.g., by the creditor's later written statement. The bank shall refuse the payment as the formal requirement in the guarantee deed wording has not been met.

CONCLUSION

To conclude, although the three relationships forming the guarantee operation are legally independent, it is essential for the creditor to align the underlying contract conditions with the terms stipulated in the guarantee deed.

As evident from Supreme Court judgments, practical challenges arise from the formal principle. In connection with the autonomy principle, the formal principle offers swift payment for the creditor; however, it is a double-edged sword. In the context of formal compliance with

[103] "Any liability for submitting incorrect or false documents lies with the creditor," states the Supreme Court in Judicial decision 23 Cdo 3042/2009.

[104] Judicial Decision of the Supreme Court of the Czech Republic of October 24, 2018. 29 Cdo 4747/2016.

the demand under the bank guarantee, the Supreme Court subjects the demand to a very stringent examination.

The creditors face a considerable challenge when confronted with the situation they are entitled to draw the guarantee under the underlying contract, but the non-fulfillment of the debtor does not fall within the scope of the required declaration.

The impact of formal principle on domestic guarantee practice as judicially derived requires emphasizing the importance of diligently drafted bank guarantee deed wordings. It promises to be interesting to observe how the case law in this field continues to develop.

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Some violations of European Union law identified by the Court of Justice of the European Union in Slovak state aid cases

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Abstract: *The General Court and the Court of Justice of the European Union issued several decisions in which they dealt with the compatibility of Slovak legislation as well as the practice of applying Slovak and European legislation by Slovak authorities with the rules of European law on the provision of state aid. Several decisions related to issues that emerged in the context of bankruptcy and restructuring of companies in difficulty. A special Act on measures related to strategic companies was assessed, which resulted in the inapplicability of standard bankruptcy procedures to selected strategic companies; the approach of the Slovak authorities in the attempt to recover the provided state aid was assessed, despite the fact that the measure representing state aid was approved by a valid decision of the bankruptcy court; the extension of the obligation to recover the provided state aid from the company – the recipient of the state aid to the company that bought it in bankruptcy was also considered, based on the application of the concept of their "economic continuity".*

Keywords: *State aid, Slovakia, Court of Justice of the European Union*

INTRODUCTION

The agenda for assessment and approving state aid provided by Member States to their companies according to Article 107 et seq. of the Treaty on the Functioning of the European Union (hereinafter "TFEU") is, both in terms of volume and significance, one of the most important agendas of the European Commission (hereinafter "the Commission"), the General Court of the Court of Justice of the European Union (hereinafter "the General Court") and the Court of Justice of the European Union itself (hereinafter "the Court of Justice"). Although the number of Commission decisions regarding state aid provided by the Slovak Republic is substantial, judgments of the General Court and of the Court of Justice regarding state aid provided by the Slovak Republic are significantly less frequent. The analysis of these judgments can be beneficial, because it allows to identify deviations in the procedures of Slovak authorities from the correct procedures of the European Union (hereinafter "EU") Member State authorities at various stages of "life" of state aid and to assess the urgency of rectifying such deviations as well as considering the authority of judgments of the General Court and of the Court of Justice.[105]

[105] State aid was also the reason for issuing judgments in the case *Dôvera vs. Commission* (judgment of the General Court of 5 February 2018, case T-216/15; see DERENNE, Jacques., and Ciara BARBU-O´CONNOR. Concurrence. N° 2/2018, 3 p.; annulled by the judgment of the Court of June 11, 2020, joined cases C-262/18 P and C-271/18 P), but the main question in them was whether or not the performance of public health insurance is an economic activity.

1. PROVISION OF UNAUTHORISED STATE AID DUE TO THE APPLICATION OF AN ACT RESULTING IN NON-APPLICATION OF STANDARD BANKRUPTCY PROCEDURES TO ASSETS OF A BUSINESS IN DIFFICULTY

In the judgment in the case *Fortischem vs. Commission* of 24 September 2019[106] the General Court assessed consequences of the application of Act No. 493/2009 Coll. on several measures concerning the strategic companies (hereinafter "Act on Strategic Companies") to the company *Novácke chemické závody* (hereinafter "*NCHZ*").

The Act on Strategic Companies granted the State a preferential right to purchase strategic companies in bankruptcy proceedings and required the bankruptcy administrator to ensure the continuation of a strategic company´s operation and to refrain from unjustified mass layoffs of employees. On 2 December 2009 the Slovak Government declared *NCHZ* as a "strategic company" under the Act on Strategic Companies; *NCHZ* held this status until 31 December 2010.

In its decision of 15 October 2014[107] the Commission concluded that: i) the declaration of *NCHZ* as a strategic company constituted state aid under Article 107(1) of TFEU, ii) this aid is incompatible with internal market, and iii) this aid must be recovered from *NCHZ* or from the company *Fortischem*, because it is linked to *NCHZ* through economic continuity.

The subject of assessment by the General Court was in particular the condition that the intervention must be an intervention on the part of the State or using state resources, as one of conditions for qualifying the intervention as state aid according to Article 107(1) of TFEU[108].

The General Court reminded that state aid in the context of bankruptcy proceedings to assets of a business in difficulty can take the form of applying regulations that deviate from standard bankruptcy regulations (paragraph 72 of the judgment). The General Court held that the application of the Act on Strategic Companies created an obstacle to mass layoffs in *NCHZ*, which gave rise to even a greater risk of increasing *NCHZ*´s liabilities, especially towards public creditors such as the Social Insurance Company and the General Health Insurance Company. Due to this obstacle, operating costs of *NCHZ* could not be decreased through a reduction in the number of employees. This obstacle also allowed *NCHZ* to retain its employees in order to continue its operations (paragraph 77 of the judgment).

In assessing the fulfilment of the condition for the intervention to give a selective advantage to the beneficiary, which is another condition for qualifying the intervention as state aid under Article 107(1) TFEU,[109] the General Court agreed with assessment by the Commission. According to the Commission, the application of the Act on Strategic Companies provided *NCHZ*, as well as its customers and suppliers, the certainty of continued operation, whereas the continuation of a company's operations in a standard bankruptcy proceeding is never

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[106] Case T-121/15 [online]. In EUR-Lex. [accessed on 2023-09-19]. Available from: https://eur-lex.europa.eu/; HARTIKAINEN, Sami. Economic continuity in a state aid recovery case • annotation on the judgment of the general court (Sixth chamber) of 24 september 2019 in case T-121/15 Fortischem v Commission. European State Aid Law Quarterly. 2020 (19), Issue 3, pp. 359–364.

[107] Decision 2015/1826 [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/.

[108] DECOCQ, André, and Georges DECOCQ. *Droit de la concurrence. Droit interne a droit de l´Union Européenne*. Issy-les-Moulineaux : LGDJ, Lextenso éditions, 2016. 978-2-275-04525-2. pp. 456–465.

[109] JANKŮ, Martin, MIKUŠOVÁ, Jana. *Veřejné podpory v soutěžním právu EU*. Praha : C. H. Beck, 2012. 9788074004308, p. 28.

guaranteed. It afforded *NCHZ* privileged treatment compared to its competitors in a similar situation (paragraph 132 of the judgment).

It must be noted that the Act on Strategic Companies had a limited temporal scope from the beginning, i.e. from 1 December 2009 to 31 December 2010, and was applied to a single company, namely *NCHZ*.

2. VIOLATION OF THE STATE´S OBLIGATION TO TAKE ALL NECESSARY STEPS FOR THE RECOVERY OF UNAUTHORISED STATE AID CONFIRMED BY A LEGALLY BINDING COURT DECISION

In the judgment in the case *Commission v. Slovak Republic* of 22 December 2010[110] the Court of Justice assessed the conduct of the Slovak Republic towards the Slovak producer of alcoholic and non-alcoholic beverages, canned fruits and vegetables, and vinegar, *Frucona*.

Frucona had accumulated a substantial debt towards the State due to arrears in excise tax payments. On 8 March 2004 *Frucona* filed a proposal for settlement with the relevant regional court.

After a vote by *Frucona'*s creditors, including a representative of the tax authority, in favour of the settlement proposal *Frucona* was to pay 35% of its debt to its creditors, including the tax authority, within one month, with the remaining 65% of the debt being forgiven by the creditors. The Regional Court in Košice confirmed this settlement by its resolution on 14 July 2004. The decision of the Regional Court became legally binding by expiration of the deadline for lodging an appeal.

After reviewing the disputed write-off of tax debt, the Commission in its decision of 7 June 2006[111] concluded that by writing off this debt the Slovak Republic provided *Frucona* with unlawful state aid and imposed on the Slovak Republic the obligation to recover this state aid from the beneficiary.

In order to recover the unlawfully provided state aid the tax authority filed a payment claim against *Frucona*. The District Court Košice II and the Regional Court in Košice rejected the claim of the tax authority, reasoning that it was impossible to review the resolution confirming the settlement that had become legally binding. On 2 July 2008, the tax authority submitted a motion to the Prosecutor General of the Slovak Republic to file an extraordinary appeal against the said decision of the Regional Court in Košice.

The Court of Justice first reminded that in case of a decision stating the unlawfulness of provided state aid, the Member State shall recover it – under the conditions laid down in Article 14(3) of Regulation 659/1999 establishing detailed rules for the application of Article 93 of the Treaty establishing the European Community[112] – without undue delay and in accordance with procedures provided for by its national law, provided that these allow the immediate and effective enforcement of the Commission's decision, and shall take all necessary steps available under its legal system in proceedings before national courts for that

[110] Case C-507/08 [online]. In EUR-Lex. [accessed on 2023-09-19]. Available from: https://eur-lex.europa.eu/; DERENNE, Jacques. Concurrences. N° 2/2011, p. 166–168.

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[112] Regulation of 22 March 1999 [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/.

purpose. The only fact on which the Member State can rely in its defence is the absolute impossibility of properly enforcing the recovery decision (paragraph 43 of the judgment).

Although the Slovak Republic did not invoke the absolute impossibility of proper enforcement of the decision in this proceeding, it failed to recover any part of the unauthorised state aid from *Frucona* even after 29 months from the notification of the Commission's decision (paragraph 45 of the judgment). The Court of Justice stated that the Slovak Republic did not present the specific facts regarding the conditions under which its state authorities used the means at their disposal to recover the unauthorised state aid, specifically that Slovak Republic did not specify the procedure followed in connection with the motion submitted by the tax authority, on 2 July 2008, to the Prosecutor General of the Slovak Republic for filing an extraordinary appeal against the judgment of the Regional Court in Košice (paragraphs 62 and 63 of the judgment). Therefore, the Court of Justice concluded that the Slovak Republic did not submit sufficient evidence to suggest that within the prescribed period it had taken all the steps it could have taken to recover the disputed aid (paragraph 64 of the judgment).

The realization that a situation where a final decision of a Slovak court can come into conflict with later decision of the Court of Justice or another EU body may recur in the future forced the legislator to adopt an amendment to the Civil Procedure Code. By Act No. 384/2008 Coll., the legislator expanded the grounds for a motion to reopen proceedings to include the reason of inconsistency between a final judgment and a decision of the Court of Justice or another EU body [Article 228 (1)(e) of the Civil Procedure Code].

3. EXPANSION OF THE CIRCUIT OF ENTITIES OBLIGED TO RETURN THE UNAUTHORISED STATE AID TO BUSINESSES CREATING ECONOMIC CONTINUITY WITH THE ORIGINAL BENEFICIARY OF AID

In the mentioned case *Fortischem vs. Commission*, after the company *NCHZ* returned to the standard bankruptcy regime under the Act No. 7/2005 Coll. on bankruptcy and restructuring, on 7 June 2011, the District Court Trenčín issued an order to the administrator to sell *NCHZ* through a public auction. Following the evaluation of the public auction the administrator signed the contract on the sale of *NCHZ* with company *Via Chem Slovakia*, which entered into force on 31 July 2012. On the next day, 1 August 2012, *Via Chem Slovakia* sold the chemical division of *NCHZ*, with exception of immovable assets (buildings and land), to *Fortischem*, a company operating in the chemical production sector. Moreover, *Via Chem Slovakia* provided *Fortischem* with immovable assets of *NCHZ* required for chemical production under a lease agreement. *Fortischem* was part of the group *Energochemica*.

The General Court reminded the established case-law, according to which unauthorised state aid must be recovered also from a company that continues the economic activities of the business that benefited from the aid, when it is demonstrated that this company continues to enjoy a competitive advantage resulting from this aid (paragraph 207 of the judgment). When assessing the existence of such economic continuity, several relevant facts can be taken into account, such as the price of the transfer, the subject and extent of the transfer of assets and liabilities and the economic rationale of the transaction (paragraph 208 of the judgment).

When assessing the purchase price for *NCHZ*, the General Court stated that bidders could submit offers with commitments or offers without commitments. At the same time, if the highest offer without commitments was higher than the highest offer with commitments, the bidder with highest offer with commitments had the opportunity to match the highest offer

without commitments. A public auction that allows certain bidders to change the price, carries the risk that bidders who can adjust their offers may be attempted not to propose the highest price and wait until it is necessary to rise the offer. It also carries the risk that bidders who cannot adjust their offers, may attempt to propose a price that is lower than the highest price assessed for the company, or even decide not to submit an offer because they believe that they can be outbid by a bidder with commitments. Therefore, the conditions set for the public auction could have influenced the selling price in the sense that it may not have corresponded to the highest possible price (paragraphs 231 and 232 of the judgment).

The bidders could only submit offers for the purchase of *NCHZ* as a whole. It cannot be assumed that if the company was offered for sale only as a whole, the resulting price would be the highest price achievable on the market. On the contrary, a sale that did not restrict the subject of sale to the company as a whole, would have allowed for an unrestricted range of potential buyers and assumed that the company was sold for the highest possible price (paragraphs 237 and 240 of judgment).

The purchase price (of most assets) of *NCHZ* in the immediate subsequent sale by the company *Via Chem Slovakia* and in favour of the company *Fortischem* was negotiated without public auction, directly between these two companies, which did not allow to determine whether the agreed price was in line with the market price or lower (paragraphs 247 and 250 of the judgment).

When assessing the subject of sale, the rule applies that the larger the portion of the original business transferred to the purchaser, the higher the probability that economic activity related to the transferred portion of the business will continue to benefit from the advantages of unauthorised state aid (paragraph 254 of the judgment). If *Fortischem* took over more than 95% of employees of *NCHZ*, all assets, all other rights and obligations related to the transferred business, and the right to use immovable assets (on the basis of the lease agreement), it is reasonable to conclude that *Fortischem* simply continues the economic activities of *NCHZ* to the same extent as before the transaction and thereby establishes economic continuity with *NCHZ* (paragraphs 255 and 258 of the judgment).

When assessing the economic rationale of the sale, the aim is to verify whether the acquirer uses the acquired assets in the same manner as the seller, or whether it integrates the assets into its own business strategy and thus implements synergies that justify its interest in acquisition of these assets. Beside of assets and liabilities of *NCHZ* mentioned in the previous paragraph, *Fortischem* also took over *NCHZ*'s product portfolio and scope of activities. This leads to the conclusion that, from *Fortischem*'s perspective, the economic rationale of the transaction was to continue the activities previously performed by *NCHZ* (paragraphs 261 and 264 of the judgment). This conclusion is not challenged by the fact that *Fortischem* is part of a larger group of companies, because the transaction did not create substantial synergic effects in relation to the other group members (paragraph 261 of the judgment).

CONCLUSION

The legislator promptly removed from Slovak legislation the risk areas that directly created the possibility of violating the prohibition of providing unauthorised state aid (by declaring a certain company as a strategic company) or hindering the fulfilment of the obligation to recover unauthorised state aid (due to the absence of a procedure allowing to reverse a final court decision approving the provision of unauthorised state aid).

A more enduring risk is seen in the way of application of some standard procedures in bankruptcy law. If the bankruptcy administrator of a business – recipient of unauthorised state aid – set the method of evaluation of the best offer for purchase of this business in a way that does not aim exclusively the achievement of the market's highest possible price, they can considerably increase the risk of imposing an obligation on the buyer to return the unauthorised state aid, received by the purchased business. This risk can materialize within the framework of bankruptcy proceedings over assets of a company that has not only received unauthorised state aid falling under Article 107(1) of TFEU, i.e. state aid with a Union dimension ("affecting trade between Member States"), but also unauthorised state aid without a Union dimension, if such state aid would fall under Article 6 of Act No. 187/2021 Coll. on protection of competition ("State authority shall not restrict competition by obvious support which advantages a particular undertaking or in other manner")[113].

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Protecting Older Adult Consumers Under EU Law

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Abstract: *Older adult consumers are an increasingly important segment to protect in Europe today. The attention paid to them in research and in consumer policy is no longer new, but it is still very dynamic. In more recent times, attention must be paid, inter alia, to the impact of energy prices on older adult consumers, the development of financial services, including those aimed at older adult consumers, and the growing number of older adult consumers shopping online. In most of Europe, including Central Europe, EU law (especially the existing regulation of protection) has an eminent role to play in ensuring effective consumer protection for older adult consumers. The objective of this paper is to capture and evaluate the main features of the current EU law approach to this important issue. Accordingly, the paper focuses in turn on the questions of who are older adult consumers and why they deserve special attention in consumer law, what constitutes the current framework for the protection of older adult consumers in EU law, and, in particular, what are the 'guiding points' for protecting older adult consumers under EU law. The analysis of the approach of the current EU consumer law is confronted with the findings from selected consumer organisations.*

Keywords: *consumer protection, consumer, older adult consumers, EU consumer law, older adult persons*

INTRODUCTION

Older adult consumers[114] represent an issue that is not new in marketing research, nor in EU policy and law, but at the same time is not losing its importance and dynamism, quite the contrary.[115] It has been the subject of marketing research since at least the 1970s.[116] In EU law, attention to this issue has been increasing gradually; in our view, this trend can be reliably observed from the 2000s,[117] and more clearly from the 2010s;[118] it must be accepted that the

[114] This group of consumers is often referred to variously as elderly consumers, older consumers, older adult consumers, or senior consumers. The authors, trying to choose the most respectful label, have chosen 'older adult consumers'.

[115] On dynamism on the subject matter see, e.g., BAŁANDYNOWICZ PANFIL, Katarzyna. The Role of Older People as Consumers – the Comparative Analysis of Old and New Member States of European Union. *Comparative Economic Research. Central and Eastern Europe* [online]. 2012, 15(1), 84–85. 1478–3320 [02 September 2023]. Available from: https://doi.org/10.2478/v10103-012-0005-y.

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[117] Here, we are referring to the Unfair Commercial Practices Directive, namely to concept of particularly vulnerable consumers [Article 5 (3)]. Directive (EU) No 2005/29/EC of the European Parliament and of the Council of 11 May 2005 on concerning unfair business-to-consumer commercial practices in the internal market [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02005L0029-20220528.

[118] Here, we are referring to the Directive on Consumer Rights, taking into account its overall potential to strengthen the protection of older consumers, and to the 2012 EU Consumer Agenda, namely

view may differ.[119] Of the current EU policy documents, the New Consumer Agenda 2020 is particularly important.[120] This document reinforces the emphasis on the special protection of particularly vulnerable consumers, which explicitly includes older adult consumers.[121] There is a specific passage dedicated to older adult consumers (including people with disabilities)who are generallyrecognised as having specific needs. *"It is important to ensure that clear, user-friendly and accessible information is available both online and offline in accordance with EU accessibility requirements for products and services. Older consumers and consumers with disabilities also need accessible products and assistive technologies that are compatible with mainstream technologies. A fair and non-discriminatory approach to the digital transformation should cater to the needs of older consumers, consumers with disabilities and more generally 'off-liners' who may be less familiar or less at ease with digital tools and more prone to fall victim to fraud."*[122]

In this paper, the authors aim to capture and evaluate the main features of the current EU law approach to the present issue. Accordingly, the paper focuses in turn on the questions of who are older adult consumers and why they deserve special attention in consumer law (chapter 1), what constitutes the legal framework for the protection of older adult consumers in EU law (chapter 2), and, in particular, what are the 'guiding points' for protecting older adult consumers under EU law (chapter 3).

In order to achieve a result that is more realistic and at least hints at the challenges ahead, the authors of this paper first analyse the approach of current EU consumer law [step (a)]. Then, they present the related results of a questionnaire survey they carried out among the European Consumer Centre Czech Republic as a specific body funded by the European Commission and the Czech Trade Inspection Authority and three Czech consumer organisations funded on private law basis as non-governmental organisation in the Czech Republic (this questionnaire survey is referred to hereafter as 'the survey') [step (b)];[123] the authors have deliberately selected responding bodies that focus on the full spectrum of consumers and, in the context of this broad focus, are able to assess the level of specificity and attention to older adult consumers objectively; the survey was conducted via Google Form from 15 August to 10 September 2023.

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[121] This builds in particular on the 'Specific needs of certain consumer groups' as the fourth of the five key priority areas of the document just cited.

[122] Point 3.4 of the same document.

[123] European Consumer Centre Czech Republic [Evropské spotřebitelské centrum České republiky], https://www.coi.cz/en/for-consumers/european-consumer-centre/. The free non-governmental organisations were (in alphabetical order) Consumer Defence Association — Syndicate [Sdružení obrany spotřebitelů – Asociace, z. s.], https://www.asociace-sos.cz/; Consumer Defence Association of Moravia and Silesia [Sdružení obrany spotřebitelů Moravy a Slezska, z. s.], https://www.sos-msk.cz/; dTEST [dTest, o.p.s.], https://www.dtest.cz/. The authors are very grateful to all of these for their willingness to participate in the survey.

Finally, the authors confront the analysis of the approach of current EU consumer law with the results of the survey [step (c)].

1. WHO ARE OLDER ADULT CONSUMERS AND WHY THEY DESERVE SPECIAL ATTENTION IN CONSUMER LAW

(a) Who are older adult consumers and why do they deserve special attention are heavily tied questions, especially in law.

If we ask the question who are older adult consumers from the point of view of the law (or, more precisely, from the point of view of the need for special legal protection), disciplines such as marketing, sociology and others can nevertheless be strongly helpful, in particular by providing typical characteristics of older adult consumers. In marketing, in some studies, older adult consumers may be defined by age (typically 65+).[124] In law, such a sharp definition could hardly work: compare, for example, the different age range of older adult consumers in the market for cosmetics products versus medical care services for elderly persons.[125]

If we ask the question why older adult consumers actually deserve special legal protection, many answers point in one way or another to their particular vulnerability. This can be expressed in general terms,[126] by types of vulnerability[127], by the sectors (fields) in which it is manifested;[128] an interesting approach taken by the OECD is to list the factors that make older adult consumers more vulnerable.[129] As an answer, the authors of this article offer four sets of reasons in response, which take into account the possible special vulnerability of older adult consumers, but also the general view of the older generation as part of society.

- Ethical reasons can be expressed by the idea that the maturity of a society is also judged by how it takes care of the old (vulnerable) citizens.[130]
- Demographic reasons are due to changes in the age structure of the society, which are logically reflected in the markets and they are very important for business, too. Contemporary Europe is one of the parts of the world facing the challenges of the so-called silver economy which is expected to grow by about 5 % a year between 2015 and 2025[131]. In this context, the very important finding is that aging affects consumers'

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[124] BERG, Hanna, and Karina T. LILJEDAL, op. cit., 1647.

[125] BAŁANDYNOWICZ PANFIL, Katarzyna, op. cit., 84.

[126] GUIDO, Gianluigi, Marta UGOLINI, and Andrea SESTINO. Active ageing of elderly consumers: insights and opportunities for future business strategies. *SN Business & Economics* [online]. 2022, 2(8), 8. 2662–9399 [22 August 2023]. Available from: https://doi.org/10.1007/s43546-021-00180-4.

[127] SEGAL, Michal, Sagit MOR, and Israel DORON. The Judicial Construction of Older Consumers' Rights: A Qualitative Case-Law Analysis. *Canadian Journal of Law and Society / Revue Canadienne Droit et Société* [online]. 2021, 36(1), 161. 1911–0227 [22 August 2023]. Available from: https://doi.org/10.1017/cls.2020.36.

[128] GUIDO, Gianluigi, Marta UGOLINI, and Andrea SESTINO, op. cit. 3.

[129] Organisation for Economic Co-operation and Development. Financial Consumer Protection and Ageing Populations. oecd.org [online]. 2020 [viewed 02 September 2023]. Available from: https://www.oecd.org/regreform/sectors/financialconsumerprotection.htm.

[130] This idea has been taken up, for example, by BUCK, Pearl S. *My Several Worlds: A Personal Record*. Open Road Integrated Media, 2013, 407. 9781480421233; or by Huber Humprey as recalled by GERSON, Michael, and Peter WEHNER. *City of Man: Religion and Politics in a New Era*. Moody Publishers, 2010, 144. 9781575679280.

[131] Green Paper on Ageing: Fostering Solidarity and Responsibility between Generations. Brussels, 27 January 2021 COM(2021) 50 final. In EUR-Lex. Available from: https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A52021DC0050.

behavior, decision making, cognition and persuasion, product evaluation attributes, e-marketing, brand awareness, advertising, reactions to the market, sensitivity to ethical aspects or luxury products purchase.[132] Therefore, the inclusion of age in marketing research is as relevant as, for example, gender.[133]

- Technological reasons are based on the well-known fact that older generations use technology less and in more limited ways than younger generations. Here, it is important to mention the rise of e-commerce and the COVID-19 pandemic which has fostered digital access, but also digital poverty. According to research on e-commerce use, it was not gender that was important, but rather family status. Problems were often faced by those living in isolation, which is the case for many older adults.[134]
- Regional reasons are based on regional specificities which must certainly not be underestimated in the European Union, as studies both older[135] and more recent[136] have shown. For example, in the post-communist EU countries, it cannot be overlooked that many older adult consumers have lived a significant part of their lives outside the market economy and have not yet learned to cope with its pitfalls (e.g., they may underestimate a trader's interest in selling a product as the essence of a marketing strategy or may not correctly assess an advertising exaggeration).

Importantly, these reasons are pre-legal and objective in nature, so the law cannot but reflect them.

(b) In relation to this section of the paper, the following two questions were asked in the survey. For each question three or more answers were offered, from which only one could be chosen. The results are shown in the table. In the column 'Selected by', the answer chosen by the European Consumer Centre Czech Republic is indicated by 'ECC'; the answers chosen by one to three Czech consumer organisations are indicated '1 CZ NGO', '2 CZ NGOs', or '3 CZ NGOs'. In the following chapters of the paper, findings from the survey are arranged in the same way.

Tab. 1 Q1: When assessing the state of consumer protection in your activities, do you use an age or age category perspective?

Answers offered:	Selected by:
A1: Yes, most of the time, if it is possible.	X
A2: Not usually.	X
A3: It depends on the nature and purpose of the evaluation. It is impossible to answer more precisely.	ECC, 3 CZ NGOs

Source: by authors of this paper

[132] RYBACZEWSKA, Maria, and Leigh SPARKS. Ageing consumers and e-commerce activities. *Ageing and Society* [online]. 2022, 42, 1881. 1469–1779. [03 September 2023]. Available from: https://doi.org/10.1017/s0144686x20001932.

[133] BERG, Hanna, and Karina T. LILJEDAL. op. cit. 1640.

[134] RYBACZEWSKA, Maria, and Leigh SPARKS. op. cit. 1894.

[135] BAŁANDYNOWICZ PANFIL, Katarzyna. op. cit. 98–100.

[136] KOPANIČOVÁ, Janka, and Dana VOKOUNOVÁ. Cultural Differences in Coping with Changes in the External Environment: A Case of Behavioural Segmentation of Senior Consumers Based on Their Reaction to the COVID-19 Pandemic. *Central European Business Review*. 2023, 12(3), 38–41. DOI: https://doi.org/10.18267/j.cebr.325.

Tab. 2 Q2: Would it be beneficial for EU law to define an older adult consumer?

Answers offered:	Selected by:
A1: Somewhat, yes, a general definition and, where appropriate, a specific definition for certain categories of products or services, methods of contracting, etc.	1 CZ NGO
A2: Somewhat, yes, but only a specific definition or definitions for certain categories of products or services, methods of contracting, etc.	ECC
A3: We would prefer not.	1 CZ NGO
A4: We do not have a definite option on this question.	1 CZ NGO

Source: by authors of this paper

(c) Question 1 was answered unequivocally, showing thus a reasonable approach whereby special consideration for older adult consumers should arise from the circumstances and not necessarily be ubiquitous; one cannot but agree with this.

Question 2 was answered in an exemplary divergent manner. In fact, as the subsequent informal communication with some organisations revealed, this is a logical consequence of their intensive practical experience with the older adult consumer segment and the difficulty of measuring the benefits and risks of the definition under consideration.

2. WHAT CONSTITUTES THE current FRAMEWORK FOR THE PROTECTION OF OLDER ADULT CONSUMERS IN EU LAW

(a) In EU law, older adult consumers are protected through a range of legislation that aims to protect the rights and interests of all consumers regardless of age, and usually does not even explicitly provide specific protection for older adult consumers. Nevertheless, this legislation also at the very least allows for the specificities of the protection of older adult consumers to be taken into account. Moreover, there are other sources of EU law that allow the specificities of the situation of older adult consumers to be reflected. With this background, the current framework for the protection of older adult consumers in EU law can be sketched as follows:

(i) The EU Charter of Fundamental Rights (hereinafter referred to as 'CFR'),[137] is applicable to EU Member States only insofar as they apply EU Law. It does not explicitly mention 'older adult consumers', but it contains a range of provisions that apply to all consumers as part of their fundamental rights within the EU. It is possible to identify provisions which work together to protect the interests of consumers and ensure that they are not discriminated against on the basis of age or any other characteristic.[138] These provisions are mainly:

- Article 21, prohibiting discrimination on various grounds, including age, and reinforcing thus the principle of equal treatment;

[137] Official Journal of the European Union. Charter of Fundamental Rights of the European Union [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/eli/treaty/char_2012/oj.

