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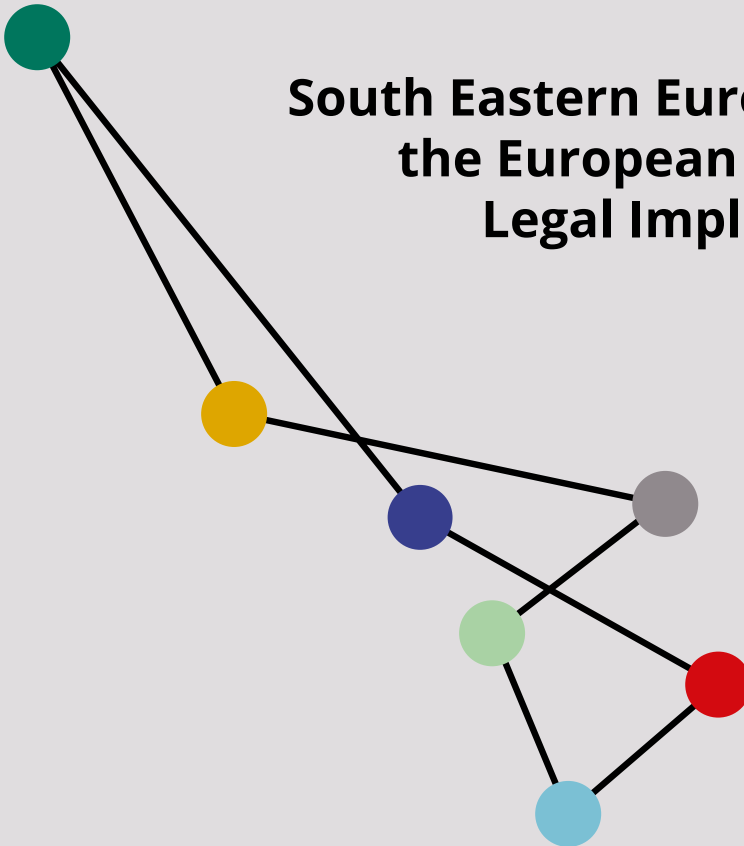

South Eastern Europe and the European Union – Legal Implications

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South Eastern Europe and the European Union – Legal Implications

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Preface

This publication is the second volume of the series of papers of the SEE | EU Cluster of Excellence in European and International Law. The series is a compilation of articles from authors of different partner law faculties in Germany and South Eastern Europe.

The Europa-Institut of Saarland University is the leading partner of the SEE | EU Cluster of Excellence in European and International Law, together with the law faculties of: the University of Belgrade (Serbia), Montenegro (Podgorica, Montenegro), Sarajevo (Bosnia and Herzegovina), Skopje (Macedonia), Tirana (Albania) and Zagreb (Croatia), and the South East European Law School Network. The project is supported and sponsored by the German Academic Exchange Service (DAAD) as well as the German Federal Ministry of Education and Research, and aims to promote the outstanding capabilities in research and teaching in the field of European and International Law.

The SEE | EU Cluster of Excellence in European and International Law will improve not only the cooperation between Germany and the South East European countries but also the cross-border regional and local cooperation in the areas of teaching and research as well as the development of common structures and strategies. The Cluster of Excellence seeks to explore new avenues in the transfer of knowledge; sharing expertise and experiences will strengthen the profile of each partner and the network as a whole. Therefore, the Cluster will implement various measures and activities aspiring to achieve the set goals: eLearning modules, a model curriculum, a graduate school, a number of research projects, summer schools, library cooperation and various publications.

This collection of papers can serve as a forum for academic staff and young academics of the partner faculties in the SEE | EU Cluster of Excellence to publish their research results on relevant questions in European and International Law. In addition to the traditional areas of law, specific areas of interest include: the integration of SEE countries in the European Union, issues of legal reform and implementation of the acquis communautaire, best practices in legal reform, and

approximation of legislation in the region of South Eastern Europe and the EU. The series will be published on a yearly basis and is peer-reviewed by the Editorial Board.

The SEE | EU Cluster of Excellence in European and International Law • Series of Papers 2016 encompasses ten papers from academic staff and junior researchers from the law faculties in Belgrade, Saarbrücken, Skopje and Tirana. This issue covers a broad variety of topics and illustrates the wide range of subjects connected to European and International Law. Particular topics in this volume discuss various civil and economic laws from a European perspective, including civil law harmonisation, tort law, transnational trade law, industrial property rights as well as investment risks.

We thank the German Academic Exchange Service (DAAD) and the German Federal Ministry for Education and Research for their financial support. We owe our special thanks to all authors for their contributions as well as to Ass. iur. Mareike Fröhlich LL.M., Dipl.-Jur. Nicolas Jung and Ass. iur. Anja Trautmann LL.M. who made this book possible.

We are confident that the SEE | EU Cluster of Excellence in European and International Law • Series of Papers will provoke greater interest in European and International Law and contribute to the achievement of the goals of the SEE | EU Cluster of Excellence in European and International Law.