[138] EKLUND, Hanna, and Claire KILPATRICK. Article 21 EU Charter of Fundamental Rights. *European University Institute* [online]. 2021, 1, 3, 1831-4066. [05 September 2023]. Available from: https://hdl.handle.net/1814/71418.

- Article 25, saying that "[t]he Union recognises and respects the rights of the elderly to lead a life of dignity and independence and to participate in social and cultural life." This article does not expressly state specific rights, but merely refers to them;[139]
- Article 38, underlining the EU's commitment to maintaining and promoting *"a high level of consumer protection"*. This means that the EU recognises the importance of ensuring that consumers are treated fairly, have access to accurate information and are protected from unfair or harmful commercial practices; this is particularly important from the point of view of older consumers.

The 'triple combination' of these provisions provides a solid constitutional basis at EU level to protect the interests of older adult consumers. In addition to these, there are other provisions contributing to this protection in CFR.[140]

(ii) From EU secondary law, the following consumer directives and regulations are particularly important in this area:

- Unfair Commercial Practices Directive that expressly mentions also the consumers who are particularly vulnerable because of age (and other reasons);
- Consumer Rights Directive that covers many various aspects of consumer transactions covers a number of aspects of consumer transactions (such as information requirements, withdrawal rights, and remedies in case of defective products) not limited to older adult consumers but particularly important for them;
- General Data Protection Regulation (GDPR)[141] that covers area of risks that older adult consumers are not aware of, and if they are aware of them, they assume that they are not threatened;[142]
- General Product Safety Regulation (GPSR)[143] that guarantees to all consumers, including the most vulnerable, a right to safe products placed or supplied on the market. This includes, *inter alia*, older adult consumers as referred to in the 5th recital. The same rights apply to the safety of the product, which should be assessed in the light of all relevant aspects of the product, including the specific needs of vulnerable persons as referred to in the 23rd recital and in Article 6 (a), too.

In addition to these directives and regulations, a number of others, for example in the field of financial products and services, including banking and insurance, are important for protecting the rights of older adult consumers.

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[139] LOCK, Tobias. Rights and principles in the EU Charter of Fundamental Rights. *Common Market Law Review* [online]. 2012, 56(5), 1215. [09 September 2023]. Available from: https://doi.org/10.54648/cola2019100.

[140] E.g., Article 41 guaranteeing the right to good administration. This is important for consumers who turn to the competent administrative authorities.

[141] Regulation (EU) No 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02016R0679-20160504&qid=1694372405370.

[142] ZANCHETTA, Chiara, Hannah SCHIFF, Carolina NOVO, Sandra CRUZ and Carlos VAZ DE CARVALHO. Generational Inclusion: Getting Older Adults Ready to Own Safe Online Identities. *Education Sciences* [online]. 2022, 12(10), 3. 2227–7102 [11 September 2023]. Available from: https://doi.org/10.3390/educsci12100715.

[143] Regulation (EU) No 2023/988 of the European Parliament and of the Council of 10 May 2023 on general product safety [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32023R0988&lang1=CS&from=CS&lang3=choose&lang2=choose&_csrf=aaae8806-a644-4a67-a11f-5bc42a038d64.

(iii) The case-law as a subsidiary source of EU law has a particular importance as a 'thought bridge' between the general provisions of EU legislation and individual cases; in this sense, it is a source of judicial reasoning which in turn serves as a valuable guide to the practical interpretation and application of EU law. On the one hand, the case law of the EU courts cannot be said to have created any 'doctrine of particular protection for older adult consumers'; on the other hand, a few decisions can be found which deal with sub-issues related to the protection of elderly consumers or emphasise the protection of elderly persons in the market in general.[144]

(b) In relation to this section of the paper, the following two questions were asked in the survey.

Tab. 3 Q3: When learning about the development of EU consumer protection policy and law, do you specifically address the implications for the protection of older adult consumers?

Answers offered:	Selected by:
A1: Yes, this procedure can be considered a rule in our organisation.	3 CZ NGOs
A2: No, this procedure is not considered a rule in our organisation, but we are considering it in the future.	ECC
A3: No, this procedure can not be considered a rule in our organisation and we are not considering it in the future.	X

Source: by authors of this paper

Tab. 4 Q4: Would it be beneficial for the EU consumer directives to pay special attention to older adult consumers?

Answers offered:	Selected by:
A1: Somewhat, yes, by adopting a comprehensive directive on the protection of older adult consumers.	X
A2: Somewhat, yes, but only by inserting specific provisions on the protection of older consumers in the various directives.	ECC, 1 CZ NGO
A3: No, it would not.	1 CZ NGO
A4: We do not have a definite opinion on this question.	1 CZ NGO

Source: by authors of this paper

(c) Question 3 was answered by all three responding Czech NGOs that when learning about the development of EU consumer policy and law, they specifically address the implications for the protection of older adult consumers as a rule. The ECC is considering introducing such a rule. Overall, the answers show that attention to the impact of developments in consumer policy and EU law on older adult consumers is not underestimated; this is in line with current realities and is a good basis for further legal policy considerations in this area.

Question 4 has appeared somewhat controversial. The answers were very different (despite a slight preference for inserting specific provisions on the protection of older adult consumers

[144] E.g., Judgement of the Court of Justice of 11 July 2013. Fédération des maisons de repos privées de Belgique (Femarbel) ASBL v Commission communautaire commune de Bruxelles-Capitale. Case C-57/12 [online], paragraph 43. In EUR-Lex. [accessed on 5 October 2023]. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A62012CA0057&qid=1695924352418. The paragraph refers to the meaning of the protection of elderly persons receiving care and assistance services.

in the various directives). However, it can be inferred that, on the one hand, the special treatment of older adult consumers is welcomed, but on the other hand, they are not the only group that would deserve such special provisions. For this reason, the legislation introduces the notion of 'particularly vulnerable consumers'. At the same time, it is important to remember the need to make legislation clearer and simpler, rather than extending it.

3. WHAT ARE 'GUIDING POINTS' FOR PROTECTING OLDER ADULT CONSUMERS UNDER EU LAW?

(a) Especially since EU legislation has not explicitly provided specific protection for older adult consumers and EU case-law has not created any 'doctrine of particular protection for older adult consumers' yet, it is necessary to ask whether more general rules or principles can be derived from EU law to protect older adult consumers, taking into account their specificities. We have referred to these more general rules or principles as 'guiding points'. They are of high relevance

- theoretical, indicating the capacity of EU law to reflect the specificities of older consumers (however blurred the definition of this category may be), and
- practical, consisting in particular of the possibility as specific aspects of the interpretation and application of consumer law in cases where the protection of the elderly is at stake,

and may be typed out, including suggestions for their practical application, as follows.

(i) The protection of consumers, and especially older adult consumers, must be applied in accordance with its purpose, which is not only economic integration but above all the protection of human rights. This is given by its basis in the CFR and is also recognised at a political level.[145] The practical application of this point should be: a guiding principle of interpretation and application and as well as a test of their result.

(ii) The protection of older adult consumers must be interpreted and applied in the light of their typical 'vulnerabilities'. These typically manifest themselves in impaired opportunities for social participation (in the broadest sense), in 'keeping up' with current developments (e.g., in the technical field) and in obtaining information. The practical application of this point can be: e.g., assessing the clarity and comprehensibility of pre-contractual information provided to the older adult consumer.

(iii) The protection of older adult consumers must be interpreted and applied in the light of the main objectives set out in EU policy documents for the protection of older adult consumers. For example, the current challenge is to protect older adult consumers from discrimination in the digital market.[146] The practical application of this point may be: adequately increasing the emphasis on the interpretation and application of legislation in favour of the consumer in such cases.

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[145] Among others, this was also recalled by Meglena Kuneva, the European Commissioner for Consumer Protection from 2007–2010. Leading the Way. Consumer Protection in Retrospect. The New Consumer. 50th anniversary special edition [online]. December 2022, 26 [viewed 5 October 2023]. Available from: https://www.eccnet.eu/sites/default/files/2023-01/50%20YEARS%20OF%20CONSUMER%20PROTECTION.pdf. 9789276593928.doi:10.2838/805805.

[146] For more detail, see Opinion of the European Economic and Social Committee on Improving equality in the EU (own-initiative opinion) [online]. Brussels, 26 October 2022. 2023/C 75/09, point 3.2. In EUR-Lex. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52022IE1002.

(iv) Technically, the protection of older adult consumers should consistently make use of rules and concepts that protect the weaker ones, especially the prohibition of discrimination on grounds of age and the concept of particularly vulnerable consumers. The prohibition of discrimination on grounds of age, although developed mainly in the field of employment and occupation, is a general principle of EU law, as has also been recognized in the case law of the EU Courts.[147] As regards particular vulnerability, this is not a characteristic of all but of most the older adult consumers.[148] The practical application of this point may be: when in doubt as to whether the reason for the differential treatment of a consumer was his age or whether an older adult consumer should be considered particularly vulnerable, lean towards a positive answer.

(b) In relation to this section of the paper, the following two questions were asked in the survey.

Tab. 5 Q5: When working with EU consumer protection legislation or decisions, do you have an overview (regardless of form) of provisions and decisions of particular relevance to the protection of older adult consumers?

Answers offered:	Selected by:
A1: Yes, we do.	ECC, 1 CZ NGO
A2: No, but we are considering it in the future.	2 CZ NGOs
A3: No, and we are not considering it in the future.	X

Source: by authors of this paper

Tab. 6 Q6: Would it be useful for the EU to produce comprehensive information or a methodological document summarising important legal provisions of EU legislation and decisions of EU courts of particular relevance to the protection of older adult consumers?

Answers offered:	Selected by:
A1: Yes, it would.	ECC, 3 CZ NGOs
A2: It would not.	X
A3: We do not have a definite opinion on this question.	X

Source: by authors of this paper

(c) In answer to the question 5, ECC as well as one Czech NGO indicated that they have prepared some form of an overview of provisions and decisions of particular relevance to the protection of older adult consumers, whereas two NGOs are considering it in the future. At the very least, this shows that all those involved perceive a growing need for special attention to the protection of older adult consumers in EU law.

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[147] BÍLKOVÁ, Veronika, Kateřina ŠIMÁČKOVÁ, and Alla TYMOFEYEVA. *Lidská práva starších lidí*. Praha: Wolters Kluwer, 2022, 171–174. 9788076766099. The case law of EU Courts cited here is Judgment of the Court of Justice of 22 November 2005. Werner Mangold v Rüdiger Helm. Case C-144/04 [online]. In EUR-Lex. [accessed on 5 October 2023]. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A62004CJ0144.

[148] BÍLKOVÁ, Veronika, Kateřina ŠIMÁČKOVÁ, and Alla TYMOFEYEVA, op. cit., 178–180; HOWELLS, Geraint, Christian TWIGG-FLESNER, and Thomas WILHELMSSON. *Rethinking EU Consumer Law*. Routledge: London and New York, 2018, 26. 9781138058743.

This corresponds to the unequivocal answer to question 6. It was agreed that it would be useful if the EU created a comprehensive single document containing important legal provisions of EU legislation and EU court decisions of particular relevance for the protection of older adult consumers. We feel this need too, not only for supporting consumer organisations' activity, but also for traders. Such a document could also improve the effectiveness of the protection of older adult consumers, already in the B2C relationship itself.

CONCLUSION

Older adult consumers are an important group of consumers who, due to their specificities and to the growth of their group, deserve special attention; this is also true in EU law. The fact that this group is difficult to define (not only in legal terms) does not change this.

EU law does not provide for a general or specific legislative definition of the older adult consumer, nor does it provide explicit legislative regulation for these consumers. Our survey has shown that there is no strong and clear demand for such a solution. On the one hand, the responding bodies recognise that older adult consumers require special protection and actively pursue and promote the interests of this group of consumers; on the other hand, they take a sober approach to the benefits and risks of any legislative definitions or special provisions.

At the same time, EU law has provisions, rules and concepts that can be used to protect older adult consumers (e.g. the prohibition of discrimination on the grounds of age or the particularly vulnerable consumer). Moreover, we believe that it currently allows certain 'guiding points' to be deduced for the effective protection of older adult consumers [namely understanding the protection of (not only older adult) consumers as a matter of human rights, taking into account the typical vulnerabilities of older adult consumers, taking into account main objectives set out in EU policy documents, and making consistent use of rules and concepts protecting the weaker party]. Our survey has shown that the responding bodies are working with consumer law, including EU consumer law, with a particular focus on the protection of older adult consumers (in general, or at least where it is needed). However, in this context, they would welcome the development of an informative and methodological document at EU level containing important legal provisions of EU legislation and EU court decisions of particular relevance for the protection of older adult consumers. Such a legal but soft instrument could significantly enhance the effectiveness of the application of consumer law in the case of older adult consumers.

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Selected issues of technology transfers agreements under Polish law

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Abstract: *This paper examines the transfer of technological assets in Polish commercial transactions governed by civil law instruments. The author defines "technology" within Polish legislation, exploring its categorization under copyright or industrial property law as well as other regulations and possible protection. The author analyses the implications of such legal classification and outlines prerequisites for efficient technology transfer. The author discusses various mechanisms for technology transfers, including copyright-related aspects and forms of legal arrangements. The paper presents manners of integration of mechanisms into various agreements, such as transfers of enterprise, sales, and donations which is explored with a focus on key clauses and consequences of mergers and acquisitions on technology ownership. The author addresses the concept of transfers within employment relationships and provides general strategies for transferring rights to technology developed with independent contractors. The importance of clear contractual agreements, specifying ownership, confidentiality, and remuneration, is emphasized for successful transfers. Additionally, the author examines alternative protective measures like confidentiality agreements, non-compete clauses, and trade secret safeguards. The author highlights the value of robust documentation of technology development, transfer, and usage in enhancing intellectual property protection. The paper emphasizes the importance of combining well-crafted contracts with alternative protective measures for successful technology transfers in a dynamic business environment.*

Keywords: *Technology/Transfers/Law/Contracts/Innovations*

INTRODUCTION

The paper focuses on a general examination of the central concerns pertinent to the transfer of various types of technological assets within the context of commercial transactions governed by various agreements under the purview of civil law instruments under Polish law. The reflections will encompass an examination of the aspects of technology that fall under legal protection. It will also explore strategies for ensuring the attainment of such protection in future agreements between the parties involved.

1. TECHNOLOGY

Dynamically evolving technological solutions necessitate legal frameworks from attorneys that are not only compliant with existing regulations but also adapted to the specifics of these new elements. The regulations currently in force in Poland were established at a time when the majority of the technological solutions we use on a daily basis did not exist. As Polish enterprises are compelled to seek solutions that will enhance their market advantage, they should find forms of cooperation with other entities that enable the implementation of

innovations[149]. Therefore, it becomes imperative to interpret existing provisions while maintaining technological neutrality and interpreting them in a manner that promotes market development and transaction security. New technologies pose a challenge not only to lawyers but also to market participants striving to maintain their competitiveness and further growth[150]. To this end, some of them opt to acquire solutions developed by other entities for their operations. Hence, it becomes essential to devise mechanisms aligned with their objectives, based on current regulations. This paper aims to provide a practical discussion of issues related to technology transfer in the context of civil law, the Industrial Property Law, and the Copyright and Related Rights Law. It will center on a general examination of the main concerns pertinent to the transfer of various types of technological assets within the context of commercial transactions, mainly governed by agreements under the purview of civil law instruments under Polish law. The reflections will encompass an examination of the aspects of technology that fall under legal protection. We will also explore strategies for ensuring the attainment of such protection in future agreements between the parties involved.

1.1 Definition

The starting point for determining the subject matter of this work will be to define the terminological scope of "technology" itself within the context of the terminology framework used in Polish legislation[151]. These considerations are particularly significant in the context of exploring the possibility of categorizing technology as a creative work protected by copyright law or as an innovation protected under industrial property law.

The concept of technology is intricate and multifaceted. In ongoing discussions, this term is often used interchangeably with terms like engineering or technical knowledge. However, as literature points out, technology is a narrower concept, encompassing only knowledge of a technical nature related to the manufacturing process[152]. The concept of technology itself is not easily confined within rigid boundaries due to its continual evolution (and in some cases, revolution), which does not allow for narrowing it down without deviating from the premise of technological neutrality. In this context, it becomes easier to explain what technology transfer is. Technology transfers are defined as "the paid or unpaid exchange of broadly defined knowledge, encompassing technical, economic, organizational, or marketing aspects, from a supplier to a recipient, who demonstrates demand for such knowledge." The generally accepted definition, however, indicates that technology transfers involve the systematic exchange of knowledge for the purpose of creating a product, applying a process, or providing services, and this concept does not include "transactions limited solely to the sale or rental of goods." [153].

A formal definition of "technology" does not exist in Polish legal regulations (it has not been included even in the law on the trade in goods, technologies, and services of strategic importance for the security of the state, as well as for the maintenance of international peace

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[149] Łącka I., The Effectiveness of Science-Industry Linkages in Innovation Processes, Scientific Association Institute of Economy and Market, Szczecin 2013a.

[150] Łącka I, Siwek L, Selected Forms of Technology Transfer and Their Utilization Opportunities by SME, Przegląd Organizacji, Nr 7 (894), 2014, s. 4–10.

[151] Wiśniewska J., Technology Transfer Processes in Commercial Banks in Poland, "Dissertations and Studies," vol. 764, University of Szczecin Scientific Publishing House, Szczecin 2010.

[152] Agnieszka Kochel, Forms of international technology transfer by transnational corporations, Challenges of the global economy Working Papers Institute of International Business University of Gdansk 2012, no. 31.

[153] Ibid.

and security[154]). Under the Regulation of the Council of Ministers dated April 17, 2015, regarding the exclusion of certain types of technology transfer agreements from the prohibition of agreements that restrict competition[155] the term "right to technology" has been explicitly mentioned. However, its description does not allow for a clear distinction of what should be understood by technology. This definition merely indicates that rights to technology encompass know-how and the rights specified in the law (or their combination) including patents, utility model rights, rights from the registration of industrial designs, rights from the registration of semiconductor topographies, supplementary protection rights for medicinal products and plant protection products, and copyright to software[156]. The legislator has thus chosen to reflect the assumption of technological neutrality, not limiting the concept of technology to specific forms, solutions, or domains. In a legal context, technology is also referred to as innovation[157]. Another complication arises from the fact that technologies are utilized in various sectors of the economy, and depending on the context of their use, they can possess different characteristics.

Should we affirm the correctness of the last of the aforementioned definitions, it would be prudent to concede that the possibility of classifying a particular object of the transfer as technology depends on whether we can classify it as know-how or as subject to protection in one of the forms specified in the definition. Within the scope of this work, considerations will be limited to the most common forms of protection – as know-how, a work, or an invention.

The classification of the subject of the agreement as know-how is particularly challenging due to the absence of a uniform definition of this concept within the framework of Polish legislation. The complexity arises from the fact that in Polish legal texts, the term "know-how" is employed in various contexts, contingent upon the specific legislative context in which it is applied. Despite its well-established usage in legal practice and the drafting of agreements encompassing know-how, its interpretation relies upon informal and, at times, intuitive criteria. As articulated by S. Sołtysiński, know-how is defined as the "capacity, knowledge, or expertise required to achieve a predetermined outcome or to engage in a specified activity."[158]. In M. Marczewska's interpretation, these are, however, "confidential technical information that is useful in the production process, taking into account the relevant knowledge and experience."[159]. The formalized definition can be found in the Regulation of the Council of Ministers dated April 17, 2015, regarding the exclusion of certain categories of agreements related to the transfer of technology from the scope of competition-restricting agreements. According to this regulation, know-how is defined as: "non-public technical, technological, or organizational and managerial information as defined in Article 2(2)(2) of the Act, which is essential for the production of goods covered by the agreement and has been described in

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[154] Act of November 29, 2000, on the trade of foreign goods, technologies, and services of strategic importance for the security of the state, as well as for the maintenance of international peace and security (consolidated text, Journal of Laws of 2023, item 1582).

[155] §3 para. 2) Regulation of the Council of Ministers of April 17, 2015, on the exclusion of certain types of technology transfer agreements from the prohibition of agreements restricting competition (Journal of Laws, item 585).

[156] Ibid.

[157] For example: A. Szewc, The Role and Significance of Industrial Property Rights in the Transfer and Commercialization of Technology, ZNUJ. PPWI 2014, no. 4, pp. 191–199, S. Sołtysiński, Patent Licenses [in:] Intellectual Property Law System. Patent Law, eds. J. Szwaja, A. Szajkowski, Wrocław 1990, p. 63.

[158] S. Sołtysiński, Patent Licenses [in:] Intellectual Property Law System. Patent Law, eds. J. Szwaja, A. Szajkowski, Wrocław 1990, p. 63.

[159] M. Marczewska, Legal Nature and Concept of Know-How Agreements, ZNUJ. PPWI 2018, no. 1, pp. 111–137.

a manner allowing for the verification of the criteria of non-publicity and significance."[160]. Importantly, the definition used in Polish tax law does not emphasize the confidentiality of know-how, defining it as "information related to acquired experience in the industrial, commercial, or scientific field."[161]. Guidance in this regard is also provided by Directive (EU) 2016/943 of the European Parliament and of the Council of June 8, 2016, on the protection of undisclosed know-how and business information (trade secrets) against their unlawful acquisition, use, and disclosure[162]. In legal doctrine, it is additionally pointed out that know-how in its general sense does not encompass knowledge related to business operations, including areas such as negotiation, sales, or marketing.[163].

1.2 Possible sources of protection

In general, transfers of technology fall under regimes of international agreements as well as directive and regulations binding within the European Union's legal framework. The most important grounds for protection which may be directly applicable to transfers of technology for the perspective of this paper are envisaged in Civil Code (KC)[164], the Act of February 4, 1994, on Copyright and Related Rights[165], Act of June 30, 2002, on Industrial Property Law, Act of April 16, 1993, on Combating Unfair Competition, Act on Competition and Consumer Protection[166] (antimonopoly law) and their executive regulations. Each of the mentioned regimes has its own distinct solutions that may determine the effectiveness of a transfer and its validity from the perspective of Polish law. It should be emphasized that the application of specific regulations does not preclude the need to utilize solutions indicated in other statutes if we are dealing with technology, the components of which may be subject to independent protection on various grounds. Within the scope of this work, I am not considering the limitations arising from individual sector-specific regulations as this issue requires a separate, detailed analysis.

Regardless of the specific definition, a technology can also be referred to as a solution that, while it may not meet the criteria mentioned above, could still be subject to protection as a trade secret when considered as part of a business. It can be regarded as one of the elements comprising a business entity, as defined in the Polish Civil Code[167]. However, the trade secret has been defined in the Act on Combating Unfair Competition as "technical, technological, organizational information of an enterprise, or other information possessing economic value, which, as a whole or in a particular combination and collection of its elements, is not generally

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[160] §3 para. 4) Regulation of the Council of Ministers of April 17, 2015, on the exclusion of certain types of technology transfer agreements from the prohibition of agreements restricting competition (Journal of Laws, item 585).

[161] Act of February 15, 1992, on corporate income tax (consolidated text, Journal of Laws of 2022, item 2587, as amended).

[162] Directive of the European Parliament and of the Council (EU) 2016/943 of June 8, 2016, on the protection of undisclosed know-how and business information (trade secrets) against their unlawful acquisition, use, and disclosure (Official Journal of the European Union L 157, 2016, p. 1).

[163] M. Marczewska, Legal Nature and Concept of Know-How Agreements, ZNUJ. PPWI 2018, no. 1, pp. 111–137.

[164] Act of April 23, 1964, Civil Code (consolidated text, Journal of Laws of 2023, item 1610, as amended).

[165] Act of February 4, 1994, on copyright and related rights (consolidated text, Journal of Laws of 2022, item 2509).

[166] Act of April 16, 1993, on combating unfair competition (consolidated text, Journal of Laws of 2022, item 1233).

[167] Act of April 23, 1964, Civil Code (consolidated text, Journal of Laws of 2023, item 1610, as amended).

known to persons who usually deal with this type of information or is not easily accessible to such persons, provided that the party entitled to use the information or dispose of it has taken due care to keep it confidential[168].” According to established jurisprudence in Poland, information for which an entrepreneur has not taken the necessary steps to maintain confidentiality cannot be considered a trade secret[169]. Indeed, information that an interested party can obtain through regular and permissible means does not meet the criteria for protection as a trade secret[170]. Moreover, industry knowledge, professional experience, and expertise acquired by an employee in the normal course of their work are not considered trade secrets either.[171]

Under Polish regulations, it is possible to ascribe technology the capacity to concurrently embody characteristics to both aforementioned legal domains. As indicated in the definition of the right to technology quoted above, it is possible to simultaneously classify technology rights as know-how and the specified rights (or even a combination of such rights). This entails a thorough exploration of the nuanced implications associated with characterizing technology as an entity amenable to various legal classification.

In the context of copyright law, its subject matter encompasses any manifestation of creative activity with an individual character, established in any form, regardless of its value, purpose, or mode of expression (a work)[172]. The possibility of granting technology such protection depends on cumulatively meeting all the criteria specified in the provision. It should be emphasized that any form of creative activity may be subject to protection, and this criterion has not been limited by the provision. As widely accepted in Polish law, the creative freedom of the author is indispensable for the creation of a work. It is emphasized in jurisprudence that when assessing the individuality of a given work, its type should be considered. Therefore, it is not possible to adopt a universal concept of individuality in relation to all elements related to technology. This assessment is particularly important in the protection of databases, where creativity and individuality are manifested in the selection, arrangement, or compilation of component elements. This corresponds to the concept presented in the U.S. Supreme Court's decision in the Feist case[173]. Furthermore, Polish regulations explicitly state that protection can only extend to the manner of expression, and discoveries, ideas, procedures, methods, principles of operation, and mathematical concepts are not covered by protection. This principle reflects the idea-expression dichotomy found in American legal doctrine.”[174]. The subject of copyright need not necessarily be the technology itself; elements accompanying it, such as documentation related to the transfer, can also be protected.

Technology may be eligible for protection as a patentable invention under Article 3(1)(6) of the Law of June 30, 2000, on Industrial Property Rights (consolidated text in the Journal of Laws of 2023, item 1170), including inventions. The possibility of obtaining patent protection

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[168] Act of April 16, 1993, on combating unfair competition (consolidated text, Journal of Laws of 2022, item 1233).

[169] Art. 11 para. 2 of the Act of April 16, 1993, on combating unfair competition (consolidated text, Journal of Laws of 2022, item 1233).

[170] Judgment of the Supreme Court of September 5, 2001, I CKN 1159/00, OSNC 2002/5, item 67.

[171] Judgment of the Court of Appeals in Poznań of November 24, 2010, I ACa 887/10, LEX no. 898663.

[172] Art. 1 item 1 of the Act of February 4, 1994, on copyright and related rights (consolidated text, Journal of Laws of 2022, item 2509).

[173] Decision of March 27, 1991, in the case of Feist Publications, Inc. v. Rural Telephone Service Company, Inc., 499 U.S. 340 (1991).

[174] J. Barta, R. Markiewicz, 1.3. Practical Issues Regarding the Qualification of Intellectual Products as Works [in:] J. Barta, R. Markiewicz, Copyright and Related Rights, Warsaw 2017.

is granted to inventions that are new, involve an inventive step, and are capable of industrial application.[175]. Therefore, if the subject of the agreement possesses the characteristics mentioned above, it is highly likely that, under Polish law, securing subsequent patent protection or similar safeguards is possible upon its transfer.

2. EFFECTIVE TRANSFERS

The overview presented in this section of the paper provides a general overview of legal solutions pertaining to contractual obligations and highlights the role that appropriately formulated contractual provisions play in protecting these obligations during transfers. In practice, certain mechanisms and solutions have been established within agreements based on existing regulations. The analysis will encompass a broad spectrum of possibilities, with a particular focus on agreements that entail the transfer of copyright-related aspects. Additionally, the author will delve into the versatile toolkit of legal instruments, drawing elements from license agreements, lending arrangements, and lease agreements, to facilitate technology transfers. The discussion will revolve around showcasing the feasibility of incorporating such transfers into the context of agreements, which encompass various types of arrangements such as the transfer of an entire enterprise, sales agreements, and donation agreements. These transfers can take the form of stand-alone transactions or as integral parts of acquisitions involving all or a portion of enterprises infused with technological assets. By doing so, we aim to provide a comprehensive understanding of the contractual dynamics that underlie technology transfers in agreements under Polish law.

2.1 Considerations prior to transaction

In doctrine, it is indicated that in the case of a desire to acquire technology by a particular entity, it is possible to obtain it from internal sources (developed within the entity itself), external sources, or through a combination of both[176]. This transfer need not necessarily encompass the complete acquisition of a particular solution; depending on the circumstances, a licensing agreement may suffice. In case of an external transfer, it requires prior analysis of its causes, external conditions (such as specific regulations related to the possibility of transferring a particular solution), and the desired outcomes for each participant. Most transfers occur within the framework of commercializing developed solutions in the private market, and as such, these types of transfers will constitute the primary subject of this work. The undertaken actions can serve various purposes, including the acquisition of solutions, cost reduction, enrichment of internal resources, gaining a competitive advantage, improving the internal operations of the entity, limiting the activities of other entities, exploring market opportunities, or reducing risk. Each of these objectives necessitates an individual approach when selecting optimal solutions.

In preparing for the effective execution of a transfer, it is crucial to primarily consider the transaction's objectives. There are often situations where the transfer itself is not the ultimate goal for the parties involved but serves to develop other products and implement new production methods[177]. Technology transfer is a subject with significant diversity depending

[175] Art. 24 of the Act of June 30, 2000, Industrial Property Law (consolidated text, Journal of Laws of 2023, item 1170).

[176] Głodek P., Gołębiowski M., Technology Transfer in Small and Medium-Sized Enterprises, Vol. 1, STIM, Warsaw 2006.

[177] Balcerowicz L. (ed.), 1987, International Economic Flows. New Trends and Regulation Attempts, PWN, Warsaw.

on how the object of the transfer agreement is formulated. It represents a particular case in which an event may be simultaneously regulated by different branches of law. The choice of the transfer method and its security measures in each case should take into account the specifics of the factual situation and the business assumptions.

2.2 Possible legal actions resulting in transfers

In parallel with the advancement of technology and the emergence of new technologies, there arises a necessity not only to create legal regulations within the field of industrial property law but also to disseminate legal constructs that can be practically utilized in economic transactions. Generally, technology transfer most commonly occurs through agreements between interested entities and as such they may involve the transfer of the technology itself (such as sales or donations), the transfer of an entire business entity containing the technology, or just a specific organized part of it (which is separately regulated under Polish law), non-monetary contributions or joint venture agreements. Additionally, technology transfer can also take place through agreements related to the merger of companies, leading to the transfer of the entire asset base to another (existing or newly formed) entity.

Depending on the needs of a particular entity, obtaining a license may be sufficient, allowing for the reduction of risks associated with attempting to develop a specific solution internally. This approach enables quicker implementation of new solutions and cost reduction[178]. In this case, obtaining a license in an appropriate form plays a significant role. It should be noted that Polish law provides for various types of licenses, including full, exclusive, non-exclusive, open, and sublicenses. This allows for the creation of a protection mechanism tailored to the specific needs of the entity.

2.3 Acquisitions of technology in contracts

The most popular form of technology transfer is its acquisition through agreements.[179] This ensures complete security for the utilized solutions, protecting them from use by third parties. These agreements also encompass various solutions in case of issues with their operation or failure to meet the buyer's expectations. Since technology sale agreements are not specifically regulated, the parties have the freedom to shape their relationships based on contractual freedom. Agreements involving technology transfers should include analogous elements, depending on the qualification of the subject being transferred. Proper qualification is indeed the key to an effective transfer and the inclusion of necessary provisions. Meticulously crafting the subject matter and procedures requisite for an efficient technology transfer is an essential component of an effective arrangement. The discussion will encompass scenarios that embrace both technology that has already been registered as a protected intellectual property object and those wherein the onus lies on the parties to undertake the registration process in the future. By addressing these diverse scenarios, we seek a nuanced understanding of the adaptable strategies and considerations inherent in technology transfers, tailored to their unique features. It is crucial to note the specific requirements related to the transfer of copyright to a work. Under the Copyright and Related Rights Act, an additional requirement is the need to explicitly include the fields of exploitation in the agreement where the transfer occurs. Attention should be given to the requirement arising from Article 41, which necessitates the full inclusion of the

[178] Łącka I, Siwek L, Selected Forms of Technology Transfer and Their Utilization Opportunities by SME, Przegląd Organizacji, Nr 7 (894), 2014, ss. 4–10.

[179] Ibid.

fields of exploitation in the agreement. In Polish law, an agreement for the transfer of copyright or a license (referred to as “license”) only covers fields of exploitation explicitly mentioned in it. Furthermore, specific provisions have been made regarding compensation for the transfer of ownership of a work. According to the law, if the agreement does not indicate that the transfer of copyright or the grant of a license is gratuitous, the creator is entitled to compensation. In cases where the amount of compensation is not determined in the agreement, it is determined with regard to the scope of the granted right and the benefits derived from the use of the work.[180]. These considerations should also be taken into account in agreements where the transfer is just one of many elements of the contract, and the compensation has been collectively determined by the parties (which might occur, for example, in the transfer of copyright within an organized part of a business).

Additionally, in the case of technology transfer, the value of maintaining robust documentation, including records of technology development, transfer, and usage in the context of the transfer, cannot be underestimated. Such documentation can serve as a crucial line of defence in protecting intellectual property interests. In the context of transfers, the subject of the transfer should explicitly include such documentation in every case. In each case, contractual solutions should anticipate the response to the default inability to adapt acquired solutions to the individual needs of the buyer. The documents should, therefore, include provisions regarding not only the transfer itself but also updates or obligations to assist during implementation, at least in the initial stages of its use.

To ensure an effective transition, various mechanisms can be employed to safeguard the parties involved. The most reliable guarantee of the agreement's effectiveness lies in a proper description of its subject matter, which serves as the foundation for its subsequent components. Accurate delineation should encompass all elements essential for utilizing the solution and should include the requisite documentation, know-how, and updates. The agreement should also allow for modifications if necessary. In technology transfer transactions, it is acceptable to employ mechanisms related to the payment of compensation only upon the fulfilment of specific conditions by the other party, ensuring the secure transfer of individual components. Deposits, such as the source code, can be utilized as a means of safeguard in case issues arise during the collaboration between the parties.

Agreements may also incorporate other solutions, such as contractual penalties for non-compliance with non-monetary obligations, alterations within protection regimes, or additional obligations related to staff training and the exchange of practical technology-related information among the parties, all of which are permissible.

Due to the specific regulations in this area, the discussion should highlight variations in legal protection and their implications for the rights, ownership, and responsibilities associated with technology developed during employment. The creation of technology within the framework of an employment relationship is governed by separate regulations that establish specific rules for the transfer of works. According to Article 12 of the Copyright and Related Rights Act, unless the law or an employment contract provides otherwise, when an employee creates a work as a result of performing duties within the scope of the employment relationship, the employer acquires, upon acceptance of the copyrighted work, the economic rights within the limits arising from the purpose of the employment contract and the mutual intent of the parties[181]. In the case of works created as part of existing employment duties, the transfer of

[180] Art. 41 and 42 of the Act of February 4, 1994, on copyright and related rights (consolidated text, Journal of Laws of 2022, item 2509).

[181] Ibid.

copyright within the employment relationship occurs by operation of law when the employee and the employer have not agreed otherwise in this regard. However, automatic transfer applies only to works created within the scope of an employment relationship. In the case of other forms of collaboration between the parties, regardless of the nature of the contract binding them, the agreement between the parties should fully encompass their arrangements in this regard, including the method of compensation for the transferred works.

CONCLUSION

Parties involved in technology transfers should place significant emphasis on clear and comprehensive contractual agreements. These agreements should leave no room for ambiguity regarding the rights, obligations, and scope of the technology transfer. Establishing well-defined terms and conditions, including clauses specifying the ownership of intellectual property rights, confidentiality provisions, and dispute resolution mechanisms, is essential. The paper highlighted the pivotal role of such agreements in fostering trust and minimizing potential conflicts. However, the landscape of technology transfer is not without its complexities and uncertainties. In recognition of this, there are alternative protective measures that can be employed when formal legal protection encounters challenges. These strategies may encompass confidentiality agreements, non-compete clauses, and trade secret safeguards. In essence, the key takeaway from our discussion is that while formal legal protection is a fundamental aspect of technology transfer, it should not be the sole reliance. A comprehensive approach that combines well-crafted contracts with alternative protective measures can provide a robust shield for technology assets, ensuring their successful transfer and safeguarding their value in an ever-evolving business landscape.

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[2] Polish Act of April 16, 1993, on Combating Unfair Competition (consolidated text in the Journal of Laws of 2022, item 1233).

[3] Polish Act of April 23, 1964, the Civil Code (consolidated text in the Journal of Laws of 2023, item 1610, as amended).

[4] Polish Act of February 4, 1994, on Copyright and Related Rights (consolidated text in the Journal of Laws of 2022, item 2509).

[5] Polish Act of February 15, 1992, on Corporate Income Tax (consolidated text in the Journal of Laws of 2022, item 2587, as amended).

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Understanding closely held corporations and the challenges they face

Belén Sánchez Luengo

Abstract: *Shareholders' conflicts hinder closely held corporations. The approach to identify conflicts has traditionally been from a minority oppression standpoint, but not only minorities can be oppressed- they can also behave opportunistically and create blockage in the corporation. This paper proposes a taxonomy for classifying shareholders' conflicts and analyses potential solutions. Conflicts can be addressed ex ante -by shareholders' agreements and through legislation- or ex post – trusting Court's know-how. We provide insights on how Spanish courts have been facing these conflicts and, specially, through the duty of loyalty between shareholders.*

Keywords: *closely held corporations, conflicts, minority shareholder, majority shareholder, abuse of law, opportunism*

INTRODUCTION

Closely held corporations are a profitable asset to economies[182]. In fact, studies suggest that continental economies are majorly supported by these. Common law countries count with these as key but to a lesser extent studies suggest[183].

Despite the distinctivness of each term embedded in the context of its jurisdiction[184], we can find the term closely held corporation worldwide (i.e. we can find the Spanish *sociedad cerrada*, the *geschlossene Kapitalgesellschaft* in Germany, *la société fermée* in France, the Italian *società chiussa*, the British private company and the US close corporation).

The EU institutions ambitiously attempted to create a European legal type through the Societas Privata Europaea (SPE), though for various reasons[185] it failed.

[182]FLEISCHER, Holger. Family Firms and Family Constitutions: A Legal Primer. European Company Law [online]. 2018, 15(1), 11 [viewed 29 September 2023]. ISSN 1572-4999. Available from: doi:10.54648/eucl2018003 the author points out impressions about family firms that make them profitable for economies (that we believe can be also applied to all kinds of closely held corporations). They provide stability to economies. Shareholders tend to have a long-term view, in comparison with widely held corporations where shareholders are just number and may seek profitability at all costs.

[183] Vid. Footnote 11.

[184] The unavoidable gap between common and civil law systems makes comparative approach to closely held corporations challenging.

[185] VELASCO SAN PEDRO, Luis Antonio. De la societas privata europaea a la societas unius personae en las propuestas europeas = From the societas privata europaea to the societas unius personae in the european proposals. *CUADERNOS DE DERECHO TRANSNACIONAL* [online]. 2017, 9(1), 341 [viewed 28 September 2023]. ISSN 1989-4570. Available from: doi:10.20318/cdt.2017.3624. The author identifies irreconciliable differences between jurisdictions and the debate concerning the registered office of a company (*Gründungstheorie vs. Sitztheorie*).as obstacles impeding as of today an European legal form for closely held corporations.

The first questions to be addressed is what are exactly closely held corporations? Our focus in this paper is to give the most detailed analysis of what we understand closely held corporations are. Once addressing their distinctiveness, we pay attention to what has been considered the biggest problem concerning closely held corporations: conflicts[186]. We provide a provisional taxonomy of the main conflicts that appear, and a offer some specific cases to illustrate the complexity and seriousness of the problems that arise in closely held corporations. Finally, we briefly give some insights of the mechanisms available in jurisdictions to prevent or handle conflicts. We will conclude giving some insights on what we believe is the best approach to conflicts in closely held corporations and pointing out which aspects are yet to be thoroughly analysed in future contributions.

1. PROMOTING THE FUNCTIONAL APPROACH TO CLOSELY HELD CORPORATIONS

The indistinctive use of the terms "closely held corporation", "closed corporation" and "close corporation" induces to certain ambiguity[187] between the use of one or another term. The most appropriate to use in this context is closely held corporations, as close corporations refer to the specific statutes applicable in the US and closed corporations refers to the fact that there are strict limits to share transfer.

Despite of being main players in economy[188], it has not been until recently that academia has started approaching closely held corporations[189]. Initially, most of the attention in academia was dedicated to big, listed companies. The reasons behind it range from the lack of accessible data to facilitate research to the enhanced party autonomy closely held corporations have in comparison to widely held corporations. To our knowledge, there is no data available concerning closely held corporations specifically, but we do have data suggesting ownership in many pioneer jurisdictions is concentrated[190].

As per recent data and to give an example, we know that currently in Spain we have a total of 821 listed companies[191]. If we compare this number with the total of companies constituted in

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[186] Academics refer to them as the Achilles Heel. WEDEMANN, Frauke. Gesellschafterkonflikte in Geschlossenen Kapitalgesellschaften. Mohr Siebeck GmbH & Company KG, 2013, 1. ISBN 9783161525407.

[187] This was pointed out by ARMOUR, John, HANSMANN, Henry, PARGENDLER, Mariana. What is Corporate Law? In: KRAAKMAN, Reinier, et al., eds. *The Anatomy of Corporate Law*. New York, 2017, 11. 9780198724315.

[188] Just looking at family firms (which generally will be closely held corporations) in Germany and Spain, data evidence shows they are the backbone of their economic system. FLEISCHER, Holger. An Introduction to Law and Management of Family Firms. In: FLEISCHER, Holger, RECALDE, Andrés and SPINDLES, Gerald, eds. *Family Firms and Closed Companies in Germany and Spain*. Tübingen, 2021, 3, 9783161598227. DEL VAL, Paula and GIMENO, Miguel, eds. Family Firms and Closed Companies in Spain. In: FLEISCHER, Holger, RECALDE, Andrés and SPINDLER, Gerald, eds. *Family Firms and Closed Companies in Germany and Spain*. Tübingen, 2021, 24, 9783161598227.

[189] FLEISCHER, Holger. Comparative Corporate Governance in Closely Held Corporations. In: GORDON, Jeffrey and RINGE, Wolf-Georg, eds. *The Oxford Handbook of Corporate Law and Governance*. New York, 2018, 679-681, 9780198743682.

[190] We do have data about ownership concentration in corporations. ENRIQUES, Luca and VOLPIN, Paolo. Corporate Governance Reforms in Continental Europe. Journal of Economic Perspectives. 2007, 21(1), 119 [viewed 4 October 2024]. Available from: https://doi.org/10.1257/jep.21.1.117 .

[191] As of September 2o23. Source: BME. Available at: https://www.bolsasymercados.es/esp/Estudios-Publicaciones/Estadisticas.

Spain from 2000 until today[192], we can see that the proportion of listed companies is small. Not all unlisted companies are necessarily closely held corporations but many of them are. From the data compiled we can see that the number of *sociedades de responsabilidad limitada* is overwhelming in comparison to any other. Also, the number of listed companies is small in comparison with the *sociedades anónima* constituted yearly (taking year 2022 as an example). So, if we exclude the groups that automatically cannot be classified as closely held, this is, sole shareholder companies and listed companies, the number of potentials closely held corporations incorporated every year only in Spain is very high. These figures are not entirely accurate, as of today we have no official reports classifying companies on listed vs. closely held, but with the information we have we have to say that these are predominant in many ways.

A functional approach, based on identifying common characteristics defining closely held corporations enable academics to identify similar problems and potential solutions. The most recurrent characteristics identified by scholars and courts are the following[193]:

(i) Manageable[194] number of shareholders.

(ii) Close relationship between shareholders and directors.

(iii) Restrictions to the transfer of shares.

(iv) Difficulties in making shares liquid or not being listed on a stock market.

These characteristics have been identified in several legal systems, which makes it easier to approach and study closely held corporations. The functional approach[195] to closely held corporations leads us to think of the various economic structures that can fall under this category. We will find traditional family firms which have been in European economies but also start-ups can be closely held corporations. Joint ventures are also potential closely held corporations. Regardless the size, the turnover, or the activity the company carries out, we can be facing a closely held corporation as defined in this paper.

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[192] As an example, only in 2022 a total of 423 companies where incorporated under de legal type of *sociedad anónima*, whereas 96.655 were incorporated under the *sociedad de responsabilidad limitada*. Another 2.616 were incorporated under types named as "others" (including, among others, *sociedades profesionales, uniones temporales, agrupaciones de interés económico*). Additionally, 53, 97 % of these companies had more than one shareholder while the remaining 46,03 % had an only shareholder. Available from the Spanish Commercial Registy report for 2022:

https://www.rmc.es/documentacion/publico/ContenedorDocumentoPublico.aspx?arch=Estadisticas\ESTADISTICAS-2022.pdf

[193] The origin of these characteristics is the ruling of a US Court (Decision of the Supreme Judicial Court of Massachusetts, USA of 2 May 1975, 578. Justia. [accessed on 2023-09-26]. Available from: https://law.justia.com/cases/massachusetts/supreme-court/1975/367-mass-578-2.html).

[194] From *überschaubar*. FLEISCHER, Holger. Vergleichende Corporate Governance in der geschlossenen Kapitalgesellschaft. Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht

(ZHR). 2015, 179(4), 409. Other scholars have referred to this as reduced number of shareholders or those with a commitment to continuity in remaining as shareholders.

[195] AGSTNER, Peter. Shareholder Conflicts in Close Corporations between Theory and Practice: Evidence from Italian Private Limited Liability Companies. European Business Organization Law Review [online]. 2019, 21(3), 506 [viewed 27 September 2023]. ISSN 1741-6205. Available from: doi:10.1007/s40804-019-00165-9.

2. CONFLICTS BETWEEN SHAREHOLDERS

The characteristics identified are the prelude to addressing their main obstacle in closely held corporations: conflicts between shareholders. From a social behavioural standpoint, personal ties[196] intertwining with business relations between shareholders [197] catalyses the appearance of disputes.

The scope of conflicts is wide and diverse[198]. A quite systematic classification[199] for conflicts in closely held corporations is the following allows to include specific cases on broader categories:

2.1 **Shareholder-shareholder conflicts.** Behaviours where the majority abuses (or oppresses) the minority fall under this category[200]. Including conducts related to the General Shareholders' Meeting, annual account reports, dividend payment[201], amendment of by laws or restructuring of the company.

We also include opportunistic behaviours conducted by the minority[202], such as creating deadlock situations, preventing the company day-to-day run efficiently or even exercising their rights in an abusive way[203].

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[196] In civil law jurisdictions personal ties are part of a broader concept (intuitus personae), which traditionally has been associated to personalistic corporations but can be very present in capitalistic corporations. Intuitus personae encompasses the intuition that one has when deciding to associate with another person because of their personal attributes.

[197] "When a conflict – whether beginning as an act of majority opportunism against the minority, a good-faith disagreement over business affairs, or any other variation – escalates into an irreconcilable fallout and a breakdown in trust between the participants, the enterprise as a going concern with its pre-dispute membership is inevitably dead. Trust, once broken, is difficult to restore." KOH, Alan K. Shareholder Protection in Close Corporations: Theory, Operation, and Application of Shareholder Withdrawal. Cambridge University Press, 2022,20. ISBN 9781108496667. This quote summarizes the problems concerning shareholders having a personal relationship, in addition to the professional, and how this intertwines with decision making in the company.

[198] In Spain, a systematization effort of the case law can be found in HERNADO, Luis. *El abuso de la posición jurídica del socio en las sociedades de capital*. Hospitalet de Llobregat: Bosch, 2013, 339. 9788497906951.

[199] BACHMANN, Gregor. Rechtsregeln für die geschlossene Kapitalgesellschaft. Berlin: De Gruyter, 2012, 6–11. ISBN 9783110269260.

[200] "Possessed with financial and participatory expectations, but powerless in a majority rule and no exit environment, *the close corporation minority shareholder is peculiarly vulnerable to abuse*". MOLL, Douglas K. Minority Oppression & the Limited Liability Company: Learning (or Not) from Close Corporation History. Wake Forest Law Review [online]. 2010, 40(1), 883-884 [viewed 28 September 2023]. ISSN Available from: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=869310.

[201] Decision of the Supreme Court, Spain 11 January 2023. 9/2023 [online]. In Aranzadi [accessed on 2023-09-29]. The Court enforces a dividend share as it is understood that there has been abusive behaviour by the majority when deciding not to share dividends. Decision of the Supreme Court, Spain of 25 October 2022. 701/2022 [online]. In Aranzadi [accessed on 2023-09-29]. This case is especially renowned. First, the corporation is in a conglomarate of family firms (Bodegas Vega Sicilia). The conflict arises precisely by groups of power (majority/minority), in which the majority seeks to expropriate the minorities voting rights. However, in this case, minority is *de facto* a third party on the specific company, while being shareholders in other companies of the group.

[202] EASTERBROOK, Frank H. And FISCHEL, Daniel, R. Close Corporations and Agency Costs. Stanford Law Review. 1985, 38, 301 [viewed 28 September 2023]. Available from: https://doi.org/10.2307/1228697 .

[203] Decision of the Supreme Court, Spain of 9 March 2007. 240/2007 [online]. In Aranzadi. [accessed on 2023-09-29]. Minority shareholders holding at least a 5% of shares may request the audit of the company's accounting. However, this request once fulfilled may not be exercise in an abusive manner. Courts try to prevent opportunistic behaviour from the minorities.

2.2 **Shareholder-director conflicts.** Close relation between shareholders and directors, even having directors that are also shareholders create conflicts. Compliance of director's duties may be harder to identify. Is the corporation's best interest that of the majority shareholders or should minorities also be considered?[204]

3. THREE-WAY PROTECTION AGAINST CONFLICTS. A LOOK AT SPANISH COURTS RULINGS

Protection against oppression and opportunism can be sought *ex ante* – through shareholders' agreements and in legislative system or *ex post* – trusting Court's know-how. No solution is truly satisfying. When it comes to shareholders' agreements, these can come handy as a negotiation tool when conflict arises, but no agreement is perfect[205].

Legislative technique necessarily influences on how Courts rule. One of the mechanisms available to shareholders, third parties or directors that believe have been harmed in an unlawful way by a resolution passed by the shareholders in their meeting is through the right of appeal (*impugnación de acuerdos sociales*).

To understand the proceeding on how resolutions are contested in Spanish we should first look at the relevant precepts in the law[206]. In a nutshell, these articles state that a corporate resolution may be contested if they are contrary to the law, the articles of association or the company's best interest (*interés social*). In its latest amendment, the Spanish Act included minority abuse to the previous reasons stated. This fuelled a debate that had been going on: is there really a duty of loyalty between shareholders?[207]

CONCLUSION

This paper intents to bring reflection on an understudied field which at the same time is crucial to economies. Thriving closely held corporations will in turn promote the creation of new ones (e.g., in the start-up market).

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[204] Decision of the Supreme Court, Spain of 21 December 2021. 889/2021 [online]. In Aranzadi [accessed on 2023-09-29]. Directors are bound to shareholders' decisions and shall act in defence of the corporations' interest (understood as the shareholders' interests as a whole, taking into account minorities). However, if a decision is agreed unanimously by the shareholders, directors cannot be held liable for executing these decisions.

[205] From an economic analysis of law standpoint, a perfect agreement is a complete agreement. Therefore, perfection should be sought but it can never be completely achieved. Also, the more perfect the agreement, the more transaction costs arise when drafting the agreement.

[206] This is regulated under articles 204–208 of the SPANISH Act No. 1/2010, the Corporate Act [Real Decreto Legislativo 1/2010, de 2 de julio, por el que se aprueba el texto refundido de la Ley de Sociedades de Capital].

[207] PEINADO, Juan Ignacio. Abnegación y silencio en la sociedad mercantil (apuntes sobre los conflictos de interés entre el socio y su sociedad). In GONZÁLEZ FERNÁNDEZ, María Belén, et al. dirs. *Derecho de Sociedades: revisando el derecho de sociedades de capital*. Valencia, 2018, 50. 978-84-9169-760-2. The author puts into stake the general belief supporting duty of loyalty between shareholders and argues that the base of this duty relies on the agency theory ruling shareholder-director relationship. Therefore, it cannot be extensively applied to the shareholder-shareholder level. A dissenting opinion is defended, among others, by PAZ-ARES, Cándido. La sociedad civil (comentario a los arts. 1665–1708). In Diez Picazo, R. et al. (dirs.), *Comentarios del Código Civil II*. Madrid, 1991, 1326. These arguments are closer, or we can even say follow the German approach (*Treuepflicht*). Since 1986 the horizontal duty of loyalty has been recognised by Court. MHLS/Lieder, 4. Aufl. 2023, GmbHG § 13 Rn. 141–145: "According to this, *the duty of loyalty should serve as a counterweight to limit the power position of the majority shar*eholders and to protect the management and the minority of shareholders from their disloyal influence".

Close relationship between shareholders – and between these and the directors they appoint – facilitates the creation of businesses. People who trust each other find motivation to develop projects together, which ultimately is beneficial for economies. But trust is a one-way-path. If broken, the intensity of the conflicts that arise is particularly detrimental.

Prevention of conflicts can be facilitated by *legislators* providing mechanisms that efficiently help parties to close the business and do a fair repartition of the wealth or allowing one of the parties to exit. However, if dissolution or exit are too easy to achieve, this can be used as a coaction mechanism by the displeased party. On the other hand, systems that are too rigid can keep the shareholders as prisoners of their own company.

Parties may also autonomously agree on exit scenarios or set out *ex ante* the means they will use once conflict arises – through *shareholders agreements*. The biggest downside on this option is the high costs of negotiating a sophisticated contract at a moment when no wealth has been yet created. However, we strongly advise this option as it allows parties to decide on the future of their corporation, rather than have the *Court* decide for them.

This brings us to the third scenario. Shareholders have not succeeded in solving the conflict and decide to bring the matter to the Court. The first argument that makes us want to avoid this option is the fact that Spanish Courts (as also happens in many jurisdictions) are overwhelmed by cases and a final ruling will potentially take years[208]. In the meantime, the corporation will surely struggle to thrive.

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[208] In Spain, the average time taken by the Supreme Court (Civil) to rule a case is in more than two years. Data available from: https://www.poderjudicial.es/cgpj/es/Temas/Transparencia/ch.Estimacion-de-los-tiempos-medios-de-duracion-de-los-procedimientos-judiciales.formato1/?idOrg=1&anio=2022&territorio=-&proc=ASUNTOS%20DE%20LO%20CIVIL

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New Insights into the Concept of Conflicts of Interest: the Practice of Legal Assessment in Latvian Public Law

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Abstract: *Public integrity and the development of an environment resilient to corruption have become a strategic direction for all public sector organizations. The prevention and management of conflicts of interest occupy a significant positionin the pyramid of the fight against corruption. Situations involving conflicts of interest can occur at any time; however, the legal tools to prevent and properly manage them are often formal and ineffective. In this article, the authors address the research problem of the legal understanding of the concept of conflicts of interest. This scientific problem arises in the relation between the integrity, and the transparency requirements for the public sector, which are precisely determined by the legal consequences resulting from situations of conflicts of interest. The purpose of this paper is to analyze in detail the elements of the content of the conflict of interest concept as formed in Latvian National Laws. Document and context analysis, problem analysis, and synthesis research methods are used to examine the core issues related to the adjustment of public and private interests in the area of the prevention and control of conflicts of interest. In conclusion, the authors propose a new definition of conflict of interest that aligns with the requirements of public law, and according to which the paradigm of supremacy of public interests would be constructed.*

Keywords: *Public Interest, Private Interest, Conflict of Interest, Official Ethics, Anti-Corruption*

INTRODUCTION

In the global world, the public sector is faced with various challenges[209]. In response to these challenges, it must find effective measures to be resilient. One of these issues is the threat of corruption[210], which endangers society, the state, and the functioning of its institutions. It affects ethical values, justice, and the rule of law[211]. Society's requirements for public sector organizations, civil servants, and the public services they provide are changing accordingly. Transparency, integrity, and serving the public interest in the activities of the public sector and their employees are necessary conditions for preventing corruption[212], abuse of power,

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discrimination against individuals, and the granting of privileges to others. Therefore, these factors are important indicators for people to trust public authorities.

In recent years, data from various empirical surveys show that the public sector is most affected by the spread of increasingly prevalent forms of corruption, such as nepotism, favouritism, cronyism, patronage, and conflicts of interest[213]. These various forms of corruption are the main risk factors for identifying conflicts of interest. In response to these tendencies, states are striving to find and implement countermeasures in their national laws. They aim to adopt, maintain, and strengthen management systems that prevent conflicts of interest, both in the private and public sectors.

The purpose of the research is manifested through the authors' analytical and contextual analysis of the content of the conflict of interest concept from an anti-corruption perspective. Additionally, it aims to provide a legal assessment of the definition of conflict of interest. The legal institute of conflicts of interest is not well explored in Latvian public law doctrine. This lack of exploration determines the nuances of the practical application of legal acts Due to the uneven interpretation of cases of conflicts of interest, public officials often succeed in avoiding liability for breaches of the law[214]. This undermines the importance of conflicts of interest as a principle of transparency in the anti-corruption management system.

The article explores the research problem related to the search for common legal features and elements in defining the concept of conflicts of interest. Conflicts of interest are assessed through various “situations” in which it is necessary to avoid the ascendancy of private interest over public interest. On the other hand, the diversity of “situations” is associated with the behaviour of public officials when the public interest should dominate in the performance of official duties or decision-making. The absence of universally accepted standards of conduct for public officials hinders the fair evaluation of situations that give rise to conflicts of interest, which usually favour public authorities.