Saarbrücken, December 2016

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Conformity of the Reform of the Rules on Donations in Serbian Law with European Projects on Civil Law Harmonisation – From the Perspective of a Serbian Lawyer

Marko Đurđević[*]

Abstract

The Preliminary Draft Civil Code of the Republic of Serbia was published in May 2015. The Preliminary Draft introduces several novelties in the area of the law of obligations. One of the most significant novelties is the codification of donations. The rules currently applied by Serbian courts on contracts for donation derive from the Civil Code of the Principality of Serbia of 1844 and have not been changed since then. From the onset of its work, the Commission tasked with the codification stated its intention to reform the existing rules of the law of obligations and harmonise them with projects for harmonisation of European civil law. In the process of codification in Serbia, the Draft Common Frame of Reference was published, prepared by Study Group on a European Civil Code and Acquis Group, This Draft includes model rules on donations. The author of this paper uses a comparative method to research the definition of donation. Following the analysis of the constitutive elements, he offers conclusions about the level of harmonisation of the rules on donations between the Preliminary Draft Civil Code of the Republic of Serbia and the Draft Common Frame of Reference.

A. Introduction

The Preliminary Draft Civil Code of the Republic of Serbia (Preliminary Draft CCRS) was published in May 2015.[1] It contains systematised and mutually aligned rules regulating all areas of civil law relationships – family rights, inheritance rights, obligations and

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1 The official title of the Preliminary Draft CCRS is „The Civil Code of the Republic of Serbia“. The working version, with alternative solutions included, was prepared for the public debate, Belgrade, 2015, www.mpravde.gov.rs/files/NACRT.pdf (1/12/2016).

proprietary rights – which are currently governed by special laws. The rules in the area of the law of obligations were not simply taken over from the existing law, but were incorporated in the Draft in a modified form along with the new rules. One of the most important novelties in the new text is the stipulation of the rules regulating donation contracts. The Preliminary Draft CCRS introduces completely new rules on donations in the Serbian law of obligations and these rules will replace the old ones stipulated in the Civil Code of the Principality of Serbia that have been applied since 1844.

The former socialist state of Yugoslavia abolished the 1844 Civil Code without creating the new rules beforehand. The special laws regulating specific areas of the civil law were introduced gradually, over a longer period of time. This evolution did not include donations. Donations were left out of the new Law of Obligations (LO) (1978), and completely new rules regulating this area have not been introduced to this day. Interestingly, this did not create a legal void, given that the rules of the abolished Civil Code have been applied to donations. What are the reasons for such a paradox? The answer is provided in the first part of this paper. Since gratuitous contracts are not typical for the area of trafficking of goods, the opinion of the redactors of the LO was that donations should be left out from the Law. Therefore, this type of contract should not be regulated under the law regulating only onerous contracts. Another reason could be found in a strict division of the legislative authority between the former federal state and individual federal republics in the former Yugoslavia.

The decomposition of the last Yugoslav state (2003) and constitution of Serbia as an independent state made the legal basis for the creation of the new Civil Code. Owing to transition and constitutional changes (1992), Serbia had previously adopted the free market economy concept. The constitutional reforms also changed the status of the so-called public ownership which was no longer favoured over private ownership. The freedom of contract was reaffirmed as a fundamental principle of contractual relations, without the limitations imposed by the need to protect public ownership. This principle and other fundamental principles under the LO – good faith and fear dealing, equality of considerations in reciprocal contracts, consensualism – could be fully developed in the new circumstances. These principles provided a solid theoretical background for the modern codification of the civil law.

The Preliminary Draft CCRS clearly demonstrates that the Government Commission for the Civil Code Drafting prepared a reform which will finally introduce the new rules on donations. The Government Commission for the Civil Code Drafting expressed from the outset its intention to formulate the rules of the future Serbian law, which would be in conformity with the projects of the harmonisation of European contract law. While the Commission was working on the Preliminary Draft CCRS, the Draft Common Frame of Reference (DCFR), elaborated by the Study Group on a European Civil Code and the Research Group on Existing EC Private Law (the Acquis Group), was published. The DCFR is the only European contract law harmonisation project which offers model rules for regulating donations. In order to determine whether the Commission's intention has been realised and the proposed reformed rules of the Serbian law on donations have been harmonised with the European projects, these rules must be viewed in juxtaposition with the model rules on donations formulated in Book IV, Part H of the DCFR.

The Preliminary Draft CCRS contains the same rules on donations formulated in the Preliminary Draft Proposal on Law of Obligations and Contracts (1969).[2] The Preliminary Draft Proposal was an unofficial Preliminary Draft of the Law of Obligations and was intended to become the official proposal of this Law.[3] However, the section on donations was left out from the final version of the official proposal. Nearly fifty years later, the Government Commission for the Civil Code Drafting included this section in its Preliminary Draft CCRS.