A comprehensive approach for revealing the content of the concept of conflicts of interest t in this study relies on the use of a combination of legal text–document analysis, contextual analysis and synthesis research methods. The outcomes, obtained through these research methods, will lead to changes in the legal regulation of the management of conflicts of interest. In the conclusions, the authors will assess the common denominators in defining conflicts of interest and propose improvements to the legal regulation in managing situations of conflicts of interest in public sector organizations.

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1. FOCUS ON UNDERSTANDING THE CONCEPT OF CONFLICTS OF INTEREST IN AN ANTI-CORRUPTION CONTEXT

The United Nations (UN) has called on Member States to regulate conflicts of interest by acceding to the Convention against Corruption This convention requires *each Member State to endeavour to adopt, maintain, and strengthen systems that promote transparency and prevent conflicts of interest, in accordance with the fundamental principles of its national law*[215]. The concept of conflict of interest is not harmonized in the European Union (EU)[216]. This area of responsibility has been left to each EU state, which transferred the integrity requirements stipulated by other international organizations to the public sector[217]. Currently, at the EU level, there is an agreement on a strong response to corruption by building a comprehensive system to prevent and address conflicts of interests[218].

The first regulation of conflicts of interest in Latvia appeared in 1995 with the adoption of the Law on Prevention of Corruption. Upon accession to the EU, Latvia significantly amended several regulatory enactments, including the Law "On Prevention of Conflict of Interest in Activities of Public Officials" (hereinafter referred to as the "Law on Prevention of Conflicts of Interest"), which was adopted in 2002 instead of the Law on Prevention of Corruption.

Section 1, Paragraph 5 of the Law on Prevention of Conflicts of Interest provided an explanation of the term "conflict of interest". Namely, it refers to *a situation where, in performing the duties of the office of the public official, the public official must take a decision, participate in the decision-making process, or engage in other activities related to the office of the public official that affect or may affect the personal or financial interests of this public official, their relatives or counterparties*.

It specifies the scope of activities of a public official in the course of which a public official may find themselves in a situation of conflict of interest. Secondly, the range of persons in relation to whom public officials may be in a situation of conflict of interest. Thirdly, in the law, the actions of a public official by which they may find themselves in a conflict of interest situation do not have to focus exclusively on the present; a conflict of interest can exist immediately upon the exercise of the official's authority. The concept of conflict of interest in the law allows for a situation in which a conflict of interest may arise for a public official in the future, despite the fact that it is obviously impossible to immediately establish personal or financial interests of the public official, their relatives, or counterparties.

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[215] Article 7, Paragraph 4, of the United Nations Convention against Corruption, under the heading "Public Sector", 01.12.2005. Available from: https://www.unodc.org/documents/treaties/UNCAC/Publications/Convention/08-50026_E.pdf

[216] Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions (COM (2023) 800 final) of 5 July 2023 on the Rule of Law Report 2023. In EUR-Lex. Available from:

https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52023DC0800

[217] The OECD provides the following definition of conflicts of interest in its guidelines for public sector: "Conflict of interest is a conflict between the public duty and private interests of public officials, in which public officials have private-capacity interests which could improperly influence the performance of their official duties and responsibilities". OECD Guidelines for Managing Conflict of Interest in the Public Service, adopted on 28 May 2003 by the Recommendation of the Council on Organisation for Economic Co-operation and Development (OECD). Available from: https://legalinstruments.oecd.org/en/instruments/OECD-LEGAL-0316

[218] Joint Communication to the European Parliament, the Council and the European Economic and Social Committee (JOIN (2023) 12 final) of 3 May 2023on the Fight Against Corruption. In EUR-Lex. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52023JC0012

Of course, one concept alone will not be enough to deter public officials from falling into a situation of conflict of interest[219]. It is necessary *to develop, in accordance with the basic principles of national regulatory enactments, the implementation of such measures and systems*[220] that would discourage public officials from finding themselves in a conflict of interest. Thus, in compliance with the requirements of the United Nations Convention against Corruption, the Law on Prevention of Conflict of Interest provides for restrictions, prohibitions, and obligations to the public officials.

2. THE IMPACT OF LEGAL REGULATION ON THE MANAGEMENT OF CONFLICTS OF INTEREST IN THE LATVIAN PUBLIC SECTOR

Periodically, opinions are voiced in the public space regarding why public officials should be subject to any restrictions or prohibitions, or why they should disclose their personal and financial information in a public official's declaration. Questions arise about whether public officials are in an unequal position compared to other members of society, and etc[221]. Recently, such opinions have been more actively defended, even by senior public officials, who argue for the need to relax both restrictions and prohibitions[222]. Some propose allowing certain public officials not to publicly disclose data on their property status and income earned in the public officials' declarations[223].

Occasionally the agenda of the relevant committee in the Saeima of Latvia lists the assessment[224] of possible relaxation of restrictions and prohibitions imposed on public officials, the authors are of the opinion that the current regulation of restrictions and prohibitions for public officials complies with the purpose of Section 2 of the Law on Prevention of Conflicts of Interest, i.e. *to ensure that public officials carry out their activities in the public interest by preventing the influence of the personal or financial interests of any public official, their relatives, or counterparties on the public official's activities, and to promote transparency, public accountability, and public trust in the activities of public officials*.

The authors' stance is based on the case law established by the European Court of Human Rights, which states *that the status of a public official is characterized by a special relationship of trust and loyalty towards the state*[225]. In turn, the Constitutional Court of Latvia also

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[219] SOBIROVA, Nozimakhon. The Concept Of "Conflict of Interest" and the relationship of this term with "Personal Interest". The American Journal of Political Science Law and Criminology, 2021, 3.12: 11–16.

[220] Article 8, paragraph 5, of the United Nations Convention against Corruption, under the heading "Codes of Conduct for Public Officials". Available from:

https://www.unodc.org/documents/treaties/UNCAC/Publications/Convention/08-50026_E.pdf

[221] NIKOLOV, Nikolay. Conflict of interest in European public law. Journal of Financial Crime, 2013, 20.4: 406–421.

[222] SOLOVEIČIK, Deividas; ŠIMANSKIS, Karolis. The evolving concept of 'conflict of interests' in the EU public procurement law. European Procurement & Public Private Partnership Law Review, 2017, 12.2: 112–131.

[223] TYTKO, Anna; STEPANOVA, Hanna. International Experience Of Declaring Property, Assets And Private Interests. Baltic Journal of Economic Studies, 2019, 5.1: 214–217.

[224] ZILE, Dace. The Saeima commission is starting to look at the controversially assessed law on higher education institutions, 02.06.2020. Available from: https://lr1.lsm.lv/lv/raksts/labriit/saeimas-komisija-sak-skatit-pretrunigi-verteto-augstskolu-likumu.a130612/

[225] European Court of Human Rights, Strasbourg, 18.11.2014, in the case of Spūlis and Vaškevičs v. Latvia, Application No. 2631/10 & 12253/10, Paragraph 41. Available from: https://hudoc.echr.coe.int/eng?i=001-148877

expresses the view on restrictions and prohibitions imposed on public officials. It indicates that *the restrictions related to public officials are based on special trustworthiness and loyalty to the state, which by nature cannot be considered disproportionate from the point of view of the equality principle*[226]. Therefore, public officials must take into account certain restrictions and prohibitions and act while avoiding situations of conflict of interest.

2.1 Legal requirements on the avoidance of conflict of interest

Thus, in order to prevent a public official from being in a situation of conflict of interest and to exercise their duties (powers) as a public official in matters that affect or may affect the personal or property interests of such a public official, their relatives, or counterparties, there is no reason to review (including the possibility of mitigating) restrictions and prohibitions imposed on public officials. These restrictions include those related to the issuance of administrative acts, supervision, control, investigation, punishment functions, and the conclusion of contracts[227].

The said restrictions directly stem from the concept of conflict of interest and are specified in Section 11, Paragraph one of the Law on Prevention of Conflict of Interest. This section stipulates that *a public official is prohibited, in the performance of their duties, from preparing or issuing administrative acts, performing supervision, control, inquiry, or punitive functions, entering into contracts, or engaging in other activities in which such public officials, their relatives, or counterparties are personally or financially interested*[228]. In public administration practice, difficulties in preventing conflicts of interest mainly arise in defining the circle of persons and understanding what constitutes personal or material interest[229].

However, the authors note that the regulatory framework for preventing conflicts of interest in Latvia was adopted more than 20 years ago, and therefore, it is necessary to check its compliance with the current situation and international standards.

2.2 Legal restrictions on activities of public officials related to private interests

One of the qualifying features for a conflict of interest situation is the specific scope of persons in respect of whom a public official may find themselves in a situation of conflict of interest in the exercise of their official duties. This scope of persons shall include the public official themselves, the relatives of the public official, and counterparties[230].

The Law on Prevention of Conflict of Interest determines *public officials* who categorically may not be in a situation or exercise their official duties in a conflict of interest. Officials who hold positions listed in the Law are considered to be public officials. In total, the aforementioned law lists more than seventy positions, the holders of which are considered to be public officials (These positions include the , *President, Member of the Saeima*

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[226] Constitutional Court of the Republic of Latvia, Riga, 27.06.2016 Judgment in case No. 2015-22-01, Paragraph 17.2 Available from: https://www.satv.tiesa.gov.lv/cases/?search[number]=2015-22-01

[227] BOYCE, Gordon; DAVIDS, Cindy Conflict of Interest in Policing and the Public Sector. Public Management Review, 2009, 11.5: 601–640.

[228] STRELCENOKS, Jaroslavs. Concept of Implementation of Artificial Intelligence for the Prevention of Conflict of Interest Situations in the Public Sector. Acta Prosperitatis, 2023, 14.1: 87–95.

[229] BLANC, Renata; ISLAM, Muhammad Azizul; PATTEN, Dennis M.; BRANCO, Manuel Castelo Corporate anti-corruption disclosure. Accounting, Auditing and Accountability Journal, 2017, 30.8: 1746–1770.

[230] HOLCOMBE, Randall G.; BOUDREAUX, Christopher J. Regulation and corruption. Public Choice, 2015, 164: 75–85.

(Parliament), Prime Minister, Minister, the executive director of the municipality, civil servant, judge, prosecutor, etc.).

However, in the regulatory enactments of Latvia, the scope of public officials is determined not only by the position held by the employee but also by certain features, such as the *rights* to *issue administrative acts, as well as performing supervisory, control, cognitive, or punitive functions, or to make or prepare decisions on the acquisition, transfer, alienation, or encumbrance of property of a public person etc.* (Section 4, Paragraph 1 of the Law on Prevention of Conflict of Interest).

The list of *relatives* of a public official is specified in Section 1, Paragraph 6 of the Law on Prevention of Conflict of Interest. These relatives include the public official's *father, mother, grandmother, grandfather, child (including adopted), grandchild, brother, sister, half-sister, half-brother, and spouse.* Another group of persons with whom public officials must be very careful in the performance of their public official duties is *counterparties.* The Law stipulates that a counterparty *is a natural or legal person or an association of natural and legal persons established on the basis of a contract, which, in accordance with the provisions of this Law, is in declarable business relations with a public official*. A qualifying feature to determine whether a person has a business relationship with a public official within the framework of the law is a declarable transaction.

Pursuant to Section 24 of the Law on Prevention of Conflict of Interest, a declarable transaction is considered to be any transaction that exceeds the amount of 20 minimum monthly salaries. Taking into account the fact that in Latvia, as of January 1, 2023, the minimum monthly salary is set at the amount of 620 euros; thus, if the transaction's amount for a public official exceeds 12 400 euros[231], then such a transaction is considered a declarable transaction. Therefore, in order to avoid a situation of conflict of interest, public officials need to be aware of the circle of persons in relation to whom it is strictly prohibited to carry out their official duties[232].

The authors note that, although the current regulatory framework of Latvia clearly defines the boundaries of a conflict of interest, it does not exclude situations when officials exercise their official powers in relation to persons with whom they have a close psychological or emotional connection. In addition, nepotism still exists in Latvia, involving the provision of profitable positions or property to relatives in order to consolidate power. The authors note that this negative phenomenon is not regulated by any normative act in Latvia.

2.3 Assessment of conflicts of interest cases in national court practice

The restrictions set out in the law to prevent a public official from entering into a situation of conflict of interest stipulates that *any activities* related to the performance of public official's duties are prohibited if, as a result of those actions, a benefit is gained by the public official themselves their relatives, or counterparties[233].

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[231] Regulations on the amount of the minimum monthly wage within normal working hours and calculation of the minimum hourly rate, Regulations of the Cabinet of Ministers of the Republic of Latvia No. 656, 24.11.2015 (i.e. No. 62 16. §). Available from: https://likumi.lv/ta/id/278067-noteikumi-par-minimalas-menesa-darba-algas-apmeru-normala-darba-laika-ietvaros-un-minimalas-stundas-tarifa-likmes-aprekinasanu

[232] MACIEL, Gustavo Gouvêa; DE SOUSA, Luís Legal Corruption and Dissatisfaction with Democracy in the European Union. Social Indicators Research, 2018, 140.2: 653–674.

[233] SOUSA, Luis de; CLEMENTE, Felippe; CALCA, Patrícia Knowledge of official ethical standards and tolerance towards corruption: an exploratory study. Institute for Political Research of the Department of Political

This benefit arises when personal or financial interests affect or may affect the impartiality of a public official, namely, when it is objectively possible to doubt that a public official is acting in the public interest and not in the private interest. Thus, in order to have a conflict of interest, it is necessary to establish that the public official has a personal or financial interest in performing any activities related to the performance of official duties, or that the public official's relatives or counterparties have a personal or financial interest in such activities[234].

Personal interest is characterized by a gain, advantage, or a loss, which is not always related to financial values[235]. Personal gain can include, for example, *in-service training courses, leave at a particular time, or information about oneself or relatives obtained from a database in a facilitated manner. It can also involve the desire to support a political force that one sympathizes with, in order to reduce supervision over oneself, one's relatives, or counterparties*[236].

Financial interest is a type of personal interest that involves a clear or potential pecuniary gain or loss[237]. The source of such interest can encompass both *things and transactions, such as property or public procurement, as well as bonuses, allowances, and remuneration received, for example, for additional work*[238].

In order to acknowledge that a public official has been in a situation of conflict of interest, it is also necessary to assess whether the personal or financial interests of the public official and their individual interests are in collision[239].

An example of the personal or financial interest of a relative of a public official may be the fact that a public official, in concluding an employment contract with his/her sister (i.e. a relative) and deciding that their sister substitutes the public official during the absence, has taken action in which *a relative of a public official* has had a personal and financial interest. Namely, *the relative* has acquired the right to perform the duties of a public official, as well as has received remuneration for the performance of these duties during his/her absence[240].

Science, University of Bucharest, 2022, 24.1: 1–17, [viewed 17 October 2023]. Available from: https://repositorio.ul.pt/handle/10451/55165

[234] LAFRANCE, Sébastien. The Rules Applicable to Conflicts of Interests for Canadian State Representatives. Vietnamese Journal of Legal Sciences, 2020, 3.2: 84–97.

[235] WICKBERG, Sofia Can policy instruments shape the policy problems they aim to solve? How interest registers redefined conflicts of interest. Policy and Politics, 2023, 51.3: 550–578.

[236] Kurzeme District Court of Latvia, 28.05.2018 Judgment in case No. 1A-0038-18/5. Available from: https://manas.tiesas.lv/eTiesasMvc/nolemumi

[237] REZNIK, Oleg; BONDARENKO, Olha; UTKINA, Maryna; UTKINA, Maryna; KLYPA, Olena; BOBRISHOVA, Liliia Anti-Corruption Transformation Processes in the Conditions of the Judicial Reform in Ukraine Implementation. International Journal for Court Administration, 2023, 14.1: 1–16.

[238] Prevention of conflicts of interest. Guidelines for civil servants, Riga, 2008, Center for Public Policy "Providus". Available from: https://www.knab.gov.lv/lv/media/870/download

[239] Department of Administrative Cases of the Senate of the Supreme Court of the Republic of Latvia, Riga, 18.06.2012 Judgment in case No. A42784509, SKA-146/2012. Available from: https://www.at.gov.lv/lv/tiesu-prakse/judikaturas-nolemumu-arhivs

[240] Administrative District Court of the Republic of Latvia, 08.05.2009 Judgment in case No. A42529307. Available from: https://manas.tiesas.lv/eTiesasMvc/nolemumi

The Supreme Court of Latvia has repeatedly stated in its judgments that the direct qualifying criterion for a situation of conflict of interest is personal or financial interest[241]. Thus, in order to establish that the concerned person (in this case, a public official) has been in a situation of conflict of interest, it is necessary to assess whether the personal and financial interests of the concerned as a public official are in collision with the personal and financial interests of the concerned as an individual[242].

It should be noted that, at the same time the Senate of the Supreme Court of Latvia has acknowledged that the restrictions mentioned in the Law on Prevention of Conflict of Interest *are not absolute and should not be construed in such a way that a public official cannot, in any circumstances, make any decisions regarding themselves*. Such a total prohibition does not stem from either the wording or the spirit of the Law[243]. Thus, in order to conclude that public officials are in situations of conflict of interest, it is necessary not only to establish, in each case, the fact of the public official's decision in relation to themselves, but also to assess the possible personal or financial interest of the public official in the decision-making[244].

A potential *de lege ferenda* proposal to enhance the legislation on conflict of interest in Latvia could include several improvements:

1. Expansion of the scope of the Law on Prevention of Conflict of Interest. For example, the law could cover not only public officials but also individuals in influential positions within business companies that have significant interactions with public administration institutions.
2. Strengthening requirements for disclosure of private interests. For instance , the law could require public officials to provide more detailed information about their financial interests, including specific transactions and holdings.
3. Increased oversight mechanism and transparency in managing conflicts of interest. For example, the law could include requirements for public officials to disclose their interactions with lobbyists or interest groups and to document the reasons for their decisions.

These *de lege ferenda* proposals would support building public trust, reducing corruption risks, and ensuring the integrity of public officials.

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[241] Department of Administrative Cases of the Senate of the Supreme Court of the Republic of Latvia, Riga, 13.01.2012 Judgment in case No. SKA-45/2012. Available from: https://www.at.gov.lv/lv/tiesu-prakse/judikaturas-nolemumu-arhivs

[242] Department of Administrative Cases of the Senate of the Supreme Court of the Republic of Latvia, Riga, 26.03.2009 Judgment in case No. SKA-68/2009, Clause 12. Available from: https://www.at.gov.lv/lv/tiesu-prakse/judikaturas-nolemumu-arhivs

[243] Department of Administrative Cases of the Senate of the Supreme Court of the Republic of Latvia, Riga, 23.10.2008 Judgment in case No. SKA-456/2008, Clause 11. Available from: https://www.at.gov.lv/lv/tiesu-prakse/judikaturas-nolemumu-arhivs

[244] SOUSA, Luis de; CALCA, Patrícia Understanding corruption through the analysis of court case content: research note. Qualitative Research Journal, 2020, 21.2: 135–147, [viewed 16 October 2023]. Available from: https://repositorio.ul.pt/handle/10451/44398

3. TOWARDS THE ESTABLISHMENT OF AN EFFECTIVE SYSTEM FOR THE PREVENTION OF CONFLICTS OF INTEREST

In order to ensure that the activities of public officials serve the public interest by preventing any official, the relatives of public officials, and their counterparties from exerting influence on the decisions and actions of public officials[245], the Law on Prevention of Conflict of Interest not only defines the concept of conflict of interest and related prohibitions for a public official when performing certain functions related to themselves, their relatives, and their counterparties but also establishes a comprehensive system of restrictions, prohibitions, and obligations aimed at ensuring that the public official carries out their official duties solely for the benefit of society.

The system of restrictions and prohibitions also includes restrictions and prohibitions that not only arise directly from the prohibition of public officials to perform their duties in a conflict of interest situation but also indirectly suggest the possibility and potential of a public official to be the future conflict of interest situation if they l do not comply with the aforementioned restrictions and prohibitions.

It is important to note that the restrictions and prohibitions apply to all public officials, with the only exception being the restrictions on commercial activities for relatives of the senior public officials in restrictions on commercial activities (Section 10, Paragraph 1 of the Law on Prevention of Conflict of Interest).

The authors note that the Law on Prevention of Conflict of Interest does not establish restrictions and prohibitions for public officials' relatives to work in the same institution, even when that public official heads that institution. However, the law requires a public official to promptly and in writing provide information to a higher public official institution about the financial or other personal interests of themselves , their relatives, or counterparties in activities that are part of the duties of the public official (Section 21, Paragraph 1 of the Law on Prevention of Conflict of Interest).

In turn, active action must also be taken by the head of the institution[246] upon receiving a written application from a subordinate public official. The head of an institution also has the duty to ensure that public officials working in the institution do not find themselves in a situation of conflict of interest and, if such a situation arises, exercise the official powers of a public official by transferring the functions or tasks of this public official to another public official. (Section 20, Paragraph 1 and 2 of the Law on Prevention of Conflict of Interest).

The authors point out that in practice, a public official does not always inform the head of the institution about a conflict of interest and continue to carry out their official duties. In such cases, the head of the institution is unable to act in accordance with the requirements of the law and transfer the performance of functions or tasks to another public official. Heads of the institutions are obliged to immediately inform the Corruption Prevention and Combating Bureau. If the head of the institution fails to inform the Corruption Prevention and Combating

[245] CRAGG, Wesley Corruption, bribery, and moral norms across national boundaries. The Routledge Companion to Business Ethics, 2018, 573–589.

[246] KHOMA, Nataliia; VDOVYCHYN, Ihor Slow strengthening of Latvia's resilience in preventing and combating corruption: an analysis of causes. Przeglad Wschodnioeuropejski, 2023, 14.1: 87–100, [viewed 17 October 2023]. Available from: http://cejsh.icm.edu.pl/cejsh/element/bwmeta1.element.desklight-6346a742-684c-45b2-8481-a49b87adf4fd

Bureau, they will be jointly responsible for any conflict of interest in their institution and will be held administratively liable[247].

The authors note that, in practice, heads of the institutions often do not inform the Prevention and Combating of Corruption Bureau about situations of conflict of interest in their institutions under the pretext of such typical excuses as: "If there is corruption, then it should be dealt with by the competent authorities, but as long as I have no evidence, it is not my business". or "How can I, as the head of an institution, delve into another individual's personal life, count their earnings, and analyse their lifestyle" or "I am not a law enforcement authority, and I do not have the authority and competence to investigate colleagues." To address the above-mentioned situations, on January 21, 2021, the Saeima of Latvia adopted amendments to the Law extending the competence of the heads of institutions and imposing an obligation on public officials working in the institution to provide information in writing at the request of the head of the institution or a person authorized by them. This information is necessary when performing internal control measures to prevent the risk of corruption and conflict of interest (Section 21, Paragraph 4 of the Law on Prevention of Conflict of Interest).

In addition, the law stipulates that public officials may refuse to perform official duties for ethical reasons, such as in cases involving close persons who are not considered in the circle of relatives.

According to the authors, Latvian legislation on preventing conflicts of interest is sufficient and of high quality. This is because it provides/offers a comprehensive definition of the concept of a conflict of interest, establishes an objectively necessary circle of interested parties, provides a very detailed mechanism for officials to avoid situations of conflict of interest, and outlines a clear procedure for the activities of the head of an institution to prevent a conflict of interest.

CONCLUSION

A new insight into the *concept of conflicts of interest* is based on a semantic analysis of *content* versus the *form* of this legal institute. Conflicts of interest represent the existence of situations (conditions) that define the boundries of behavior for individuals (including civil servants) while performing their (official) duties within the organization. In public law, the paradigm of the rule of law and serving the public interest is of paramount importance. Consequently, legal regulations must clearly articulate s the constituent elements and characteristics of the concept of conflicts of interest to avoid/prevent any ambiguities and gaps in the application of legal norms. The definition of situations that constitute conflicts of interest should encompass public, private, financial, and political interests, thus ensuring fair and integrity-driven conduct when carrying out official duties and upholding the supremacy of public interests in decision-making. Latvia has laws and regulations in place that require public officials to disclose their financial interests and establish conflict of interest guidelines. Similar mechanisms could be adopted by neighboring countries (Lithuania, Poland, Estonia) to enhance transparency and accountability in public administration. The success and adaptability of these practices would depend on the specific legal and institutional frameworks in each neighboring country. Factors such as political will, public awareness, and capacity building of institutions would also play a crucial role in implementing effective conflict of interest prevention practices.

[247] Section 7, Paragraph one, Clause 1 and Section 8, Paragraph one, Clause 1 of the Law on Corruption Prevention and Combating Bureau. Available from: https://likumi.lv/ta/en/en/id/61679-law-on-corruption-prevention-and-combating-bureau

The case law of Latvian national courts, examining the cases involving violations of legal norms governing conflicts of interest, emphasizes the importance of the principle of legitimate expectations in protecting the public interest of society. Individuals in civil service bear a direct duty to act with utmost integrity and to ensure that the public does not even harbour doubts about the presence of a conflict of interest in their official activities and decision-making process. National courts adhere to the provision that conflicts of interest arise from a civil servant's bias when making decision, and their positive or negative attitude. Therefore, to identify the violation of law, it is sufficient to indicate that, when making a decision, the civil servant did not act in a manner that leaves no doubt about the existence of a conflict of interest.

Research outcomes indicate that situations causing conflicts of interest should be standardized, and management of such situations should be ensured by using anti-corruption measures. An effective way to manage situations that cause conflicts of interest is to have an anti-corruption standard (code) of conduct in a public sector organization. The code of conduct for public sector employees and civil servants should clearly describe corruption risks in the area of conflicts of interest and the actions of employees in the face of them.

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CSRD as a leverage for a more circular economy?

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Abstract: *The central research question of this paper*[248] *is whether and to what extent European ESG Regulation, more specifically the Corporate Sustainability Reporting Directive of 2022 (CSRD), can contribute to circularity and therefore act as a leverage for circular economy. The CSRD introduces – as its name suggests – a duty of information for specific companies regarding sustainability. The study examines whether and to what extent such information also covers information on circular economy and whether ESG reporting pushes companies to embrace the circular economy. The answer to these questions is nuanced.*

In order to achieve the aforementioned research aim, this study examined a recent European Directive on Corporate Reporting and its complementary reporting standards. The research methodology used, is classical legal analysis of legislation, policy documents and relevant literature.

Keywords: *Circular economy, ESG-reporting, CSRD, ESRS*

INTRODUCTION

Our study focusses on the Corporate Sustainability Reporting Directive of 2022 (CSRD), which is the most recent directive in force concerned with non-financial ESG-reporting. The CSRD introduces a duty to disclose sustainability-information. Our study examines whether such information covers information on circular economy (CE) and whether ESG-reporting pushes companies to embrace CE.

This paper is structured as follows. First, attention is given to the concept of CE. Subsequently, this paper touches upon recent initiatives in the field of ESG-reporting, with a focus on CSRD. The study then connects both topics and ends with a short conclusion. The study is based on an extensive literature review and on desk top research. Although there is a growing number of academic literature on ESG, academic legal research on the topic of this paper is very scarce.

1. CE AND ESG-REPORTING

1.1 CE

CE can be contrasted with the classic linear economy (or "business as usual"[249]). In the latter, products are being produced, used and thrown away. A CE steps away from this pattern of "take-make-waste" and tries to "close the loop". There exists no unanimously accepted

[248] This paper is part of the ongoing research in the CE centre for circular economy (financed by the Flemish Government). The research and study are 'work in progress'.

[249] EFRAG draft ESRS E5 and ESRS E5 as adopted by Commission.

definition of a CE. In 2023 KIRCHHER et al. analysed 221 definitions of CE.[250] The definition of the concept changes according to which element of a CE is emphasised, which implies that CE functions as an umbrella term.[251]

The EU has nonetheless defined CE in its Taxonomy Regulation as "an economic system whereby the value of products, materials and other resources in the economy is maintained for as long as possible, enhancing their efficient use in production and consumption, thereby reducing the environmental impact of their use, minimising waste and the release of hazardous substances at all stages of their life cycle, including through the application of the waste hierarchy" (prevention; preparing for re-use; recycling; other recovery, e.g. energy recovery; disposal).[252]

On an international level, moving towards a CE can help reach the Sustainable Development Goals (SDG's).[253] CE also plays a pivotal role on the EU level, since the EU considers its new CEAP as one of the main building blocks of the European Green Deal.

More consideration is given to the CE on a national level as well. In Belgium, the competent authorities have taken initiatives with regards to CE: "Vlaanderen Circulair"[254], "Circular Wallonia"[255] and "Gewestelijk Programma voor Circulaire Economie (GPCE)".[256]

Thus, achieving a CE has become increasingly relevant on all levels, with a growing recognition of the possible prominent role it can play in combating the climate crisis.

1.2 ESG-reporting

ESG-initiatives in the EU include the Sustainable Finance Disclosures Regulation of 2019 (SFDR), the Taxonomy Regulation of 2020 and the Corporate Sustainability Reporting

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[250] KIRCHHERR, Julian, et al. Conceptualizing the Circular Economy (Revisited): An Analysis of 221 Definitions. *Resources, Conservation and Recycling* [online]. 2023, 194, 107001 [viewed 4 October 2023]. ISSN 0921-3449. Available from: doi:10.1016/j.resconrec.2023.107001.

[251] VOORTER, Jonas, Aura IURASCU, and Steven VAN GARSSE. The concept "circular economy": towards a more universal definition. *Ius publicum* [online]. 2021, (2), 2 [viewed 4 October 2023]. ISSN 2039-2540. Available from: http://www.ius-publicum.com/repository/uploads/10_06_2022_17_24-2_DEF_The-concept-circular-economy_-towards-a-more-universal-definition-svgJVAI.pdf.

[252] Art. 2, (8) Taxonomy Regulation and art. 4 of Directive 2008/98/EC.

[253] THE 17 GOALS | Sustainable Development. *United Nations* [online]. [no date] [viewed 4 October 2023]. Available from: https://sdgs.un.org/goals. For a more in depth analysis, see: DONG, Liang, Zhaowen LIU, and Yuli BIAN. Match Circular Economy and Urban Sustainability: Re-investigating Circular Economy Under Sustainable Development Goals (SDGs). *Circular Economy and Sustainability* [online]. 2021 [viewed 4 October 2023]. ISSN 2730-5988. Available from: doi:10.1007/s43615-021-00032-1. https://link.springer.com/article/10.1007/s43615-021-00;Circular Economy and Sustainability: the Past, the Present and the Future Directions | SpringerLink https://link.springer.com/article/10.1007/s43615-021-00064-7

[254] Vlaanderen Circulair - Knooppunt van de circulaire economie in Vlaanderen. *Vlaanderen Circulair*. [online]. [no date] [viewed 4 October 2023]. Available from: http://www.vlaanderen-circulair.be/nl.

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Directive of 2022 (CSRD).[257] Given the scope of this paper, our study only focusses on the latter.

The CSRD introduces or – respectively – extends an obligation for certain undertakings to report information regarding ESG and their sustainability performance.

The CSRD applies to listed undertakings[258] and amends a series of other directives, among which most importantly the "Accounting Directive".[259] This paper focusses on the amendments of the CSRD to the Accounting Directive (as amended by the Non-Financial Reporting Directive of 2014 (NFRD)).

Noteworthy is that the no longer carries the label "Non-Financial Reporting", as many stakeholders conceived the label non-financial to be inaccurate. It created the (false) impression that the particular information was considered financially irrelevant, while in practice that information is – on the contrary – becoming increasingly financially relevant.

Important reformations brought by the CSRD are the expansion of the number of companies subject to sustainability reporting, compulsory review (the "limited/reasonable assurance") of the sustainability reports and the principle of double materiality.[260]

2. CE and the CSRD

2.1 The CSRD and the European Sustainability Reporting Standards

The CSRD introduces a reinforced duty for certain undertakings to disclose sustainability-information. The CSRD entrusts the Commission with the responsibility to provide sustainability reporting standards (ESRS[261]).[262]

The CSRD states for each ESG-factor which topics need to be addressed in the ESRS. For these topics, the ESRS has to specify which particular information undertakings should disclose. CE together with resource use, is one of these topics.[263] So clearly both notions are interlinked.

When adopting the ESRS, the Commission had to take into account the advice from the European Financial Reporting Advisory Group (EFRAG).[264] EFRAG is organised in a financial

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[257] See also: HESEKOVÁ, Simona. ESG and recent changes in EU legislation within financial markets. In: *Proceedings of the 14th International Scientific Conference*. Prague: Prague University of Economics and Business, Czech Republic, 2022, p. 186. ISBN 978-80-88055-14-3.

[258] Art. 1 of the Accounting Directive, as amended by art. 1 CSRD.

[259] Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013.

[260] FALKENBERG, Christof, Carina SCHNEEBERGER, and Siegfried PÖCHTRAGER. Is Sustainability Reporting Promoting a Circular Economy? Analysis of Companies' Sustainability Reports in the Agri-Food Sector in the Scope of Corporate Sustainability Reporting Directive and EU Taxonomy Regulation. *Sustainability* [online]. 2023, 15(9), 7498 [viewed 4 October 2023]. ISSN 2071-1050. Available from: doi:10.3390/su15097498; The concept of double materiality means reporting on both the impact the company has on society and the environment and the sustainability risks the company experiences (e.g., due to climate change and scarcity of resources). See also infra.

[261] European sustainability reporting standards.

[262] Art. 29 b. §1 NFRD, as amended by art. 2 CSRD.

[263] Art. 29b, §2, a, iv NFRD, as amended by art. 2 CSRD.

[264] Art. 49, §3, b NFRD, as amended by art. 2 CSRD.

reporting pillar and a sustainability reporting pillar and is considered to be a centre of expertise on corporate reporting.[265]

EFRAG took international reporting standards into consideration,[266] to ensure maximal convergence (e.g. the proposed standards by the International Sustainability Reporting Standards Board (ISSB)).[267] This was a fundamental objective of the CSRD[268] and was indicated by stakeholders during the standard setting process.[269]

EFRAG finalised twelve draft ESRS in November 2022,[270] subsequently adopted by the Commission.[271] The ESRS would apply from the first of January 2024. [272]

2.2 General principles

Undertakings only have to report on topics material to them. Thus, the first step in sustainability reporting is a materiality assessment,[273] following the double materiality principle. According to this principle, materiality has to be assessed from an "inside out" (impacts the undertaking can have on the environment or society) and "outside in" perspective (how the undertaking itself is – e.g. financially – impacted). A topic becomes more material to the undertaking as its external or financial impact increases.[274]

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[265] Preamble 39 CSRD; GINER, Begoña, and Mercedes LUQUE-VÍLCHEZ. A comentary on the "new" institutional actors in sustainability reporting standard-setting: a European perspective. *Sustainability Accounting, Management and Policy Journal* [online]. 2022 [viewed 4 October 2023]. ISSN 2040-8021. Available from: doi:10.1108/sampj-06-2021-0222; EFRAG Today. *EFRAG* [online]. [no date] [viewed 4 October 2023]. Available from: http://www.efrag.org/About/Facts.

[266] First Set of draft ESRS. Home – *EFRAG* [online]. [no date] [viewed 4 October 2023]. Available from: http://www.efrag.org/lab6.

[267] First Set of draft ESRS. Home – *EFRAG* [online]. [no date] [viewed 4 October 2023]. Available from: http://www.efrag.org/lab6; GINER, Begoña, and Mercedes LUQUE-VÍLCHEZ. A commentary on the "new" institutional actors in sustainability reporting standard-setting: a European perspective. *Sustainability Accounting, Management and Policy Journal* [online]. 2022 [viewed 4 October 2023]. ISSN 2040-8021. Available from: doi:10.1108/sampj-06-2021-0222.

[268] Preamble CSRD.

[269] Implementing and delegated acts – CSRD. *European Commission* [online]. [no date] [viewed 8 October 2023]. Available from: https://ec.europa.eu/finance/docs/level-2-measures/csrd-delegated-act-2023-5303_en.pdf.

[270] First Set of draft ESRS. Home – *EFRAG* [online]. [no date] [viewed 4 October 2023]. Available from: http://www.efrag.org/lab6.

[271] ANNEX to the Commission Delegated Regulation (EU) …/… supplementing Directive 2013/34/EU of the European Parliament and of the Council as regards sustainability reporting standards [online]. [31 July 2023] [viewed 4 October 2023]. Available from: https://ec.europa.eu/finance/docs/level-2-measures/csrd-delegated-act-2023-5303-annex-1_en.pdf (hereinafter: Annex).

[272] Corporate Sustainability Reporting Directive. *European Commission* [online]. [no date] [viewed 4 October 2023]. Available from: https://finance.ec.europa.eu/regulation-and-supervision/financial-services-legislation/implementing-and-delegated-acts/corporate-sustainability-reporting-directive_en?fbclid=IwAR19ZCjN39-lpw1UJ1pquuT_6Y9dvXgyqTiyqxNKH2CvEK38NmsSQTmT2l8.

[273] Annex,33.

[274] Annex, 5-8; BAUMÜLLER, Josef, and Karina SOPP. Double materiality and the shift from non-financial to European sustainability reporting: review, outlook and implications. *Journal of Applied Accounting Research* [online]. 2021, 23(1), 8–28 [viewed 4 October 2023]. ISSN 0967-5426. Available from: doi:10.1108/jaar-04-2021-0114; LEVERAGING CORPORATE SUSTAINABILITY REPORTING FOR CIRCULAR TRANSFORMATION – Insights – Circle Economy. *Circle Economy* [online]. [no date] [viewed 8 October 2023]. Available from: https://www.circle-economy.com/resources/leveraging-corporate-sustainability-reporting-for-circular-transformation.

2.3 ESRS E5: "resource use and circular economy"

Some undertakings might already report on CE, but the CSRD and ESRS now contain clear obligations for the first time in that respect.[275]

The ESRS E5 consists of six disclosure requirements (ESRS E5-1 – E5-6). ESRS E5-1 obliges the undertaking to describe its policies to manage its material impacts, risks and opportunities relating to CE and resource use. The undertaking has to take into account how its policies address the waste hierarchy; prioritising minimal waste (by e.g. reusing) over waste treatment (recycling). If material, the undertaking should also indicate how its policies address *inter alia* the depart from using virgin resources.[276]

Under ESRS E5-2 undertakings should report on resources as well as actions taken or planned to achieve their objectives regarding the CE and resource use. In its sustainability statement, the undertaking may specify if those activities also cover e.g. increasing product durability by applying circular design.[277] The actions reported upon might also be collective actions.[278]

Following ESRS E5-3 the undertaking has to disclose targets supporting its policy regarding CE and resource use. It has to be specified if and how those targets relate to resource in- and outflows, including waste. For each target it should also be clearly indicated which level of the waste hierarchy the target pertains to. The undertaking is free to refer to ecological thresholds as targets. If the target addresses shortcomings in connection with the *"Substantial Contribution criteria for Circular Economy*"[279] or the *"Do No Significant Harm criteria"*[280], the undertaking may indicate this or not.[281]

ESRS E5-4 pertains to resource inflows relating to the undertakings material impacts, risks and opportunities. If material, the undertaking has to report on e.g. products (including packaging), property, equipment, … used in its own operations and in the upstream value chain.[282]

Undertakings also need to report on resource outflows (including waste) of their own operations or the downstream value chain, following ESRS E5-5. A description is needed on products and materials produced by the undertaking, if they are designed along circular principles such as "durability, reusability, repairability, disassembly, remanufacturing,

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[275] OPFERKUCH, Katelin, et al. Circular economy disclosure in corporate sustainability reports: The case of European companies in sustainability rankings. *Sustainable Production and Consumption* [online]. 2022, (32), 436–456 [viewed 4 October 2023]. Available from: doi:10.1016/j.spc.2022.05.003; OPFERKUCH, Katelin, et al. Circular economy in corporate sustainability reporting: A review of organisational approaches. *Business Strategy and the Environment* [online]. 2021 [viewed 8 October 2023]. ISSN 1099-0836. Available from: doi:10.1002/bse.2854.LEVERAGING CORPORATE SUSTAINABILITY REPORTING FOR CIRCULAR TRANSFORMATION – Insights – Circle Economy. *Circle Economy* [online]. [no date] [viewed 8 October 2023]. Available from: https://www.circle-economy.com/resources/leveraging-corporate-sustainability-reporting-for-circular-transformation.

[276] Annex, 147 and 153

[277] *Ibid*, 147

[278] *Ibid*, 153.

[279] As defined in the delegated acts adopted pursuant to Article 13(2) of Regulation (EU) 2020/852.

[280] As defined in delegated acts adopted pursuant to Article 10(3), Article 11(3), Article 12(2), Article 14(2), and Article 15(2) of Regulation (EU) 2020/852.

[281] Annex, 148 and 154.

[282] *Ibid*, 148–149.

refurbishment, recycling, recirculation by the biological cycle, or optimisation of the use of the product or material through other circular business models".[283]

If outflows are material, the sustainability statement needs to include the expected durability of the product in relation to the average within the industry. The rates of recyclable content also needs to be stated and the reparability products. Information also needs to be disclosed on the total amount of waste generated and further specifications regarding the composition of the waste (e.g. hazardous) and weight thereof is needed. Additionally, undertakings need to disclose the waste streams relevant to its sector or activities and the materials present in the waste.[284]

Lastly, undertakings should[285] report on anticipated financial effects due to material risks arising from material impacts, risks and opportunities related to CE (ESRS E5-6). In this way, undertakings and readers of the sustainability statement can e.g. gain insight in how risks (could reasonably) have a material influence on the financial position and performance, and cash flows over the short-, medium- and long-term.[286]

2.4 Other ESRS?

Given the broadness of the concept CE, not only the ESRS E5 is relevant when it comes to embracing the CE. Several other ESRS are also concerned with topics linked to CE. ESRS E5 refers to the ESRS on climate change (ESRS E1), pollution (ESRS E2), water and marine resources (ESRS E3) and biodiversity and ecosystems (ESRS E4).[287] However, addressing all these disclosure requirements would exceed the scope of this paper.

3. CSRD (and ESRS) as a leverage for CE?

In the previous part, the disclosure requirements regarding CE, following the CSRD and the ESRS, were set out. The question still needs to be answered whether CSRD can act as a leverage for the circular economy and thus can push companies towards embracing circularity in their entire supply chain.

The answer is nuanced. Undertakings have to report on matters concerning CE when these are considered material to them. When this is the case, they will have to report on their policy on CE, their targets set in order to support this policy, actions taken or planned addressing the CE, resource in- and outflows as well as anticipated financial effects. The aforementioned reporting requirements are not to be underestimated and cover a wide range of aspects of CE As stated in the beginning of this paper, there's no unanimously accepted definition of CE, which makes it harder to assess to what extent CE-aspects are covered.

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[283] *Ibid*, 149–150.

[284] *Ibid*, 149–150.

[285] The undertaking may omit this for the first year of preparation of its sustainability statement and for the first three years thereof, undertakings will be considered compliant to by only reporting on qualitative disclosure. Annex,31

[286] Annex, 150–151.

[287] Annex, 146.

In light of the independent expert report "Categorisation system for the circular economy",[288]it can be concluded that the latter imposes higher circularity-requirements to companies than the ESRS E5 e.g. the categorisation system often indicates that companies should go beyond what European or international standards impose,[289] whereas this is not the case with the ESRS E5. Thus, the obligations imposed by the ESRS and the CSRD are rather vague in comparison with the Expert Report. A possible explanation is that CSRD focuses on reporting, while the Categorisation system categorizes effective ways to engage in CE and sets minimum criteria for activities in order to be considered as contributing to the CE.

Reporting on CE, however, does not necessarily equate to caring about or implementing CE. This can be illustrated by previous research. A relatively small-scale study in the food industry, carried out expert-interviews and noted that: *"The experts see the promotion of a circular economy through mandatory reporting as a general possibility, although a connection between reporting and actual implementation by the companies in practice is considered difficult. In general, experts agree that the additional reporting requirements can be seen as a good first step towards the circular economy and raising awareness."*[290]

That conclusion can, in our opinion and with some remarks, be generalised for circular economy-reporting as a whole. Indeed, the contribution of the CSRD and ESRS to the CE is indirect. The majority of efforts towards CE remain with the undertakings. It is thus not necessarily the CSRD and ESRS that act as a leverage for CE, rather the companies subject to the CSRD and ESRS can seize the opportunity of sustainability reporting to embrace the CE. It is up to the companies to show they are frontrunners or how well they care about CE. From that perspective companies might be incentivised given the high reputational[291] cost of non-adherence. A comparable incentive was identified in prior academic research on the NFRD, when reporting became obligatory. Certain companies took that as an opportunity to *"develop internal processes to improve its relations with external subjects that hold key resources"*.[292]

Nonetheless, the ESRS discussed above exclusively apply to large undertakings.[293] Standards should still be developed for small and medium-sized undertakings.[294] In the EU, not even 1 % of the total corporate landscape qualifies as a large company.[295] Consequently, the implications of these ESRSs needs to be nuanced.

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[288] Categorisation system for the circular economy – Independent Expert Report. *Publications Office of the EU* [online]. 2020 [viewed 16 October 2023]. Available from: https://op.europa.eu/en/publication-detail/-/publication/ca9846a8-6289-11ea-b735-01aa75ed71a1/language-en.

[289] Ibid, 9.

[290] FALKENBERG, Christof, Carina SCHNEEBERGER, and Siegfried PÖCHTRAGER. Is Sustainability Reporting Promoting a Circular Economy? Analysis of Companies' Sustainability Reports in the Agri-Food Sector in the Scope of Corporate Sustainability Reporting Directive and EU Taxonomy Regulation. *Sustainability* [online]. 2023, 15(9), 7498 [viewed 4 October 2023]. ISSN 2071-1050. Available from: doi:10.3390/su15097498.

[291] See e.g.: OPFERKUCH, Katelin, et al. Towards a framework for corporate disclosure of circular economy: Company perspectives and recommendations. *Corporate Social Responsibility and Environmental Management* [online]. 2023 [viewed 8 October 2023]. ISSN 1535-3966. Available from: doi:10.1002/csr.2497.

[292] AURELI, Selena, et al. Nonfinancial reporting regulation and challenges in sustainability disclosure and corporate governance practices. *Business Strategy and the Environment* [online]. 2020, 29(6), 2392–2403 [viewed 8 October 2023]. ISSN 1099-0836. Available from: doi:10.1002/bse.2509.

[293] Undertakings are considered large if, on their balance sheet dates, they exceed minimum one of the following three criteria: balance sheet total 20.000.000; net turnover 40.000.000; average number of employees during the financial year: 250. See definition in art. 3 of the Accounting Directive.

[294] Art. 29c NFRD, as amended by art. 2 CSRD.

[295] Small and medium-sized enterprises: an overview. *EUROSTAT* [online]. [no date] [viewed 8 October 2023]. Available from: https://ec.europa.eu/eurostat/en/web/products-eurostat-news/-/ddn-20200514-1

Additionally, the CSRD is a Directive and thus still needs to be nationally transposed, for which the member states in principle have time until the 6th of July 2024.[296] In transposing a Directive, member states can go beyond minimum requirements set in the Directive. In order to assess the entire concrete impact of the CSRD, the national transposition thereof needs to be assessed as well.

Even so, the influence of the CSRD and ESRS towards more circularity is still considerable. First, it raises awareness on circularity. Second, as the EU already indicated in its Taxonomy Regulation, *"economic activities can contribute substantially to the environmental objective of transitioning to a circular economy in several ways"*.[297] Thirdly, policies of large ESG ambitious companies relating to the selection of contract partners, but also CSRD-rules on disclosure of practices of business partners in the value chain, could stimulate other companies to be more engaged in the CE.

Lastly, the materiality assessment of topics is a management decision.However, management most probably won't be able to omit certain topics that are in fact material to the undertaking, nor will they take the risk to engage in greenwashing given the sustainability statement of undertakings is subject to auditing practices ("limited/reasonable assurance").

CONCLUSION

The aim of this study was to examine whether and to what ESG-regulation and more precisely the CSRD, can contribute towards circularity and thus act as a leverage for the CE. The scope of the research was therefore limited, but it would be interesting to explore in future research to what extent the same conclusions can be drawn with regards to other ESG-regulation such as the SFRD...

Following the CSRD, it will be mandatory for companies, falling within the scope, to report on CE, as far as it is material to the company. Whether something is material (inside out or outside in) is determined by the company itself and thus is (to some extent) a management decision. However, this can be countered by the fact that the CSRD henceforth makes limited or reasonable assurance mandatory. How far this assurance reaches and how effective it is, could not be ascertained in this study due to its scope, but could inspire further research.

Companies within the scope of the CSRD and ESRS discussed in this paper will have to look at their value chain and if materially relevant report on the circular dimension. As indicated, the ESRS discussed in this paper apply only to large companies, which in the EU constitute a very small minority. For (listed) small and medium-sized companies, standards are still pending. Thus, whether for those companies the CSRD will really be able to leverage the CE will strongly depend on the content of these standards. Future research should therefore examine this. However, one can expect that, large companies might want to force or push their suppliers and subcontractors to embrace circularity or as part of a value chain, companies might thus still be asked by larger companies to provide information on CE.[298]

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[296] Art. 5.1 CSRD.

[297] Preamble 28 Taxonomy Regulation.

[298] Information material to the sustainability matter involved. Note that CSRD is limiting the requests large companies can make.

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[3] Directive 2008/98/EC of the European Parliament and of the Council of 19 November 2008 on waste and repealing certain Directives [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32008L0098

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[5] Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013L0034

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Annulment of Debt Relief Due to Dishonest Intention of the Debtor in the Decision-making Practice of Slovak Courts

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Abstract: *Debt relief is a way of dealing with the insolvency of a debtor who is a natural person. The current legislation on insolvency in the Slovak Republic, which has been in force since March 2017, allows for two forms of insolvency of a natural person, namely bankruptcy or a instalment plan. A debtor can be discharged if he has an honest intention, but this is not examined by the court in bankruptcy proceedings or in proceedings for the determination of a instalment plan. It is examined only in proceedings for annulment of the insolvency for dishonest intent, which may be initiated by a creditor affected by the insolvency within six years of the declaration of bankruptcy or the setting of an instalment plan. A prerequisite for the revocation of the insolvency proceedings is the proof that the debtor had a dishonest intention. The article focuses on the analysis of available decisions of Slovak courts on the cancellation of debt relief for dishonest intent and concludes with a summary of the results of the analysis. Based on the research, it was found that the petition for annulment of the debt relief was rejected in the majority of cases on the grounds that the debtor's dishonest intent was not proven.*

Keywords: *debt relief of natural persons, dishonest intent, annulment of debt relief, case law*

INTRODUCTION

Debt relief (so-called personal bankruptcy) is a procedural institute of getting rid of debts, intended for debtors – natural persons. Debt relief and a fresh start is a modestly progressive safety net for addressing over indebtedness.[299] The point of debt relief is to help individuals who wish to settle their adverse situation in active manner.[300] Debt relief (personal bankruptcy) is intended to give a second chance, in particular to debtors who would otherwise be forced to pay their debts for life and to avoid a situation where debtors start to move into the shadow economy.[301] This institute was introduced into the Slovak legal order in 2006 by Act No 7/2005 Coll. on Bankruptcy and Restructuring and on Amendments and Additions to Certain Acts, as

[299] RAMSAY, Iain. Towards an International Paradigm of Personal Insolvency Law? A Critical View. QUT Law Review. 2017, 17(1), 15–39.

[300] PASEKOVÁ, Marie, Zuzana FIŠEROVÁ, Luboš SMRČKA and Dagmar BARINOVÁ. Debt Relief of Individuals and the Rate of Satisfaction of their Creditors in the Czech Republic. In PASTUSZKOVÁ, Eliška, Zuzana CRHOVÁ, Jana VYCHYTILOVÁ, Blanka VYTRHLÍKOVÁ and Adriana KNÁPKOVÁ (eds.) Finance and the Performance of Firms in Science, Education and Practice. Conference proceedings. 7th International Scientific Conference "Finance and the Performance of Firms in Science, Education and Practice". April 23–24, 2015, Zlín, Czech Republic: Tomas Bata University in Zlín, Faculty of Management and Economics, 2015. pp. 1169–1187. 978-80-7454-476-7.

[301] PASEKOVA, Marie, Zuzana FISEROVA, Zuzana CRHOVA and Dagmar BARINOVA. Debt Relief of Natural Persons and the Rate of Satisfaction of Their Creditors in the Czech Republic. *Verlas: teorija ir praktika.* 2015, 16(2), 185-194.

amended (hereinafter referred to as “ZKR” or “Act on Bankruptcy and Restructuring”). On the basis of the amendment of the ZKR by Act No. 377/2016 Coll., with effect from 1 March 2017, there was a significant change in the original rules of debt relief,[302] to make debt relief available to as many insolvent debtors as possible. As of March 2017, natural persons who are insolvent, have at least one execution or similar enforcement proceeding pending against their property, have their centre of main interests in the Slovak Republic and have an honest intention to satisfy their creditors may be relieved of their debts in two ways, either by bankruptcy (under Part IV of the Bankruptcy Code) or by a instalment plan. In the case of bankruptcy, the debtor's assets are monetised and the proceeds of the monetisation are used to satisfy the claims of creditors registered in the bankruptcy proceedings. However, a debtor who has no assets, no income or only a low income may also be discharged by bankruptcy. This type of insolvency is more popular among debtors, as evidenced by the fact that, as of March 2017, more than 70 000 debtors have been insolvent through bankruptcy, and only more than 600 debtors have been insolvent through the instalment plan.[303] In the case of instalment plan, the debtor retains his/her assets, but must have a regular income from which to pay creditors' claims over a five-year period according to a instalment plan set by the court, so that at a minimum of 30% is being repaid. Each debtor chooses the form of debt relief by filing the appropriate petition with the court. When submitting a petition the debtor must be represented by the Legal Aid Centre or an attorney appointed by the Legal Aid Centre. The court decides on the debt relief directly in the decision on the bankruptcy order or the order setting a instalment plan by discharging the debtor from all debts which can only be satisfied in bankruptcy or by means of a instalment plan, to the extent that they will not be satisfied in bankruptcy or the instalment plan. All claims of creditors which are filed in bankruptcy proceedings are subject to debt relief (Article 166a of the Act on Bankruptcy and Restructuring).[304] These claims become unenforceable, i.e. the legal right to enforce them is extinguished. If the claim is voluntarily fulfilled despite its unenforceability, there is no unjust enrichment on the part of the creditor.[305] Bankruptcy can only be declared if the debtor has an honest intention. But the honest intention is not being examined by the court in bankruptcy proceedings or in proceedings for the determination of an instalment plan. It is examined exclusively in proceedings for annulment of the insolvency for dishonest intention. Pursuant to Section 166f of the Act on Bankruptcy and Restructuring, a creditor affected by the insolvency proceedings may apply to the court for the debt relief to be annulled if the creditor proves that the debtor did not have an honest intention in the insolvency proceedings. Since the burden of proof in proceedings for the annulment of the debt relief rests on the creditor, at his initiative and at his expense, the administrator is obliged, pursuant to Article 166i Act on Bankruptcy and Restructuring, to make investigations to ascertain facts which may have a bearing on the assessment of the debtor's honest intention in

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[302] Cf. DEÁK, Marko. Niekoľko poznámok k zrušeniu oddlženia pre nepoctivý zámer dlžníka. Justičná revue. 2020, 72(8-9), 944–959.

[303] SLOVAK MINISTRY OF JUSTICE. Insolvency Register. [online]. 2023. [viewed 16 September 2023] Available from:

https://ru.justice.sk/ru-verejnost-web/pages/searchKonanie.xhtml?page=4&sudy=&typy=OddlzenieKonkurz&zive=false&triedenie=DatumZacatiaKonania&zaciatokOd=1488322800000&zaciatokDo=1694901599000&obdobie=all

[304] Cf. ŠEVČÍKOVÁ, Andrea. K oddlženiu fyzických osôb podľa štvrtej časti ZKR. In: Košické dni súkromného práva II – recenzovaný zborník vedeckých prác z medzinárodnej vedeckej konferencie konanej v roku 2018. Košice: Univerzita Pavla Jozefa Šafárika v Košiciach. Právnická fakulta, 2018, pp. 691–701. ISBN 978-80-8129-088-6.

[305] SOJKA, Pavol. Oddlženie podľa nových pravidel. Justičná revue. 2017, 69(5), 669–690.

the debt relief.[306] However, we know from practice that creditors do not give such incentives to administrators. A petition for the annulment of the insolvency due to the debtor's dishonest intention in the insolvency can also be filed by the public prosecutor. The time limit for filing a petition for annulment of the insolvency proceedings is six years, starting from the declaration of bankruptcy or the establishment of a instalment plan. Upon the entry into force of the decision on the annulment of the insolvency, the insolvency becomes ineffective against all creditors, which means that the claims are restored to the full extent to which they have not yet been satisfied, both as regards enforceability and the original maturity. The revocation of the insolvency starts a new limitation period of ten years in respect of such claims.

The aim of the article is to outline briefly the Slovak legislation regarding debt relief for natural persons with a focus on the debtor's honest intention and then, on the basis of an analysis of selected Slovak court decisions issued in cases of debt relief annulment, to summarise the findings at the end of the article. In the paper the method of analysis and synthesis are mainly being used.

1. HONEST INTENTION

In the Act on Bankruptcy and Restructuring no legal definition of the term honest intention is being anchored. In the Article § 166g of the Act on Bankruptcy and Restructuring, the legislator only mentions by a way of examples the facts when the debtor has an honest intention, as well as negatively defines the facts when the debtor does not have an honest intention. An honest intention is given by the debtor if from the debtor´s conduct after the filing of the petition can be inferred , that he/she has made a sincere effort to resolve his/her debt within the limits of his means and abilities, in particular if he/she has provided necessary cooperation to the administrator and the creditors, has made an effort to obtain employment, has obtained employment or other source of income, has, in the case of a not insignificant inheritance, gift or winnings from a bet or game, offered at least half of such source voluntarily to creditors in satisfaction of an irrecoverable debt, or has made an effort to join or re-join the society (Article 166g Paragraph 1 of the Act on Bankruptcy and Restructuring). The burden of proof of these facts, or of other facts by which the debtor seeks to prove his honest intention in the debt relief, shall be on the debtor.[307] In Article 166g Paragraph 2 of the Act on Bankruptcy and Restructuring there are being anchored circumstances where, on the contrary, it can be concluded that the debtor does not have an honest intention. This is e.g. a situation where the debtor intentionally conceals part of his assets, does not have a centre of main interests in Slovakia, does not provide cooperation to the administrator, etc.

The court is required to look more strictly at facts affecting honest intent in the case of a debtor who has had or still has significant assets in the past, has business experience, is or has been a senior employee or is or has been a member of a body of a legal person, or has other special life experience (Article 166g Paragraph 3 of the Act on Bankruptcy and Restructuring). The court takes a more lenient view of facts affecting honest intent in the case of a debtor who has attained only primary education, is of or near retirement age, has serious health problems, has temporarily or permanently lost his home, or has suffered some other event in his life that has

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[306] Cf. MANÍK, Rudolf. K inštitútu oddlženia v konkurznom práve Slovenska. In: Košické dni súkromného práva III – zborník vedeckých prác z II. ročníka medzinárodnej vedeckej konferencie. Košice: Univerzita Pavla Jozefa Šafárika v Košiciach. Právnická fakulta, 2021, pp. 219–225. ISBN 978-80-574-0024-0.

[307] ĎURICA, Milan. *Zákon o konkurze a reštrukturalizácii. Komentár.* Praha: C.H.Beck, 2021, 1476. ISBN 978-80-1400-846-7.

made it difficult for him to find a place in society (Article 166g Paragraph 4 of the Act on Bankruptcy and Restructuring).

It is clear from the legislator's attempt to normatively regulate the concept of honest intent, even if only by its exemplified definition, that the legislator seeks to avoid the need for judicial law-making when assessing a debtor's honest intent to become relieved of his or her debts. Nevertheless, the legislator left it to the court to ascertain the specific circumstances and facts. [308] If the court finds that the debtor's conduct shows signs of dishonest intent, it may attach to that conduct the sanctioning consequence of annulment of the debt relief.[309]

2. DISHONEST INTENT OF THE DEBTOR FROM THE PERSPECTIVE OF JUDICIAL PRACTICE

The District Court Bratislava I issued the first court decision annulling the debt relief due to the debtor's dishonest intention; this decision file number: 8Odi/1/2018, dated October 18,2018,[310] had been issued approximately one and a half years after the entry into force of the amended legislation on debt relief. Gradually, the decisions on the annulment of debt relief for dishonest intent began to increase. On the basis of the cooperation provided by the Slovak bankruptcy courts, we have found that so far, the competent courts have decided on the annulment of the debt in about 130 cases. A larger number of decisions are decisions by which the courts decided to dismiss the action for annulment of the insolvency proceedings on the grounds that the debtor's dishonest intent was not proven. More than 140 such decisions have been issued so far. In many cases (about 320), the action for annulment of the insolvency proceedings was withdrawn or the proceedings were discontinued. In the following part of the article, we will focus in particular on the decisions in which the court annulled the debt relief for the debtor's dishonest intention in the discharge. The selection of decisions was based on those available on the website of the Ministry of Justice of the Slovak Republic.

The District Court Nitra by decision file number: 31Odi/2/2022 dated 13.01.2023 cancelled the debt relief on the grounds that the debtor did not have an honest intention according to Article 166g Paragraph 1 of the Act on Bankruptcy and Restructuring. The court found that the defendant, following his bankruptcy order of 27.10.2018, inherited from his deceased father, who died in 2020, co-ownership interests of 1/8 in real estate – a family house with land and a holiday cottage with land with a total value of EUR 9 375. Accordingly, the defendant was obliged under Article 166g Paragraph 1 of the Act on Bankruptcy and Restructuring to offer at least half of such resource to creditors in satisfaction of the unenforceable debt. The court saw as proven that the defendant, after acquiring an inheritance of not insignificant value, did not take any action either to monetize the inheritance which had been acquired or to offer at least half of that resource – i.e. the co-ownership interests in the properties in question acquired directly by inheritance – voluntarily to creditors to satisfy an unenforceable debt. This had the effect that the debtor had no honest intention of satisfying his/her creditors in relation to his/her insolvency proceedings.

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[308] BARAN, Radoslav. Neproporcionalita práv veriteľov a dlžníka v oddlžení konkurzom a zodpovednoť dlžníka za škodu. Bulletin slovenskej advokácie. 2023, 29(2). 16–23.

[309] DZIMKO, Jakub, and Lenka UŠIAKOVÁ. Nepoctivý zámer dlžníka ako predpoklad zrušenia oddlženia fyzickej osoby. In: Právne rozpravy on-screen – zborník z online vedeckej konferencie konanej dňa 29.05.2020 na Právnickej fakulte Univerzity Mateja Bela v Banskej Bystrici. Banská Bystrica: Belanum, 2020, pp.21–30. 978-80-557-1770-8.

[310] ZABRENSZKI, Tomáš. *Zrušenie oddlženia pre nepoctivý zámer dlžníka s vybranou judikatúrou.* Žilina: Poradca podnikateľa, 2023, 60. 978-80-8186-189-0.

In accordance with Article 166g Paragraph 2 Letter a) of the Act on Bankruptcy and Restructuring the debtor does not have an honest intention, in particular if he/she has not indicated part of his/her assets in the list of assets or at the request of the administrator, even though he/she knew or ought to have known of them in view of the circumstances, while assets of negligible value are not taken into account. District Court Košice I in the decision file number: 32Odi/5/2019 dated February 13, 2020 considered a case where in the list of assets of greater value owned by the debtor in the last three years, the defendant provided false information consisting in the fact that he/she declared that he/she did not own assets of greater value (i.e. more than EUR 2,000) in the last three years, despite the fact that the list was filled in on January 25,2018 and in January 2016, the plaintiff paid him /her an amount exceeding EUR 2,000. The court found that the statement in question was false and annulled the debt relief for dishonest intent.

In accordance with Article 166g Paragraph 2 Letter a) of the Act on Bankruptcy and Restructuring the debtor does not have an honest intention, in particular if he/she has not indicated a natural person creditor in the list of creditors or in response to the administrator's enquiry, as a result of which the creditor did not declare his/her claim even though he/she knew or, having regard to the circumstances, ought to have known of the creditor, whereas small creditors are not taken into account. In the decision file no.: 27Odi/1/2022 dated 10.06.2022 the District Court Nitra considered a case in which the debtor did not indicate a creditor – a natural person – in the list of creditors even on the administrator's inquiry. The court held that in the present case, the reason set out in Article 166g Paragraph 2 Letter b) of the of the Act on Bankruptcy and Restructuring was not a ground for annulling the discharge for dishonest intent. Although the debtor did not list a natural person as a creditor in the list of creditors, the creditor-plaintiff learned of the bankruptcy in time to file his/her claim. That ground could have been accepted for the annulment of the insolvency, if the creditor had not lodged his/her claim.

In accordance with Article 166g Paragraph 2 Letter c) of the Act on Bankruptcy and Restructuring the debtor does not have an honest intention, in particular if, in the petition or in an annex to the petition or at the request of the administrator, the debtor has misrepresented relevant information or has failed to disclose relevant information even though the debtor knew or, having regard to the circumstances, ought to have known that it is a relevant information. In the decision file number: 3Odi/1/2018 dated November 11, 2018 the District Court Žilina came to the conclusion, that information about property owned by the debtor in the last three years qualifies as relevant information under Article 166g Paragraph 2 Letter c) of the Act on Bankruptcy and Restructuring. The court found that the defendant had failed to disclose in the annex to the bankruptcy petition the property which he/she had transferred to his/her daughter by a sale agreement that has had two amendments. This property was undoubtedly owned by the defendant during the three years prior to the filing of the bankruptcy petition, as the petition was received by the bankruptcy court on August 2, 2017. The legal assessment of the facts thus established appeared to be disputed between the parties. The defendant referred to its subjective belief that he/she had already lost ownership of the transferred immovable property by signing the sale agreement. However, such a defence by the defendant cannot stand. The defendant's internal subjective belief cannot be assessed by the court solely on the basis of the defendant's assertion, but can be inferred, in particular, in the light of the evidence which shows how it has objectively manifested itself in the defendant's conduct. The evidence shows that the defendant signed two amendments to the sale agreement dated September 17, 2015 and September 23, 2015, during which the defendant must have established that he/she had not yet lost the ownership right to the properties, as he/she disposed of the properties in the amendments. The list of assets owned by the debtor in the last three years is not a mandatory attachment to the bankruptcy petition under Part IV of the Act on Bankruptcy and Restructuring by chance.

Information on the assets owned by the debtor in the last three years is of particular importance in relation to the examination of the possible challengeability of the debtor's legal acts. This information can thus undoubtedly qualify as relevant information under Article 166g Paragraph 2 Letter c of the Act on Bankruptcy and Restructuring. The defendant filed an appeal against the decision, which was decided by the Regional Court of Banská Bystrica by decision file number: 41CoKR/11/2019 dated August 21, 2019, which confirmed the first-instance decision. The Court of Appeal did not share the defendant's objections. It referred to the concluded amendments to the contract of sale, which show that they take effect on the date of their signature by the parties to the contract. From that, the court concluded that the sale agreement did not come into force until the date of the second amendment, i.e. within the three years before the bankruptcy petition was filed. The court also found that the defendant had failed to prove that he/she had acted under the direction of the Legal Aid Centre worker, but that even if he/she had been able to credibly prove that fact, it would only have resulted in his/her claim for damages against the worker who had caused her harm by his conduct, which related to the address of an individual creditor of which the debtor was aware. The address had not been disclosed to the administrator. Pursuant to Article 166g Paragraph 2 Letter d) of the Act on Bankruptcy and Restructuring, the debtor does not have an honest intention, in particular if he/she has failed to provide the administrator with the necessary cooperation which may fairly be required of him/her. The District Court of Banská Bystrica in the decision file number: 2Odi/16/2022 dated February 22, 2022, cancelled the debt relief of the defendant due to the fact that he/she did not provide the administrator with cooperation. In its decision, the court stated that it did not dispute the defendant’s assertion that he/she had failed to cooperate with the administrator in the proceedings, where he/she had failed to respond to repeated requests for cooperation and had failed to appear at the administrator's office. He/she explained his/her passivity in relation to the administrator by the fact that the summonses were not properly served on him/her as they ended up in the mud and were illegible. The court found the defendant's allegations to be purposive and unproven. On the contrary, the applicant effectively denied the defendant's allegations, stating that he had proved that the letters had been returned to the administrator as unclaimed and, more importantly, intact.

Pursuant to Article 166g Paragraph 2 Letter e) of the Act on Bankruptcy and Restructuring, the debtor does not have an honest intention, in particular if it can be inferred from the debtor's conduct prior to the filing of the petition that the debtor has deliberately brought himself/herself into insolvency in order to be entitled to file the petition. The District Court in Trnava in the decision file no.: 36Odi/2/2019 dated November 27, 2019, by which it annulled the defendant's bankruptcy, stated that the filing of an unfounded lawsuit and an unfounded appeal in the court proceedings initiated by the plaintiff is the defendant's (debtor's) behaviour prior to the filing of the bankruptcy petition, by which he/she deliberately brought himself/herself into insolvency. If the defendant had not initiated the frivolous litigation giving rise to the plaintiff's claim for unpaid costs, it would not have been insolvent and would have avoided declaring personal bankruptcy. The defendant himself/herself, in the bankruptcy petition, named only the plaintiff as a creditor, which shows that it was precisely and exclusively the plaintiff's substantial claim that should have led to the insolvency alleged by him/her (and thus to the entitlement to file for bankruptcy), into which, however, in the court's view, he/she deliberately placed himself/herself. The defendant filed an appeal against the decision, which was decided by the Regional Court in Bratislava by the decision file number: 3CoKR/23/2020 dated December 4, 2020, which confirmed the first-instance decision. On the basis of the facts found by the Court of First Instance, the Court of Appeal agreed with the legal opinion that the defendant did not have an honest intention in the debt relief and found that the debtor's conduct, which demonstrably abused the debt relief institution, could not be protected by the law.

Pursuant to Article 166g Paragraph 2 Letter f) of the Act on Bankruptcy and Restructuring, the debtor does not have an honest intention, in particular if the debtor was not insolvent at the time the petition was filed, and he/she knew or, having regard to the circumstances, ought to have known it. The District Court of Nitra in the decision file number 31Odi/1/2022 dated April 3,2023, by which it cancelled the defendant's bankruptcy, concluded that the defendant was not insolvent at the time of the bankruptcy, while it must have been aware of this fact, taking into account the circumstances, consisting in the fact that insolvency must be proved in the debt relief bankruptcy by a document not older than 30 days proving the conduct of enforcement proceedings, which the defendant did not attach to the petition for the declaration of debt relief bankruptcy.

The District Court of Žilina, in its decision file number: 9Odi/1/2021 dated August 5, 2022, by which it rejected the petition for cancellation of debt relief, did not agree with the plaintiff's opinion that if the debtor has at least some income from which he can even partially pay his/her debts, it is not possible to speak of his/her insolvency. In its decision, the court stated that the statutory definition of insolvency requires two conditions to be met, namely the existence of at least one outstanding monetary obligation and the passage of a period of more than 180 days after the maturity of that obligation within which the natural person is unable to meet that obligation. However, the essence of the definition of insolvency of a natural person is not whether the debtor is able to pay his obligation in instalments, but whether he has sufficient financial assets with which to pay the obligation in its entirety at the amount due. In the Court's opinion, the interpretation that the solvency (ability) to pay the 180-day overdue obligation by instalments (in instalments), is ad absurdum, even one euro per month, has no support in the text of the law. Moreover, such an interpretation would unfairly disadvantage an economically active debtor engaged in the labour market as opposed to a debtor who is indolent and inactive.

According to Article 166g Paragraph 2 Letter g) of the Act on Bankruptcy and Restructuring the debtor does not have an honest intention, in particular if it can be inferred from the debtor's conduct prior to the filing of the petition that, in assuming the debts, he/she relied on bankruptcy or a instalment plan to resolve his/her debts. The District Court Banská Bystrica in the decision file number: 4Odi/2/2018 dated August 7, 2019, concluded that in assessing the debtor's dishonest intent it is not bound by a specific time frame, but assesses the debtor's behaviour towards creditors from the moment the debts arose, which in this case is the period from 2003 onwards. Despite the fact that the defendant was aware of its business obligations towards the claimant, in 2006 the defendant made an irreconcilable act by which he/she divested itself of its only asset from which the claimant could be satisfied, not to mention the fact that in the same year it subsequently devalued its shareholding in HELOIL, s.r.o., thereby minimising the satisfaction of the claimant's claim in the enforcement proceedings. The assertion that at the time of those acts the defendant did not envisage that he/she would one day file for bankruptcy, as this is a newly introduced institute as of March 1, 2017, has no bearing on the fact that it must be held liable for its actions prior to the filing of the bankruptcy petition and that it must take into account the risk that creditors affected by the bankruptcy may seek its annulment because of the defendant's dishonest intent. The court concluded that the defendant's conduct towards its creditors prior to the filing of the bankruptcy petition had the effect of defrauding its creditors, thereby demonstrating that the defendant, as debtor, did not have an honest intent in filing the bankruptcy petition, and that the logical sanction provided by the Act on Bankruptcy and Restructuring is the revocation of the debtor's bankruptcy petition.

According to Article 166g Paragraph 2 Letter h) of the Act on Bankruptcy and Restructuring the debtor does not have an honest intention, in particular if it can be inferred from the debtor's conduct prior to the filing of the application that he/she had an intention to harm his/her creditor or to favour a creditor. The District Court Banská Bystrica in its decision file number:

2Odi/1/2017 dated February 27, 2020 concluded that the defendant had been in business for 20 years, ceased doing business on August 31, 2016, and two months prior to its cessation had ordered from the plaintiff a supply of goods of substantial value for which he/she had not paid the purchase price in full. The defendant was obliged to pay the purchase price for the goods delivered. The defendant did not prove or assert in the proceedings that he/she had taken any action to fulfil its obligation under the sale agreement with the plaintiff, that he/she had communicated with the plaintiff about possible legal solutions for the settlement of his/her obligation – the return of the goods to the plaintiff, and that it had allegedly not accepted the plaintiff's proposal. Two months after receipt of the goods, the defendant dissolved his/her trade license and, after the new legislation allowing his insolvency came into force, filed for his/her insolvency by debt relief, and the court assesses this fact, in correlation with the defendant's 'failure to act' after receipt of the ordered goods from the plaintiff, as a deliberate act in reliance on the legal possibility of resolving the debt by bankruptcy, and, in view of the defendant's long experience as a business entity, also as a deliberate act in a conscious attempt to harm the creditor. It is irrelevant that the desire to harm the plaintiff as a creditor was not the primary reason and therefore the direct intention of the defendant's conduct (ordering the goods before the business was closed) and subsequent failure to act (failing to pay the purchase price and responding to any calls by the plaintiff to settle the debt). The defendant, as a natural person with many years of experience in business, must have been aware of the consequences of his/her actions, including the fact that, given the amount of his/her liabilities and the value of his/her assets, the rate of satisfaction of the plaintiff's claim in bankruptcy would be low. Nevertheless, he/she did not communicate in any way about how to settle his/her debt; on the contrary, he/she ignored the plaintiff's efforts. In this case, the court concluded that the debtor had dishonest intent within the meaning of Article 166g Paragraph 2 Letter h) of the Act on Bankruptcy and Restructuring.

According to Article 166g Paragraph 2 Letter i) of the Act on Bankruptcy and Restructuring the debtor does not have an honest intention, in particular if, without serious reason, he fails to comply properly and on time with the instalment plan set by the court. The District Court Prešov in its decision file number: 3Odi/4/2020 dated December 6,2022, cancelled the defendant's debt relief in form of instalment plan for dishonest intent. The court found that on June 17, 2020, the court decision on the approval of instalment plan in the case of discharge, which the defendant applied for, had been issued. By June 30,2022, the defendant should have paid the fourth instalment to the plaintiff, but he/she failed to do so, although he/she had funds from the sale of his/her family home.

According to Article 166g Paragraph 2 Letter j) of the Act on Bankruptcy and Restructuring the debtor does not have an honest intention, in particular if, without serious reason, he/she fails to pay properly and on time the child maintenance to which he/she is entitled after the decisive day; this ground may be invoked only by the child or the child's legal representative. The District Court Trnava by its decision file number: 28Odi/4/2019 dated July 1, 2021, set aside the defendant's discharge, stating in the decision that the evidence adduced by the plaintiff clearly established that the defendant, without good cause, had failed to properly and timely pay the child support to which he/she was entitled after the operative date. The defendant did not prove in the proceedings that he/she had fulfilled his/her maintenance obligation towards the child in due and timely manner, nor did he/she even claim that he/she had done so. The defendant has not shown in the proceedings that he/she is not duly and timely paying child support for a child who became entitled to it after the decisive day for serious reasons.

According to Article 166g Paragraph 2 Letter j) of the Act on Bankruptcy and Restructuring the debtor does not have an honest intention, in particular if, without good reason, the debtor fails to reimburse the Legal Aid Centre duly and on time the value of the advance granted for the payment of the administrator's flat-rate fee; this ground can only be invoked by a Legal Aid

Centre. The Municipal Court Bratislava III by its resolution file number: 31Odi/8/2022 dated May 24, 2023, adjudicated on an action brought by the Legal Aid Centre for the annulment of a debtor's discharge on the grounds of dishonest intent. The court reversed the defendant's discharge, stating in its decision that the defendant had consented to the annullment of the debt relief, and the defendant had admitted the plaintiff's claim.

According to Article 166g Paragraph 2 Letter l) of the Act on Bankruptcy and Restructuring the debtor does not have an honest intention, in particular if the debtor seeks to get rid of the debts despite the fact that the debtor did not have its centre of main interest in the territory of the Slovak Republic at the time of the filing of the petition. Comi is defined as the place where the debtor conducts the administration of its interests on a regular basis and which is ascertainable by third parties.[311] The District Court Nitra in its decision file number: 23Odi/1/2020 dated April 14, 2021 annulled the defendant's debt relief, stating in the decision that the court had proven that at the time of filing the petition for discharge at the District Court in Nitra on Januray 13, 2020, the defendant had only a formally registered permanent residence in V.S. The defedant´s wife and children also resided at that address, although they did not own the property at that address, did not have any occupancy rights to it, and did not reside at that address. The defendant and his family lived in F. since XXXX, where they rented an apartment, later a house, and had the right to officially reside in F. The defendant was employed in F., had a work contract and worked there permanently until March XXXX, as well as the wife. In F. they were all socially and medically insured, the defendant had a bank account and currently receives unemployment benefits from F. The defendant's children finished primary and secondary school in F. They went to Slovakia every other weekend, during their stay in Slovakia they took care of the defendant's mother, stayed in her house or in the brother's house. The defendant has not owned any movable or immovable property in Slovakia since XXXX, he does not manage his personal or family affairs (except for taking care of his mother and meeting his relatives) from Slovakia. The court unequivocally concluded that the defendant did not have a centre of main interests in the territory of the Slovak Republic at the time of the filing of the petition for bankruptcy and therefore, pursuant to Article 166g Paragraph 2 Letter l) of the Act on Bankruptcy and Restructuring the claimant did not have an honest intention when filing the petition for insolvency.

CONCLUSION

The current Slovak legislation on debt relief is strongly pro-debt oriented and allows in principle any natural person who meets the formal conditions laid down by law to become discharged. Among other things, because the court does not examine the debtor's honest intention to satisfy the creditors' claims when deciding on the debtor's debt relief, debtors who file for discharge for speculative reasons, in order to get rid of their debts at the expense of their creditors, are also subject to debt relief. The burden of proving the debtor's dishonest intent in the case of debt relief is shifted to the creditor, who generally has minimal means of proof. In most cases, the courts dismiss motions to set aside the annulment for debt relief because the creditor has not carried the burden of proof. This is probably one of the reasons why creditors are relatively passive in filing petitions for annulment of debt. The case law on annullment for dishonest intent is providing the answers to questions such as: how should the debtor behave to make his/her conduct honest or,

[311] MORAVEC, Tomáš. The Center of Main Interest (COMI) in Recent Case-law. In: GRMELOVÁ, Nicole (eds.). Perspectives of Law in Business and Finance. Conference proceedings. 14th International Scientific Conference "Law in Business of Selected Member States of the European Union". November 3–4, 2022, Prague, Czech Republic. Bucarest, Paris, Calgery: Adjuris, 2023. pp. 52–62. ISBN 978-606-95351-5-8.

conversely, dishonest; what evidentiary means should the creditor use to prove the lack of honesty? We have found that the decision-making practice of Slovak courts in the matter of cancellation of debt relief is not uniform. This is manifested, for example, in the assessment of the debtor's insolvency, if the debtor is able to at least partially repay his/her obligations, or in the question from which point on the debtor's behaviour should be examined.

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Disqualification of Company Directors in the Czech Republic: Selected Issues

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Abstract: *Various mechanisms for the disqualification of company directors are widely employed in nearly all EU Member States. Disqualification regimes vary significantly from one jurisdiction to another. In a number of countries, ineligibility to retain or assume position of a company director stems from a conviction for certain criminal offences. Another approach is represented by the United Kingdom and its Company Directors Disqualification Act 1986, under which the capacity to act as a company director can be lost as a result of a court order issued in specific disqualification proceedings. The Czech Companies Act, following the British model, introduces several wrongs that may lead to a court-imposed prohibition on acting as a company director.*

The purpose of the paper is to outline the basic contours of the Czech disqualification regime, to point out possible ambiguities or shortcomings in the regime and to offer possible answers to some as yet unresolved questions. First, the personal scope of the regulation is presented, showing that not only managing directors are subject to disqualification. Secondly, the paper focuses on the individual grounds on which a person may be disqualified from being or becoming a company director. Thirdly, the sanction of disqualification itself is examined. Finally, a brief mention of the disqualified persons' information duty and newly established register of disqualified persons is added. The paper concludes that despite the fact that disqualification has been a part of the Czech legal system for almost 10 years, there are still a number of aspects of the Czech disqualification regime that need to be clarified by scholars and courts.

Keywords: *company law, company directors, disqualification, corporate governance, Czech Republic*

INTRODUCTION

Disqualification of company directors is a legal mechanism that prevents certain persons from holding or assuming the position of a company director. It is an important corporate governance tool aimed at safeguarding the interests of shareholders, creditors and the general public. A range of distinct approaches to disqualification are utilised throughout nearly all EU member states.[312] In certain countries, disqualification is based on convictions for specific criminal offences. An alternative approach is exemplified by the United Kingdom and its Company Directors Disqualification Act 1986, under which a person may be rendered ineligible to act as a company director by virtue of a court order made in specific disqualification proceedings.

[312] McCORMACK, Gerard, Andrew KEAY, and Sarah BROWN. *European Insolvency Law*. Cheltenham: Edward Elgar Publishing Limited, 2017, pp. 51 et seq. ISBN 978-1-78643-330-5.

The paper centres on the disqualification regime in the Czech Republic, which follows the British model.[313] The objective of the paper is to outline the basic contours of the Czech disqualification regime, to point out possible ambiguities or shortcomings in the regime and to offer possible answers to some as yet unresolved questions. In doing so, it provides an overview of the relevant Czech legislation, including its personal scope, the individual grounds for disqualification, the sanction of disqualification itself and the means of informing a company that a particular person has been disqualified.

The paper utilises two primary methodological approaches: qualitative analysis of jurisprudence and legal literature, and, in instances where a foreign regulation is discussed, a micro-comparison method.

1. PERSONAL SCOPE OF THE REGULATION

According to Section 63(1) of the Czech Companies Act[314], the regulation of disqualification applies primarily to members of a company's so-called statutory body, i.e. an executive or management body authorised to act in the name and on behalf of a company (hereinafter referred to as "managing directors"). Therefore, where a two-tier system of the internal organisation of a company is in place, the regulation is generally not applicable to the members of a supervisory board or any other non-executive body of a company.

Czech law allows legal entities to act as members of company bodies, provided that they appoint a representative (an individual) who will act and perform their duties on their behalf (Section 154 of the Czech Civil Code[315], Section 46a of the Czech Companies Act). In such a case, both the managing director (legal entity) and its representative (an individual) fall within the scope of the regulation and can be disqualified (Section 69(1) of the Czech Companies Act).

The Czech Companies Act also extends liability for disqualification wrongs to former managing directors (Section 69(2) of the Czech Companies Act). This can be understood in one of two ways: either that the termination of office cannot relieve a managing director of liability for his or her previous wrongful acts (which is such a trivial conclusion that it does not even deserve to be enshrined in law), or that a former managing director can also commit a disqualification wrong by breaching obligations after termination of office. Remarkably, to a certain extent, directors' obligations owed to the company continue to exist even after they have left their position. This can be inferred partly from the regulation of agency contract,[316] partly from the duty of loyalty.[317] However, it is important to distinguish between the fulfillment of residual obligations after the termination of the office and the situation where a former managing director effectively behaves as though he or she continued to hold the

[313] HURYCHOVÁ, Klára. Diskvalifikace z výkonu funkce v komparativním pohledu. *Obchodní právo*. 2014, 8, p. 324, 326. ISSN 1210-8278.

[314] CZECH REPUBLIC Act No. 90/2012 Coll., on Companies and Cooperatives, as amended [zákon č. 90/2012 Sb., o obchodních společnostech a družstvech, ve znění pozdějších předpisů].

[315] CZECH REPUBLIC Act No. 89/2012 Coll., the Civil Code, as amended [zákon č. 89/2012 Sb., občanský zákoník, ve znění pozdějších předpisů].

[316] Decision of the Supreme Court of the Czech Republic of 26 October 2015, file no. 29 Cdo 4245/2014.

[317] JOSKOVÁ, Lucie. Povinnosti členů volených orgánů kapitálových společností po zániku funkce. In: EICHLEROVÁ, Kateřina, eds. *Rekodifikace obchodního práva – pět let poté. Svazek I. Pocta Stanislavě Černé*. Praha: Wolters Kluwer ČR, 2019, pp. 91 et seq. ISBN 978-80-7598-426-5.

position. In the latter case, he or she may be held liable as a de facto director, not as a former member of the body.[318]

The personal scope of the regulation of disqualifications is further extended to "persons in a similar position to that of a company's managing director" (Section 69(2) of the Czech Companies Act). This is a concept that is open to interpretation and has yet to be clarified by case law. In the literature, the guardian of a company or its liquidator is usually given as an example of such a person.[319]

When considering what other persons are "in a position similar to that of a managing director of a company", there are in my opinion two crucial aspects to be taken into account. From a formal point of view, it is a question of whether a particular person has original (non-derived, non-delegated) authority within the company. This will not be the case, in particular, with regard to employees or contractual representatives (typically proctors) who, in principle, always act on the basis of an instruction (order) from another person. This is not to say that they cannot also act completely independently, but in such a case they already go beyond their contractual relationship with the company and, depending on the circumstances, could be held liable as de facto directors rather than as persons "in a position similar to that of a managing director of a company". From a substantive point of view, what is relevant is the scope of competence, i.e. whether it can be considered (at least in part) qualitatively comparable to that of a managing director.

This can be illustrated on the example of members of supervisory bodies. It is conceivable that a member of a supervisory body might be considered to be in a similar position to a managing director if he or she interferes in the management of the company (e.g. on the basis of Section 49 of the Czech Companies Act).[320] More generally, it will probably be possible to see an analogous position wherever a member of the supervisory body is charged with an original (non-derived, non-delegated) duty to act actively and directly to protect the property interests of the company (e.g. by filing a derivative action to recover a debt, by convening a general meeting to discuss the serious economic situation of the company etc.). However, this analogous position can only be found in relation to those parts of the supervisory body's competencies that can be considered comparable to those of the managing directors. Only a breach of these duties can warrant disqualification. The possibility of sanctioning a member of a supervisory body under this provision is thus considerably narrower than in the case of managing directors. Although failure to supervise the activities of the managing directors may ultimately also constitute a serious breach of a duty of care owed to a company, the disqualification is not an applicable sanction in such a case.

Finally, the disqualification regulation also applies to so-called de facto director, i. e. any person who is actually in the position of a managing director, although de iure he or she is not a managing director, and regardless of his or her relationship to the company (Section 69(2) of the Czech Companies Act).

The existence of de facto directors is also envisaged in foreign legal systems. For instance, according to settled French case law, a de facto director (dirigeant de fait) is one who exercises, directly or through another person, a practical and independent activity in the general

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[318] Decision of the Supreme Court of the Czech Republic of 29 March 2017, file no. 29 Cdo 4095/2016.

[319] ŠUK, Petr In: ŠTENGLOVÁ, Ivana et al. *Zákon o obchodních korporacích*. 2. vydání. Praha: C. H. Beck, 2017, p. 197. ISBN 978-80-7400-540-4.

[320] HURYCHOVÁ, Klára. Diskvalifikace z výkonu funkce v komparativním pohledu. *Obchodní právo*. 2014, 8, p. 329. ISSN 1210-8278.

management of a legal person.[321] The emphasis is put on full freedom and independence in management.[322] The de facto directors have been found by French case-law (based on the specific circumstances of the cases under examination) to be, for example, persons related to or friendly with the de iure directors, former members of the company bodies, employees, shareholders, the parent company and its directors, but also suppliers or banks.[323]

Similarly, UK company and insolvency law does not limit the duties owed to the company and liability for breach thereof solely to de iure directors. Compared to French law, the UK approach is more nuanced, distinguishing between de facto directors and a separate category of shadow directors. Shadow directors are, by statutory definition, persons in accordance with whose directions or instructions the directors of the company are accustomed to act (Section 251 of the UK Companies Act 2006, Section 251 of the UK Insolvency Act 1986, Section 22 of the UK Company Directors Disqualification Act 1986).[324]

The explanatory memorandum to the major amendment of the Czech Companies Act explains that under Czech law, "a person who effectively is in the position of a member of an elected body" includes both a de facto director who effectively performs the activities that belong to the de iure directors and a shadow director who substitutes the will of the de iure directors. The common feature is the independence of the de facto/shadow director in the management of the company, i.e. his full decision-making discretion without regard to the will of the de iure directors. This aspect is much more important than who actually implements the will of the de facto/shadow director in practice.

2. GROUNDS FOR DISQUALIFICATION

The Czech Companies Act sets out four grounds on which a managing director (or other person within the personal scope of the regulation) may be disqualified.

The first ground for disqualification is serious or repeated breach of duties (Section 63(1) of the Czech Companies Act). Thus, the Czech Companies Act provides for the breach of any duty to be punishable by disqualification and does not limit the sanction to the breach of the duty of care only. Nevertheless, the specific duties imposed on managing directors can generally be subsumed under the overarching duty of care anyway.

In this context, it is important to emphasise that a duty of due care includes a duty of legality. This means that a managing director is bound to manage the affairs of a company in such a way that the company does not violate its legal obligations. If a managing director manages a company in such a way that the company is in breach of the law, he or she acts unlawfully and violates his or her duty of care.[325] This opens a wide scope for punishing managing

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[321] Decision of the Cour de Cassation de la République Française, Chambre criminelle, of 23 November 2004, file no. 04-80.830.

[322] PÉTEL, Philippe. et al. *Code de Commerce 2010*. 22e édition. Paris: Litec, 2009, p. 767. ISBN 9782711011292.

[323] DI MARTINO, Michel. Dirigeant de fait. *Revue Française de Comptabilité*. 2017, 511, pp. 37–38. ISSN 0151-0428.

[324] FINCH, Vanessa, and David MILMAN. *Corporate Insolvency Law. Perspectives and Principles*. 3rd edition. Cambridge: Cambridge University Press, 2017, pp. 579 et seq. ISBN 978-1-107-03991-9.

[325] FLÍDR, Jan. *Deliktní odpovědnost člena statuárního orgánu obchodní korporace vůči třetím osobám*. Praha: Wolters Kluwer ČR, 2021, pp. 20-24. ISBN 978-80-7676-034-9. For German law see JOSKOVÁ, Lucie. Národní zpráva – Německo. In: BORKOVEC, Aleš et al. *Fiduciární povinnosti (povinnosti správců cizích záležitostí)*. Praha: Leges, 2022, p. 128. ISBN 978-80-7502-493-0.

directors for unlawful conduct of the company, to which they have given rise by their management. It can even be argued that if the purpose of disqualification is to protect the public interest, as is often emphasised,[326] then the typical conduct deserving disqualification is not conduct manifested only within the company, but that which has negative effects externally.

Therefore, under Czech law, managing directors may be punished by disqualification for, for example, anti-competitive behaviour by the company,[327] violations of human rights,[328] violations of health and environmental protection regulations etc.

Another two grounds for disqualifying a managing director are linked to the specific wrongs set out in Section 66 of the Czech Companies Act, often referred to as the bankruptcy wrongs (Section 63(2) of the Czech Companies Act).

Notwithstanding the importance and significance of this subject, a comprehensive and thorough analysis of bankruptcy wrongs cannot be provided here. However, it is sufficient to state that the essence of both bankruptcy wrongs lies in the managing director's "contribution" to the company's bankruptcy. Therefore, while a managing directors cannot be held responsible for a company's bankruptcy per se, they can be sanctioned for their role in "contributing" to the bankruptcy.[329]

The term "contribution" is a vague concept that is interpreted more loosely than classical causality in liability law. This raises the question of whether the level of contribution necessary for establishing liability for bankruptcy wrongs ought to be identical to that which justifies the application of disqualification sanctions. Especially considering that disqualification is a mandatory sanction in these instances. This has yet to be clarified by the courts.

The fourth and final ground upon which a person can be (repeatedly) disqualified is their disobedience of a prior disqualification order (Section 65 of the Czech Companies Act).

Notably, this disqualification wrong overlaps with the crime of obstructing the enforcement and execution of an official decision under Section 337 of the Czech Criminal Code[330]. Finding a boundary between the two is not an easy task. It is true that committing a crime necessitates the intent on the part of the perpetrator, which is not explicitly required in case of the wrong under Section 65 of the Czech Companies Act. Even so, it is questionable whether it is even feasible to contravene a prohibition to perform certain activity unintentionally. In other words, the presence or absence of the intention on the part of a wrongdoer can hardly be regarded as

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[326] Decision of the Supreme Court of the Czech Republic of 21 February 2018, file no. 29 Cdo 2227/2016. See also ŠTENGLOVÁ, Ivana. Některé souvislosti vyloučení člena statutárního orgánu z výkonu funkce. *Obchodněprávní revue*. 2016, 4, pp. 104 et seq. ISSN 1803-6554. HURYCHOVÁ, Klára. Diskvalifikace z výkonu funkce v komparativním pohledu. *Obchodní právo*. 2014, 8, p. 329. ISSN 1210-8278.

[327] CALISKAN, Samet. Company Liability and Competition Law: Exposure of Company to Risk of Undesirable Behaviour of Directors. *Liverpool Law Review*. 2019, 40, pp. 1 et seq. ISSN 1572-8625. See also OECD. Director Disqualification and Bidder Exclusion in Competition Enforcement, OECD Competition Policy Roundtable Background Note [online]. 2022 [viewed on 5 November 2023]. Available from: http://www.oecd.org/daf/competition/director-disqualification-and-bidder-exclusion-in-competition-enforcement-2022.pdf

[328] FEIGERLOVÁ, Monika, and Monika PAUKNEROVÁ. Private International Law for Corporate Social Responsibility. *The Lawyer Quarterly*. 2018, 4, p. 387. ISSN 1805-840X.

[329] This follows from the general principle that the director is responsible for the proper performance of his/her duties (his/her activities), not for the result of his/her activities. See e.g. Decision of the Supreme Court of the Czech Republic of 19 July 2018, file no. 29 Cdo 3770/2016. See also ŠTENGLOVÁ, Ivana, and Petr, ŠUK. Některé důsledky porušení péče řádného hospodáře (nejen) v judikatuře českých soudů. In *XXVIII. Karlovarské právnické dny*. Praha: Leges, 2021, p. 154. ISBN 978-80-7502-462-6.

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

definite criterion distinguishing the crime under Section 337 of the Czech Criminal Code from the disqualification wrong under Section 65 of the Czech Companies Act. Remarkably, the principle of subsidiarity of criminal repression, however vague, seems to be the only determining factor in this case.

3. SANCTION OF DISQUALIFICATION

The sanction of disqualification primarily entails the loss of the capacity to be a managing director of a company (Section 64 of the Czech Companies Act). The disqualified person automatically loses their position not only in the company where they have violated their duties, but also in other companies (unless an exception is granted by the court for a particular company). At the same time, a hindrance to taking on a new position is established (Section 155 of the Czech Civil Code, Section 46(1)(a) of the Czech Companies Act).[331] Hitherto, it could be contended that disqualification presents a mere legal impediment to serving as a company managing director, alongside, for instance, bankruptcy or convictions for certain criminal offenses.

The substance of the discussed sanction is broader, though. It is, in the true sense of the word, a prohibition on professional activity, specifically a prohibition on acting as company managing director.[332] Up until the end of 2020, the relevant provision was worded more broadly, prohibiting disqualified persons from not only acting as a company managing director, but also from exercising similar activities within a company. In essence, however, it appears that nothing has changed. In my view, the prohibition on acting as a company managing director should not be construed just formally, as a mere restriction on holding the formal position of managing director. Instead, it should be understood materially as a prohibition on performing activities falling within the competence of company managing directors. Such interpretation is consistent with the wording of Section 65 of the Czech Companies Act, which provides for legal consequences for those who "contrary to the prohibition have de facto exercised the activity of company managing director".

Disqualification of a company managing director is usually a mandatory sanction. Should the grounds for disqualification be met, the court has no choice but to disqualify the person concerned. The only exception is the first ground (serious or repeated breach of the duties) where, because of its general nature, the court is given discretion as to whether or not to impose the sanction.

The court also has wide discretion as to the duration of the sanction. The Czech Companies Act provides that a person can generally be disqualified for up to three years, with a maximum of 10 years in the case of the fourth ground (non-compliance with the previous disqualification order).

The question therefore arises as to what criteria the court should apply in determining whether and for how long the person should be disqualified. The case law of the Czech Supreme Court in relation to various sanctions applicable to company directors emphasises the principle of proportionality. By cross-referencing different decisions relating to different institutions, the Supreme Court invokes the impression that there is something like a "universal principle of

[331] Decision of the Supreme Court of the Czech Republic of 21 February 2018, file no. 29 Cdo 2227/2016.

[332] EICHLEROVÁ, Kateřina. Ústavnost zákonné úpravy diskvalifikace z výkonu funkce člena statutárního orgánu obchodní korporace. *Právník*. 2022, 7, pp. 698.

proportionality".[333] However, proportionality is essentially always based on the comparison of certain criteria, and these will vary according to the nature of the different types of sanctions.

For instance, according to Section 61(2) of the Czech Companies Act, the director's remuneration is to be reduced if he or she has obviously contributed to the negative economic result of the company. It is a corrective tool designed to maintain the proportionality of the mutual performance of the director (agent) and the company (principal). Therefore, proportionality should be sought within the contractual relationship between these persons, and the criterion for reducing the director's remuneration and perquisites must be the extent of the (in)quality of the performance provided by the director. In a sense, this is analogous to a reasonable reduction in price for defective performance.

Disqualification, on the other hand, presupposes an impact on, or at least a threat to, the public interest,[334] i.e. a certain negative manifestation of the managing director's misconduct externally (outside the company). Otherwise, it would be difficult to justify excessive interference by public authorities in the autonomous relations between private persons. If a company is dissatisfied with a managing director, it is free to remove him or her from the position; the termination of the relationship with him should not be subject to judicial intervention.

Therefore, in the case of disqualification, a proportion must be primarily sought between the sanction and the extent to which a public interest has been affected. From this perspective, for example, the manipulation of the financial statements of a limited liability company by a managing director who is also the sole shareholder is clearly less serious than the same wrong committed by a member of the board of directors of a listed company. In the latter case, the public interest (interest in capital market transparency and investor protection) is disproportionately more affected.

Non-compliance with the court-imposed prohibition on acting as a company managing director is punishable by re-disqualification for up to a further ten years (see above) and liability of the wrongdoer for company´s debts (Section 65 of the Czech Companies Act). The liability of the disqualified person is unlimited, but it applies only to debts incurred during the time when he or she were violating the court-ordered ban.

Moreover, the general regulation of legal persons provides that if the disqualified person causes damage to the company by the prohibited activity, they will be liable for all debts of the company (regardless of when they arose), but only up to the amount of uncompensated damage (Section 159(3) of the Czech Civil Code in conjunction with Section 62(1) of the Czech Companies Act). In a specific case, the disqualified person may therefore be liable under both legal provisions.

4. INFORMATION DUTY OF THE DISQUALIFIED PERSON AND THE REGISTER OF DISQUALIFIED PERSONS

A managing director is obliged to inform the company that a legal impediment to acting as a managing director has arisen or may arise as a result of disqualification (Section 46(2) and (3) of the Czech Companies Act). This information duty is a manifestation of the duty of

333 See e.g. the decision of the Supreme Court of the Czech Republic of 18 December 2018, file no. 27 ICdo 62/2017 or decision of the Supreme Court of the Czech Republic of 26 February 2020, file no. 27 Cdo 1319/2018.

334 HURYCHOVÁ, Klára. Diskvalifikace z výkonu funkce v komparativním pohledu. *Obchodní právo*. 2014, 8, p. 327. ISSN 1210-8278.

loyalty, so we would be able to infer it even without an express provision. In this case, there is no doubt that liability covers both proprietary loss and non-proprietary harm (see Section 3(2) of the Czech Companies Act).

Similarly, a person who applies to be a managing director of a company ("a candidate") is required to inform the company (or the founder before it is incorporated) of his or her disqualification. Failure to comply with the duty again results in the liability of the candidate. Notably, the candidate's liability is limited solely to the proprietary loss. According to recent Czech case law, a legal person is not entitled to claim compensation for damage to its reputation or goodwill (non-proprietary harm) unless the law expressly provides otherwise (which is not the case here).[335] Thus, while managing directors are liable for non-proprietary harm suffered by a company as a result of a breach of their duties, candidates are not. Nevertheless, the duty to inform remains, so if a disqualified person assumes the position of a company director (even if only de facto), he or she can be held liable for non-proprietary harm as a de facto director. In such a case, however, it will be necessary to distinguish between non-proprietary harm arising from a breach of the pre-contractual information duty (for which there is no liability) and that arising from a breach of the de facto director's information duty (for which there is full liability).

Furthermore, a new register of disqualified persons has been established as of 1 July 2023. Unlike the British disqualification register, the Czech register is non-public. The data in the register can only be accessed by courts or public notaries.

Apart from this, the Ministry of Justice shall, upon request, provide (a) an extract from the register of disqualified persons of the current and expired disqualifications of the applicant or (b) a certificate stating that there are no entries in the register of disqualified persons or that the applicant is not subject to any current disqualification. An extract from the register or a certificate might be submitted with the application for a position in a company and then on request or periodically, thus reducing the so-called monitoring costs on the part of a company and its members or shareholders (principals) and the bonding costs on the part of a managing director (agent). Despite not being public, the register can still help to diminish the well-known "lemons problem".[336]

CONCLUSION

The disqualification of company directors is an important corporate governance tool designed to protect companies, their shareholders and creditors and to ensure that companies are managed by competent and trustworthy individuals.

Despite having been part of the Czech legal system for almost 10 years, there are still many aspects of the disqualification regulation that need to be clarified by scholars and courts. As pointed out by the paper, there is still some uncertainty as to which categories of persons are covered by the regulation, what exactly constitutes disqualification wrongs, or what criteria should be used to determine whether and for how long a wrongdoer should be disqualified. The paper offers some possible answers to these questions, but it is ultimately for the courts to provide definitive solutions to these issues.

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[335] Decision of the Supreme Court of the Czech Republic of 30 November 2021, file no. 23 Cdo 327/2021.

[336] MORAVEC, Tomáš, and Petr VALENTA. The Comparison of Efficiency of Disqualification of Directors in New Czech Business Corporation Act and in the Legal System of England. *Acta Universitatis Agriculturae et Silviculturae Mendelianae Brunensis*. 2015, 5, pp. 1711 et seq. ISSN 2464-8310.

Due to its limited scope, the paper has not covered many more important aspects of the Czech disqualification regime, such as the procedural aspects of disqualification proceedings or the relationship between disqualification and criminal law. These issues have not yet been adequately addressed in the legal literature, leaving much room for further research.

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[2] Decision of the Supreme Court of the Czech Republic of 26 October 2015, file no. 29 Cdo 4245/2014 [online]. In Nsoud.cz. [accessed on 2023-11-05]. Available from: https://nsoud.cz/Judikatura/judikatura_ns.nsf/WebSearch/71124CC53966BFB6C1257F390035A485?openDocument&Highlight=0,

[3] Decision of the Supreme Court of the Czech Republic of 29 March 2017, file no. 29 Cdo 4095/2016 [online]. In Nsoud.cz. [accessed on 2023-11-05]. Available from: https://nsoud.cz/Judikatura/judikatura_ns.nsf/WebSearch/41B6EA648754231BC125812F003C6996?openDocument&Highlight=0,

[4] Decision of the Supreme Court of the Czech Republic of 21 February 2018, file no. 29 Cdo 2227/2016 [online]. In Nsoud.cz. [accessed on 2023-11-05]. Available from: https://nsoud.cz/Judikatura/judikatura_ns.nsf/WebSearch/FC578C3B2CF927E0C1258283003127D7?openDocument&Highlight=0,

[5] Decision of the Supreme Court of the Czech Republic of 19 July 2018, file no. 29 Cdo 3770/2016 [online]. In Nsoud.cz. [accessed on 2023-11-05]. Available from: https://nsoud.cz/Judikatura/judikatura_ns.nsf/WebSearch/FD10301F066194C8C125832F00316CBF?openDocument&Highlight=0,

[6] Decision of the Supreme Court of the Czech Republic of 18 December 2018, file no. 27 ICdo 62/2017 [online]. In Nsoud.cz. [accessed on 2023-11-05]. Available from: https://nsoud.cz/Judikatura/judikatura_ns.nsf/WebSearch/9DC05B25CE626136C12583BB003F6763?openDocument&Highlight=0,

[7] Decision of the Supreme Court of the Czech Republic of 26 February 2020, file no. 27 Cdo 1319/2018 [online]. In Nsoud.cz. [accessed on 2023-11-05]. Available from: https://nsoud.cz/Judikatura/judikatura_ns.nsf/WebSearch/F844FAD742595A4DC1258579001A038C?openDocument&Highlight=0,

[8] Decision of the Supreme Court of the Czech Republic of 30 November 2021, file no. 23 Cdo 327/2021 [online]. In Nsoud.cz. [accessed on 2023-11-05]. Available from: https://nsoud.cz/Judikatura/judikatura_ns.nsf/WebSearch/1DF439E1A4714DD1C12587CF00491BB6?openDocument&Highlight=0,

- Legal acts

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

[2] CZECH REPUBLIC Act No. 89/2012 Coll., the Civil Code, as amended [zákon č. 89/2012 Sb., občanský zákoník, ve znění pozdějších předpisů].

[3] CZECH REPUBLIC Act No. 90/2012 Coll., on Companies and Cooperatives, as amended [zákon č. 90/2012 Sb., o obchodních společnostech a družstvech, ve znění pozdějších předpisů].

Specificities of the legal regulation of the financial intermediation in the bank deposit sector in the Slovak Republic

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Abstract: *From the legal point of view financial intermediation in the mortgage credit, insurance and partly also financial instrument sectors is harmonised at the EU level. However, beyond the scope of the above-mentioned harmonisation the Slovak Republic has adopted legislation on financial intermediation in additional financial sectors – capital market including undertakings for collective investment in transferable securities, pension savings, credit in general as well as the bank deposit sector. It is the regulation of financial intermediation in the bank deposit sector that is unique in the Slovak Republic and has its own specificities, which are analysed in the present paper. After analysing this specificities, the aim of this paper is to propose de lege ferenda solutions to improve the existing legal framework of the matter.*

Keywords: *financial intermediation, financial agent, deposit-taking sector, home savings, freedom of establishment*

INTRODUCTION

At the European Union level, the regulation of intermediation of financial products and services is harmonised only in the following areas:

(a) insurance and reinsurance under the Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution (hereinafter referred to as "IDD"),

(b) housing loans under the Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010 (hereinafter referred to as "MCD") and

(c) investment services under the 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 (hereinafter referred to as "MiFID").

Beyond the above regulation, the Slovak legislator has proceeded to adopt a legal regulation of financial intermediation in all financial sectors, i.e. in addition to the above mentioned ad (a), (b) and (c) also:

(d) products provided by UCITS, which, together with products ad (c) above, form one capital market sector (Article 4(a)(2) Act No. 186/2009 Coll. on Financial Intermediation and Financial Advisory Services as amended – hereinafter referred to as "AFIFAS"),

(e) supplementary pension scheme within the meaning of Act No. 650/2004 Coll. on Supplementary Pension Scheme as amended,

(f) old-age pension scheme within the meaning of Act No. 43/2004 Coll. on Old-age Pension Scheme as amended (hereinafter referred to as "AOPS"),

(g) loans and consumer credit, which, together with products ad (b), form a sector for the provision of loans, housing loans and consumer credit (Article 4(a)(5) AFIFAS); and

(h) deposit-taking.

This is a unique approach in the European Union. The Slovak Republic is probably the only EU Member State that has such a comprehensive regulation of financial intermediation.[337] In our paper we will focus on deposit-taking sector, which is in a specific position in relation to other sectors. First of all, it is necessary to define the concept of deposit and analyse it from both private and public law perspectives. We will then look at the specific obligations imposed on financial intermediaries active in this sector by the legislation in force. We assume that the most common financial service provided in this sector is home savings.[338]

In this paper we used scientific methods of analysis, synthesis, induction, deduction and generalization.

1. PUBLIC-LAW AND PRIVATE-LAW REGULATION OF DEPOSITS

The term "deposit" has several meanings in Slovak private law. According to the Act No. 513/1991 Coll. Commercial Code as amended (hereinafter referred to as "ComC"), a shareholder's deposit is the aggregate of cash (cash deposit) and other values measurable in money (non-monetary deposit) which the shareholder contributes to the company and participates in the company's profits or losses (§ 59(1) ComC). Act No. 34/2002 Coll. on Foundations as amended (Article 3(2)) and Act No. 147/1997 Coll. on Non-investment Funds as amended (Article 7) use the term "deposit" in a similar sense. The provision of property values on the basis of an association agreement (Article 831 of the Act No. 40/1964 Coll. Civil Code as amended – hereinafter referred to as "CC") can also be likened to it. The deposit as a contribution of a silent partner, which does not create a material basis for the creation of a separate legal entity but is only an obligation under a contractual relationship (Article 673(1) ComC) and as a contribution to a gambling game, the provision of which does not guarantee the return of the funds invested, should be interpreted slightly differently (cf. Article 2(m) of the Act No. 30/2019 Coll. on Gambling Games as amended).

Thus, in private law, a deposit is usually of a contractual nature. In this sense, we distinguish the following forms of contractual relationships relating to deposits[339]:

(a) deposit contract (Art. 778-780 CC),

(b) deposits in a deposit book (Art. 781-785 CC),

(c) deposits in certificates of deposit (Art. 786 CC),

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[337]Similarly SLEZÁKOVA, Andrea; ŠIMONOVÁ, Jana; JEDINÁK, Peter a kol. *Zákon o finančnom sprostredkovaní a finančnom poradenstve. Komentár.* Bratislava : Wolters Kluwer SR, 2020, p. 29.

[338]Author´s own estimate based on brief analysis of the list of agents active in this sector according to: https://subjekty.nbs.sk/?s=1120 [6. 10. 2023].

[339]For details see WINKLER, Martin: Právna úprava distribúcie finančných služieb v sektore poskytovania úverov, úverov na bývanie a spotrebiteľských úverov a v sektore prijímania vkladov a jej aktuálne otázky. In: SLEZÁKOVÁ, A.; HAJNIŠOVÁ, E.; MIKLOŠ, P.: *Spoločnosť s ručením obmedzeným vykonávajúca činnosť samostatného finančného agenta*. Bratislava: Wolters Kluwer, 2023, pp. 129 et seq.

(d) other forms of deposits (Art. 787 CC) including home savings under the Act No. 310/1992 Coll. on home savings as amended,

(e) current account agreement (Art. 708-715 ComC),

(f) deposit account agreement (Art. 716-719a ComC).

Having analysed private law deposit obligations, let us look at the concept of deposit from a public law perspective. According to Article 5(a) of the Act No. 483/2001 Coll. on Banks as amended (hereinafter referred to as "AB"), a deposit means entrusted funds or other repayable funds received from the public, representing an obligation towards the depositor to repay them. The definition of deposit in the Act No. 118/1996 Coll. on Protection of Deposits as amended is much more precise. For the purposes of this Act, a deposit is a claim by a natural or legal person (depositor) for the payment of funds entrusted to a bank or a branch of a foreign bank by the depositor in a banking transaction carried out in its name and for its own account, or received by the bank or a branch of a foreign bank as amounts of payment transactions or other payments for the benefit of the depositor, including interest and other property benefits associated with the entrustment of these funds (Article 3(1)).

The taking of deposits and the granting of loans from the funds thus obtained is a defining business activity of a bank or a branch of a foreign bank, which distinguishes them from other business entities.[340] No one may accept deposits without a banking licence, unless a special regulation provides otherwise (Article 3(1), first sentence AB). Footnote 5 in this provision refers to the AOPS. According to the AOPS, the pension fund management company receives contributions for the benefit of the pension funds it manages and records the number of pension units credited from these contributions (both compulsory and voluntary) in favour of the personal pension accounts of the savers (Article 94). The assets in a pension fund thus consist of the savers' shares in those assets, the saver's share of those assets being expressed in the ratio of the pension units in the saver's personal pension account to all the pension units in that pension fund (Art. 74(1) AOPS). It is evident from the above that contributions received by a pension funds management company for a saver cannot be considered *stricto sensu* as deposits. Moreover, a pension management company does not act on its own behalf when accepting contributions (unlike a bank, which accepts deposits from clients in its own name and on its own account), but on behalf of the saver, who is entitled to a share of the assets in the pension fund, in return. The saver cannot therefore have a claim for payment towards the pension funds management company. However, the legislator considered it necessary, apparently for the avoidance of doubt, to mention pension funds management companies specifically among the exceptions of the prohibition on taking deposits.

Without a banking permit, no one can provide interest or other remuneration on deposits, which is a tax expense under Act No. 595/2003 Coll. on Income Tax as amended (Article 3(1) second sentence AB). Also, no one may grant loans and credits within the scope of their business or the scope of their other activities, from repayable funds obtained from other persons on the basis of a public call, unless a special regulation (e.g. Act No. 150/2013 Coll. on the State Fund for Housing Development as amended, Act No. 80/1997 Coll. on Export and Import Bank of the Slovak Republic as amended, Act No. 566/1992 Coll. on National Bank of Slovakia as amended) provides otherwise (Article 3(2) AB) without a banking licence.

[340]For the history of this conceptual feature of a bank (credit institution) in European and Slovak law, see PECEŇ, Pavol; MELIŠ, Roman: *Bankové právo záväzkové.* Bratislava: Wolters Kluwer SR, 2018, pp. 41, 42.

In the case of some financial institutions or their activities, the law explicitly excludes that they do deposit-taking activities, even though they may look similar to these activities. For example, according to Article 77(4) of the Act No. 492/2009 Coll. on payment services (hereinafter referred to as "APS"), a payment institution shall hold payment accounts for the provision of payment services, which are to be used solely for payment transactions. Any funds received by a payment institution from payment service users for the provision of payment services shall not constitute a deposit or electronic money. Funds received by a payment institution from payment service users for the provision of payment services are neither deposits nor electronic money. Pursuant to Article 80(2) APS, electronic money may be issued only on the basis of prior receipt of funds in the amount of the nominal value of the funds received. Funds received for which the electronic money issuer immediately issues electronic money are not a deposit. Neither a payment institution nor an electronic money institution may accept deposits (Articles 77(6) and Art. 81(4) APS). Therefore, even the intermediation of their services cannot be intermediation in the deposit-taking sector.

2. LEGAL REGULATION OF THE INTERMEDIATION IN THE DEPOSIT-TAKING SECTOR

2.1 Foreign person as a financial agent operating in the deposit-taking sector

As intermediation in the deposit-taking sector is not harmonised at EU level, its cross-border provision in the Slovak Republic by entities from other EU Member States is also not possible. The AFIFAS only allows cross-border intermediation without licence by financial intermediaries from other EU Member State in the insurance or reinsurance sector and in the field of provision of housing loans within the loans, housing loans and consumer credit sectors, through a branch or on the basis of the right of free provision of services (cf. Articles 11, 11a and 11d). If an entity wishes to carry out intermediation in the deposit-taking sector in the territory of the Slovak Republic, it must be authorised to do so under the AFIFAS, i.e. it must be:

(a) an independent financial agent which has been granted licence by the National Bank of Slovakia (Article 18 AFIFAS) to operate in the deposit-taking sector and is subsequently entered in the Register of financial agents, financial advisors, financial intermediaries from other Member State in the insurance or reinsurance sector and financial intermediaries from other Member State in the field of housing loans (hereinafter referred to as the "register") in the deposit-taking sub-register (Article 14(9) in conjunction with Article 13(1)(c) and (4)(a) AFIFAS),
(b) a tied financial agent that is entered in the register in the deposit-taking sub-register on the basis of an application for entry provided by a bank or a branch of a foreign bank (Article 14(1) and (2) in conjunction with Article 13(1)(c) and (4)(b) AFIFAS),
(c) a subordinated financial agent, which is entered in the register, in the deposit-taking sub-register on the basis of an application for entry provided by an independent financial agent (Article 14(1) and (2) in conjunction with Article 13(1)(c) and (4)(c) AFIFAS).

According to the website of the National Bank of Slovakia[341], which lists financial market entities, there are currently 84 independent financial agents operating in the deposit-taking

[341] https://subjekty.nbs.sk/?s=1120 [6. 10. 2023].

sector (out of a total of 408), 653 tied financial agents (out of a total of 7266) and 5264 subordinated financial agents operating in this sector (out of a total of 17047).[342]

In contrast to P. Mikloš, one of the commentators of the AFIFAS, who states in his commentary to Article 6[343] that a financial agent may be (in addition to a natural person) only a legal entity with its registered office in the territory of the Slovak Republic, we believe that a foreign entity with an organisational unit located in the territory of the Slovak Republic may also be a financial agent. This view is supported by the sample application for a licence to act as an independent financial agent[344], which also has fields for the case that the applicant is a legal person established outside the Slovak Republic, as well as by the text of the Act itself (Article 17(1)(d), (3)(c) and (5)(c) AFIFAS). This conclusion is also supported by the valid principle of non-discrimination in EU law[345] and by the regulation of the ComC itself, which provides in Article 21(1) that foreign persons may do business in the territory of the Slovak Republic under the same conditions and to the same extent as Slovak persons, unless otherwise provided by law.[346]

Should a foreign person wish to become a tied or subordinated financial agent, this is not restrictive for it, as its entry in the register would not be preceded by the granting of licence by the National Bank of Slovakia. However, the situation is the opposite in the case of an independent financial agent. One of the facts that an applicant for licence must prove to the National Bank of Slovakia is the professional competence of itself if it is a natural person or of at least one member of its statutory body if it is a legal entity. The law requires a higher level of professional competence for these persons, which is the completion of at least secondary vocational education, at least three years of professional experience in the relevant sector, successful completion of a professional examination and completion of specialised financial education for the relevant sector. As the sector concerned is deposit-taking, professional experience in banking and passing a professional examination in this sector in the Slovak language would be required (Article 1(2) of the Decree of the National Bank of Slovakia No. 5/2018 of 13 February 2018 on professional examination and professional examination with certificate for the provision of financial intermediation and financial advice as amended). This is almost impossible in practice, as a foreign national (except for a Czech national) will probably not be able to pass this exam in Slovak and, because of this, applicant will not appoint a Slovak-speaking member to its statutory body.

The requirement to pass a professional examination may constitute an obstacle to the freedom of establishment enshrined in Article 49 in conjunction with Article 54 of the Treaty on Functioning of the EU (hereinafter referred to as "TFEU"), since the current legislation does not allow for the recognition of foreign professional qualifications or the passing of a professional examination in a language other than Slovak. However, it follows from the case-

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[342]However, it should be noted that one and the same entity may operate in several sectors (e.g. Allianz – Slovenská poist'ovňa, a.s. operates as an independent financial agent in 5 out of 6 sectors), so the sum of entities operating in all sectors is higher than the total number of independent financial agents.

[343]SLEZÁKOVA, Andrea; ŠIMONOVÁ, Jana; JEDINÁK, Peter a kol. *Zákon o finančnom sprostredkovaní a finančnom poradenstve. Komentár.* Bratislava : Wolters Kluwer SR, 2020, p. 72.

[344]Accessible here: https://nbs.sk/dohlad-nad-financnym-trhom/dokumenty-na-stiahnutie/financne-sprostredkovanie-a-financne-poradenstvo/ [6. 10. 2023].

[345]For more details see e.g. BENOÎT-ROHMER, Florence: Lessons from the Recent Case Law of the EU Court of Justice on the Principle of Non-discrimination. In.: ROSSI, Lucia Serena; CASOLARI, Federico: *The Principle of Equality in EU Law*. Cham: Springer, 2017, pp. 151–166.

[346]For commentary to this provision see PATAKYOVÁ, Mária et al.: *Obchodný zákonník, 1. vydanie*, 2022, Bratislava: C. H. Beck, 2022, pp. 97 et seq.

law of the Court of Justice of the EU that *"national measures liable to hinder or make less attractive the exercise of fundamental freedoms guaranteed by the Treaty must fulfil four conditions: they must be applied in a non-discriminatory manner; they must be justified by imperative requirements in the general interest; they must be suitable for securing the attainment of the objective which they pursue; and they must not go beyond what is necessary in order to attain it".*[347] Additionally, *"a Member State which receives a request to admit a person to a profession to which access, under national law, depends upon the possession of a diploma or a professional qualification must take into consideration the diplomas, certificates and other evidence of qualifications which the person concerned has acquired in order to exercise the same profession in another Member State by making a comparison between the specialized knowledge and abilities certified by those diplomas and the knowledge and qualifications required by the national rules".*[348] Only if it would not be possible to demonstrate professional competence in the home EU State (e.g. the authorities there would not require such a condition), could the National Bank of Slovakia require proof of experience and a professional examination, which should, however, also be possible to pass in a foreign language, at least in English. Knowledge of the Slovak language should be sufficient for the head of the organisational unit of the foreign person, which the foreign person must establish in the territory of the Slovak Republic anyway. The second option would be to allow that the conditions of professional competence need not be fulfilled by a foreign natural person or a statutory body of a foreign legal person, but only by the head of its organisational unit at the Slovak territory. Thus, under the current conditions, a foreign person wishing to carry out financial intermediation in the deposit-taking sector in the Slovak Republic would most practically fulfil the conditions of professional competence by establishing a daughter company in the Slovak Republic, which would then apply to the National Bank of Slovakia for the relevant licence. Thus, only a member of the statutory body of this daughter company will have to comply with the professional competence requirements.

Under the current legislation, a natural person who must meet the requirements for a higher level of professional competence must pass a professional examination at least every four years and, in addition, must undergo specialised financial education annually (Article 22(1) AFIFAS). This requirement for a foreign natural person or a member of the statutory body of a foreign legal entity with an independent financial agent licence is as problematic as above. *De lege ferenda*, it must be sufficient for the head of its organisational unit located in the Slovak Republic to fulfil these conditions.

2.2 The content of the specialised financial education and examination in relation to a financial agent operating in the deposit-taking sector

Let us return to the professional competence of financial agents operating in the deposit-taking sector. The topics covered by the professional examination and specialised financial education consist of the following headings (Article 1(3)(e) in conjunction with point E of Annex 1 to the Decree of the Ministry of Finance of the Slovak Republic No. 39/2018 Coll. on specialised

[347]Point 37. of the Judgment of the Court of 30 November 1995 Reinhard Gebhard v. Consiglio dell'Ordine degli Avvocati e Procuratori di Milano (case C-55/94).

[348]Point 16. of the Judgment of the Court of 7 May 1991 *Irène Vlassopoulou v Ministerium für Justiz, Bundes- und Europaangelegenheiten Baden-Württemberg* (case C-340/89).

financial education of persons carrying out financial intermediation and financial advisory services as amended; Article 2(3) in conjunction with point E of Annex 1 to the Decree of the National Bank of Slovakia No. 5/2018 on the professional examination and the professional examination with a certificate for the provision of financial intermediation and financial advisory services):

1. Legal regulation of banking, the banking system and the central banks,
2. Banking products and home savings,
3. Deposit protection, guarantees and guarantee schemes,
4. Interest rates, banks' passive operations, payment services (payment transactions),
5. Cost of deposit intermediation and the level of fees and charges for deposit products,
6. The Euro Area and the role of the European Central Bank,
7. Taxation in the field of deposit-taking,
8. Supervisory principles and sanctioning system.

In addition, both the professional examination and the special financial education are to include general knowledge and legal aspects of the financial market (Article 1(3)(e) in conjunction with point H of Annex 1 to the Decree of the Ministry of Finance of the Slovak Republic No.39/2018 Coll., Article 2(3) in conjunction with point H of Annex 1 to the Decree of the National Bank of Slovakia No.5/2018).

We can see that both the professional examination and the specialised financial education for the deposit-taking sector include the issue of payment services or payment transactions. As the activity of a payment institution or an electronic money institution does not consist in accepting deposits, neither will the intermediation of their services be intermediation in the deposit-taking sector (see chapter 1. above). Nevertheless, matters of deposit-taking, e.g. for payment accounts held by a bank, are closely related to matters of payment services, and thus it makes sense to include the issue of payment services in the criteria of professional competence in the deposit-taking sector.

2.3 Specific obligations of a financial agent operating in the deposit-taking sector towards customers

One of the important areas of the duties of a financial agent are the duties in the field of anti-money laundering and countering the financing of terrorism (hereinafter referred to as "AML/CFT"). The financial agent is obliged to adjust the relationships between the statutory body and the employees and the powers and responsibilities of a financial agent and a financial adviser as regards the AML/CFT matters (Article 24(1)(c) AFIFAS). The financial agent is also a so-called obliged person pursuant to Article 5(1)(b)(6) of Act No 297/2008 Coll. on the protection against money laundering and terrorist financing (hereinafter referred to as the "AAML"), i.e. it is subject to all important obligations under the AAML, such as identification and verification of the client's identification (Articles 7 and 8), to draw up and update in writing a programme of its own AML/CTF activities (Article 20(1)), the exercise of basic, enhanced or simplified due diligence in relation to the client (Articles 10, 11, 12), obligations in relation to the prevention of suspicious business transactions (Articles 14 et seq.), etc. While these obligations are more or less formal for financial agents operating in other sectors, the risk of money laundering is particularly high for financial agents operating in the deposit-taking sector, given that the banks and branches of foreign banks whose financial services they intermediate delegate a number of AML/CFT obligations to them as first contact persons. This is made possible by Article 13(1) AAML, according to which a bank or a branch of a foreign

bank may take over the documents necessary for the exercise of due diligence in relation to a client from a financial agent[349], which is also widely used in practice due to cost savings and simplification of processes. The onus is all the greater on the financial agent to ensure that it properly discharges these obligations and does not become a weak point through which the bank's clients become the launderers of the proceeds of crime. Therefore, the focus on compliance in this area should be not only on the financial agent itself but also on the bank for which the financial agent operates. It is the bank that faces the greatest risks from any failure of the financial agent in the field of AML/CFT, either in terms of potential sanctions imposed or reputational risk.[350]

In certain specific cases, a financial agent has the right to collect, i.e., under a contract with a financial institution, (i) to receive amounts intended for a client or a financial institution in cash or in an account of the financial agent established for the purpose of collection in a bank or branch of a foreign bank, or (ii) to pay claims arising from concluded financial service contracts or amounts to a client or a person entitled under such contracts (Article 4(i) AFIFAS). The authority to collect is excluded in the capital market sector (Article 37(1)(b) AFIFAS) and in the old-age pensions scheme sector (Article 37a AFIFAS), but not in the deposit-taking sector. Here, however, there may be a clash with another Act, namely APS. One of the payment services is the so-called money remittance service (Article 2(1)(f) APS), where, solely for the purpose of transferring funds deposited by the payer in cash or non-cash, the amount of those funds is transferred to the payee or to another payment service provider acting on behalf of the payee, and that amount is received on behalf of the payee and paid to the payee in cash or non-cash, where the payer or the payee does not have a payment account set up for that purpose (Article 2(8) APS). There is a risk here that if the financial agent were to receive funds from the client which were subsequently to be transferred to the account of a financial institution (bank) or even the client himself, this could be perceived as a money remittance, i.e. a simulated payment service (transaction). Money remittance can only be carried out by a payment institution licensed by the National Bank of Slovakia (Articles 63, 64 APS), for which the financial agent would be subject to a fine (Article 78(10) APS). Conversely, if a financial agent operating in another sector receives or disburses funds intended for a financial institution or for a client (e.g. insurance payment payable to an insurance company or insurance claims for a client), we do not see this risk here, as the financial agent is not acting as an intermediary between the client and the payment institution. These ambiguities are probably also the reason why financial agents selling home savings as the backbone product of the deposit-taking sector are not entitled to collect funds from or for the benefit of clients.[351]

[349]For details of using third party see DAUDRIKH, Yana: Regulácia ochrany pred legalizáciou príjmov z trestnej činnosti a financovaním terorizmu v korelácii uplatnenia zvýšenej starostlivosti o klienta. Vedecká monografia. Praha : Wolters Kluwer ČR, 2022, pp. 54–57.

[350]NAHEEM, Mohammed Ahmad: AML compliance – A banking nightmare? The HSBC case study. *International Journal of Disclosure and Governance*, 2015, 12(4), pp. 300-310. ISSN 1741-3591; YEOH, Peter: Banks' vulnerabilities to money laundering activities. *Journal of Money Laundering Control*, 2019, 23(1), pp. 122–135. ISSN 1758-7808. See also GEIGER, Hans; WUENSCH, Oliver: The fight against money laundering: An economic analysis of a cost-benefit paradoxon. *Journal of Money Laundering Control*, 2007, 10(1), p. 91. ISSN 1758-7808.

[351]https://www.pss.sk/wp-content/uploads/Ako-vklada-FO_6_2023.pdf, https://www.csob.sk/documents/11005/99131/Sposoby_poukazovania_vkladov.pdf, https://www.wuestenrot.sk/informacie/servis-pre-stavebne-sporenie-uvery [6. 10. 2023].

The financial agent is obliged to ascertain and record the requirements and needs of the clients, their experience and knowledge regarding the relevant financial service and their financial situation, taking into account the nature of the financial service which is the subject of the financial intermediation (Article 35(1) AFIFAS). Although this is a general obligation for a financial agent, as long as it operates only in the deposit-taking sector, in our view it will be very simple to comply with this obligation, as deposit products, as the most conservative financial products protected by the Deposit Guarantee Fund, will not be explicitly unsuitable for almost any client. Nevertheless, under the law, it will be necessary to formally fulfil this obligation and record the results in writing, otherwise the client could not be offered to conclude a financial service contract unless – admittedly – the client refuses the provision of the relevant information and insists on concluding a specific contract (Article 35(5) AFIFAS). Of course, a financial agent operating in several other sectors in addition to the deposit-taking sector will be obliged to fulfil this obligation from the point of view of whether his client has a higher risk appetite and whether other financial products, e.g. investment or insurance products, would not be more suitable for him. On the basis of the determination of the client's risk profile, the financial agent will provide the client with professional assistance, information and recommendations that are appropriate for the client and, on that basis, will also make a statement of the suitability of the relevant financial service (Article 35(3) and (6) AFIFAS).

In this respect, the potential liability for damages that a financial agent would bear when carrying out financial intermediation in the deposit-taking sector must also be seen. The legislator is also aware that the risk of such damage is low[352], which is why, in the case of an independent financial agent, the bottom limit of indemnity for this insurance coverage is set at EUR 100,000 for each insurance event and EUR 150,000 for all insurance events occurring in one calendar year (Article 30(2) AFIFAS). This is different from the bottom limit for an independent financial agent operating in the capital market sector or in the insurance or reinsurance sector, which is set at EUR 1,250,000 for each insurance event and EUR 1,850,000 for all insurance events occurring in one calendar year, while at the same time the insurance contract must also be valid in the territory of other EU Member States (Article 30(3) AFIFAS). Subordinate and tied financial agents do not need to be insured, as the liability for them is assumed by a superior entity – an independent financial agent or a financial institution (if they are active in the deposit-taking sector, it is a bank or a branch of a foreign bank).

CONCLUSION

Financial agents operating in the deposit-taking sector in the Slovak Republic can only intermediate bank deposit products such as deposit books, current and deposit accounts or building savings, which is the most frequent product among them. Slovak regulation of intermediation in the deposit-taking sector is unique in the EU and has its own specificities.

As intermediation of financial products is harmonised in the EU only in the insurance and reinsurance sector and in the area of housing loans (also in the area of investment services, but this is not the subject of this paper), a foreign person cannot carry out intermediation of deposit-taking products across borders. Although a foreign bank may offer its deposit products in the Slovak Republic directly on the basis of the single passport principle, either with or without establishing an organisational unit, an intermediary from another Member State may do so only after obtaining a licence to operate from the National Bank of Slovakia (if it wishes to become

[352]The other question is conflict of interest between client and financial agent which we do not analyse in this paper. For detail see e. g. PALAZZO, Guido; RETHEL, Lena: Conflicts of Interest in Financial Intermediation. *Journal of Business Ethics* 2008, 81, pp. 193–207.

a so-called independent financial agent) or after being entered in the register maintained by National Bank of Slovakia by an independent financial agent with its seat or residency in the Slovak Republic as its subordinate agent, or by a Slovak bank as its tied agent, respectively. In such a case, however, tied agent could only sell this bank´s financial products. However, if a foreign natural or legal person wanted to become an independent financial agent in the Slovak Republic (and sell here, for example, financial deposit products of foreign banks), it would have to fulfil conditions that would be very difficult for it to achieve. We suspect that in this respect the Slovak legislation is discriminatory and contrary to the freedom of establishment guaranteed by the TFEU.

The professional competence of financial agents or their statutory bodies operating in the deposit-taking sector covers specific areas which shows us how the legislator perceives the content of the term 'deposit-taking'. Although the area of payment services and payment transactions is also part of the specialised financial education, these areas cannot be considered as part of the deposit-taking sector.

A financial agent in the deposit-taking sector has specific rights and obligations, unlike financial agents operating in other sectors. In particular:

(a) a much greater emphasis on AML/CFT compliance given the increased risk of money laundering in the conduct of its business,

(b) the right of a financial agent to collect funds from or for the benefit of a client has some unintended consequences in the deposit-taking sector, for which we would recommend not to engage in this activity (the exercise of collection may be considered as an unauthorised activity, subject to severe sanctions by the regulator)

(c) the analysis of client needs may be more benevolent given the low risk nature of the products offered,

(d) this implies a lower risk of causing damage to the client, for which lower liability insurance is sufficient.

This paper summarises the specificities of financial agents operating in Slovakia in the deposit-taking sector as a special group of financial intermediaries, which is unparalleled in other EU Member States, and provides an insight into their specific position.

Finally, we would like to propose specific *de lege ferenda* recommendations of the matter:

(a) for foreign entities applying for licence in deposit-taking sector – domestic proof of competence shall be recognised or proof of professional competence shall be provided by the head of its organizational unit located in Slovakia,

(b) AML/CTF obligations for financial agent operating in deposit-taking sector shall be legislatively strengthened,

(c) the contradiction between the right to collect in deposit-taking sector and remittance services falling under payment services shall be resolved,

(d) certain obligations of financial agent in deposit-taking sector towards the client can be simplified.

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Artificial Intelligence utilization at workplace in European Union law

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Abstract: *Employment relations is one the most AI-used areas in the light of recent developments. Therefore, it is important to set forth which phases in the employment relations AI can be used by the employer. Recruitment system, workplace management and even monitoring employees and their productivity is easier and faster with the utilization of AI. AI can be seen as a friend, but employers should always be careful about the AI.*

Keywords: *Artificial intelligence (AI), digital discrimination, workplace organization, employment relationship, human resources management.*

INTRODUCTION

Artificial Intelligence (AI) utilization is getting more and more impacts at workplace. Employers use AI as a hiring system, as work management system and use for termination the employment contracts. Our study focuses on the utilization of AI in the recruitment and in work management. Occupational health and safety is also crucial usage area of AI in employment relationships. Digital discrimination is the newly trend topic after the utilization of AI. The second and third titles assess these topics. AI utilization with regards to termination of employment relationships is the last part of our study. This study sets out a brief outline of the advantages and possible problems may be raised from the utilization of the artificial intelligence by reviewing existing literature such as books, articles, reports, and European Union regulations.

1. RECRUITMENT

The most time-consuming part of the Human Resources' activity is finding a right candidate employee for a position. Because of the long list of applications of the candidates and the evaluation criteria it is the most important and time-consuming part. Artificial intelligence may involve the recruiting phase such as posting job advertisement, screening the resumes, interviewing, eliminating of the candidates who do not meet the requirements of job advertisement, and selecting[353].

AI can direct an applicant to a different position in the company even if the applicant does not meet the requirements for the position or keep the application for a suitable job later[354]. For example, as a recruiting AI, HiredScore, create a database of applicants and automatically

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creates a shortlist of previous suitable applicants[355]. As another example, HireVue Hiring Platform provides services such as making video interviews, assessments, conversational AI.

AI utilization in the recruiting phase as decision making system can bring lots of advantages. When the AI makes its decision, it is purely objective based on the facts and not affected by the emotions. Yet there are some concerns regarding incorrect evaluations of AI may lead to discrimination.

2. WORK MANAGEMENT

2.1 Right to Give Instructions and Task Management

In employment relationships the employer is entitled to give instructions to the employee related to which specific tasks the employee must perform when, where and how the work is done. It is also possible for employers to transfer the right to give instructions to the third party. It is conceivable that employer may transfer the right to give instructions to AI[356]. Decisions are made by the AI, but the basic decision comes from the employer. However, the right to give instructions is not limitless, this right shall use in accordance with the reasonable discretion[357].

When the AI automatically receives all necessary information, it can make a perfectly rational selection decision. The examples of AI's decision-making regarding workflow are assignment of employees to workplaces and tasks, determination of remuneration, opportunity to book shifts, automated draft for the feedback supervisors. It is possible with the use of AI in task management that employees are guided and instructed.

To make allocation, AI needs to process personal data of the employees. Otherwise without relevant information about the employees (age, level of education, state of health, etc.), a meaningful and fair allocation of tasks is not possible. Therefore, it is important to take the art. 22 of the GDPR into account in which it the data subject has the right not to be subject a decision based solely on automated processing, including profiling, which produces legal effects concerning him or her or similarly significantly affects him or her. To avoid being held liable for damages under Art. 82 of the GDPR, employers should at least subject instructions to "a plausibility check" by a natural person with the corresponding decision-making authority[358].

2.2 Performance assessment via AI

One of the areas that AI can be used is monitoring employees' performance[359]. Employers can easily track the productivity of employees via AI. For instance, call center employees can be monitored via call recordings and call feedback to evaluate and improve the performance. As another example platform workers can be shown. In digital platforms, employees' performance and productivity are assessed according to customer ratings and comments.

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[359]BALES and V. W., STONE. op. cit., 9.

2.2.1 Employee Monitoring and Data Protection Issues

Employers need to monitor their employees to ensure that equipment are used efficiently, to protect commercial confidentiality and management workplace risks, and that no crimes are committed by their employees[360]. AI can monitor employees by analyzing e-mail texts and social media messages, GPS tracking, desktop monitoring, recognition of facial features, collecting biometric data such as fingerprints and eye screening, facial recognition software, call recordings, keystrokes, searching queries, and can monitor via smart devices such as smartphone sensors, and smart glasses[361].

On the one side there is employer's right to instruction and economical interest, on the other side there is employees' private life and personal data protection[362]. So that employers need to comply with the rules regarding monitoring. As it is pointed out in GDPR and the Article 29 Data Protection Working Party Opinion 2/2017 on data processing at work employer should consider: The processing activity is legitimate and necessary, the processing of personal data should be limited with a purpose, data storage should be limited, the processing activity is proportionate to the concerns raised; and the processing activity is transparent[363]. To ensure transparency, employer is obliged to inform the employees regarding the purpose and extent of usage of algorithmic management[364].

The Czech Data Protection Authority and the Municipal Court of Prague found disproportionate the GPS tracking of the post messengers which included information on the route, length, and time of delivery[365].

There are also some drawbacks emerging from the monitoring by AI at the workplace. Wide range of monitoring may cause stress of employees, decrease job satisfaction[366], increases the psycho-social risks and employees may feel anxious about making the job on determined time or have a sense of resentment about the work because of the targets need to be meet.

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[363]BALL, op. cit., 11.; ALOISI and GRAMANO. op. cit., 103.

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[366]BALL, op. cit., 16.

2.2.2 Wearables Technology

Wearables technologies can be used in two areas in the workplace. First is ensuring occupational health and safety and second is performance assessment[367]. It is accepted that wearable technologies can be used for ensuring workplace safety. For example, wearing sensors that will encounter the worker's skin in jobs where voltage and electric current pose a danger or hazardous chemicals are used can be a great advantage. Instead of heavy and difficult to carry equipment such as protective vests, helmets, and protective glasses, it is accepted that lighter wearable technologies such as smart glasses, smart vests, which will not adversely affect their work process, will not make the work process difficult and can increase occupational safety to a higher level[368].

It is also stated that all these hazards can be prevented with a wearable technology that contains sensors for instantly changing body temperature, sudden change of body posture, sound or smoke measurement that may adversely affect hearing and warns the employee[369].

3. DIGITAL DISCRIMINATION

Although AI has many advantages in employment relations, it is observed that the most dangerous drawback is discriminatory decisions of AI. Some legal scholar believe that AI has the potential to reduce discrimination by minimizing or eliminating human judgment, and by identifying hiring practices that are unintentionally exclusionary. On the other hand, some scholars have warned that Al can amplify mask discriminatory prejudices and disproportionately exclude underrepresented groups.

Discriminatory results may occur not only in recruitment phase of the employment, and in payment and benefit systems, task allocation, disciplinary proceedings and finally termination of the contract[370]. There is always a risk of automated hiring platforms can be biased and therefore discriminatory. For example, if women and racial minorities were underrepresented in a company's demographics, then training data would create a predictive model that would similarly undervalue applicants from those underrepresented groups.

One of the biggest reason why AI is described in AI Act Annex III as high-risk area[371] is the discriminatory decisions of AI.

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[367]Ibid. 25.

[368]CHOI, Byungjoo and Sungjoo HWANG and SangHyun LEE, "What drives construction workers' acceptance of wearable technologies in the workplace?: Indoor localization and wearable health devices for occupational safety and health", Automation and Construction, 2017, 84, 32.

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[371] The Article 6(2) of AI Act Annex III is as follows: 4. Employment, workers management and access to self-employment: (a) AI systems intended to be used for recruitment or selection of natural persons, notably for advertising vacancies, screening or filtering applications, evaluating candidates in the course of interviews or tests;

Discrimination prohibition has always close relation to personal data protection. Collecting personal data of employees' such as health information may cause discrimination.

Indeed, given the often-elusive working methods of artificial intelligence applications or the complexity of the algorithms, it is very difficult for prospective employees to prove discrimination[372]. AI is described as "black box", and it is virtually impossible to question where the disadvantage arises from the decisions taken by the algorithm stems from[373]. their internal workings are not easily interpretable by humans. Because of the lack of explainability and accountability, transparency of the AI's decision will always be an issue. In order to provide transparency, employers must inform employees about the purposes and functioning of the system, the categories of data and main parameters of the system and the person who is in charge of the system.

Lastly it should be emphasized that AI aims to treat equally and not to be discriminative, but because of that approach, indirect discrimination has occurred. Bologna Civil Court decided on 31.12.2020 in Deliveroo Case that the practice of Deliveroo violates several non-discrimination provisions. The indiscriminate nature of the algorithmic determination also penalised employees absent due to reasons protected by non-discrimination provisions, such as sickness, family reasons, or participation in a strike. In this case, employees wishing to participate in the strike were affected by AI's work management decision which is the opportunity to reserve future shifts in advance and earlier than low scored employees.

CONCLUSION

AI utilization at the workplace may bring great convenience for employers but also may cause some problems such as discrimination. In our study it is found out that the most important issue is the control the AI in order not to violate the current regulation and cause harm. According to the Ethics Guideline for Trustworthy AI issued by High-Level Expert Group, AI should be lawful, which means it should be complied with all the applicable laws. Yet, at the same time adapting the laws or making new laws regarding AI utilization has crucial importance.

Automated systems may fail to take real-world challenges employees face every day basically consideration. Therefore, human interference is always needed, when making decisions or supervising the decisions in order to be in compliance with art. 22 of GDPR which provide to data subject a right not to be subject to a decision based solely on automated processing. The other side of the coin is that one of the reasons why AI can be discriminatory is biased inputs. If the employer or HR department use biased search criteria when using the AI, then the result is also biased.

In our study, it is reached out that providing transparency might be the key to prevent discrimination through AI. Firstly, employees have right to information regarding how AI makes decisions, the reasoning for AI's decisions must be clear, transparent, and traceable, and

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(b) AI intended to be used for making decisions on promotion and termination of work-related contractual relationships, for task allocation and for monitoring and evaluating performance and behavior of persons in such relationships."

[372]WAAS, Bernd, Künstliche Intelligenz und Arbeitsrecht, Frankfurt am Main: Bund-Verlag, 2023, 131. 9783766372949.

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workers and their representatives must have access to the data and the right to appeal such a decision. If there is not the right to appeal against AI's decisions and the internal appealing system does not work properly, it is not possible to mention a transparent system. In that point human intervention can be discussed.

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