The regulation of donation in the Preliminary Draft CCRS was not inspired by international projects for the civil law harmonisation. The inspiration came from the national source – the Preliminary Draft Proposal on Law of Obligations and Contracts (1969) – the text that was written at the time when the European initiatives for the harmonisation of the civil law did not even exist. This fact inevitably raises the following questions: Is the section on donations in the Preliminary Draft CCRS indeed harmonised with the DCFR model rules which were formulated four decades later? Is this proposal

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2 *Konstantinovic*, Obligacije i ugovori, Skica za Zakonik o obligacijama i ugovorima, 1969.

3 *Orlic*, La cause des obligations dans le droit Serbe, in: Mélanges en l'honneur du professeur Jean Hauser, 2012, p. 969.

outdated? Does it have to be re-evaluated and modernised? These questions are addressed in the second part of this paper. In the author's opinion, the answers can be provided through comparing the Preliminary Draft rules with the DCFR rules defining donation and by determining its constitutive elements.

To summarise, Section B of the paper looks at the reasons why the rules from the abolished 1844 Civil Code are still applied in Serbia. In addition, the process of the preparations for the civil law codification and the law of obligations reform will be described in detail, as it is expected to result in the new rules on donations. In Section C, the constitutive elements of a donation as defined in the Preliminary Draft CCRS and DCFR are compared and analysed. Conclusions are drawn regarding the extent of harmonisation of the future rules on donation in Serbia with the rules from this proposal for the harmonisation of the European law of obligations.

B. Reasons for the Absence of the Rules on Donations from the Law of Obligations and Preparations for the New Regulation of Donation

The Republic of Serbia is among the few European countries which still do not have a Civil Code. The Civil Code of the Principality of Serbia enacted in 1844, which was in force in the Kingdom of Serbia, was abolished in the aftermath of the socialist revolution. Under only one law, the Statute on Invalidity of Legal Regulations Enacted before 6 April 1941, the Yugoslav legal system nullified the entire previous legal order and all of its regulations, including the Civil Code. However, the new regulations were not immediately passed. Consequently, the above-mentioned Statute stated explicitly that the general rules of law formulated on the basis of the regulations passed by the toppled social system would be applied, unless they contradicted the new Constitution and the regulations arising from it, at least until they were replaced by the new ones. The general rules of law derived from the formally nullified Civil Code, which did not have legal force, were nevertheless applicable under the new legal order and are commonly known in Serbian jurisprudence and legal theory as "the old rules of law".[4]

[4] *Konstantinovic*, Stara 'pravna pravila' i jedinstvo prava, The Annals of the Faculty of Law in Belgrade 3-4/1982, p. 540.

With the passage of time, new regulations were being adopted, the provisions of which gradually replaced the relevant parts of the 1844 Civil Code. Consequently, "the old rules of law" tacitly stopped being implemented in the Yugoslav legal system. After the modern laws governing family and succession relations took effect, the courts did not need to apply the rules of family and succession laws anymore. The promulgation of the LO in 1978 resulted in the abandonment of the old rules used in the settlement of disputes within a large part of the field of obligations. Namely, the provisions of the LO did not apply to all obligations included in the nullified Civil Code. The LO did not govern some types of classic nominate contracts (donation, loan for use, partnership), nor the liability for damage caused by an animal or damage caused by waste disposal or leakage.

The reason why the provisions applicable to donations were not included in the Yugoslav federal Law of Obligations is well known. In Yugoslavia, the federation and the republics, members of the federation, partly shared legislative jurisdiction over the regulation of the matters pertaining to obligations. The federation regulated "the basic principles of obligation relations (the general part of obligations) as well as contractual and other obligation relations in the area of transactions involving goods and services."[5] The remaining areas of obligation relations were to be regulated by the republics. Only onerous contracts were regulated in line with the criterion of typicality at the federal level.[6] Given that a donation, as a gratuitous contract, is not typical for the transactions involving goods and services, the regulation of this civil law issue was in the hands of the legislative bodies of the republics.

In the Republic of Serbia the issues of the enactment of new regulations governing donations and the replacement of "the old rules of law" with the new ones became relevant after the cessation of the legal and state continuity with the Yugoslav state. Serbia then became an independent state with full legislative jurisdiction over the area of civil law legal relations and expressed its intention to create its own Civil Code. This intention began to materialise in 2006 with the Government Decision to form the Commission for Drafting the Civil Code of

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5 Article 281(1) of the Constitution of the Socialist Federal Republic of Yugoslavia, The Official Gazette of the SFRY, No. 30/1974.

6 *Perovic*, Obligaciono pravo, 1986, p. 42.

the Republic of Serbia.[7] At the beginning of its work, the Commission stated that it intended to harmonise the existing corpora of legal norms included in the laws governing obligations, inheritance and family relations, which had already been mutually harmonised, with the property law rules and the principles of the general part of the civil law. These were to be incorporated in the uniform civil codex later on.[8]

The latest result of the codification activities, the Preliminary Draft CCRS, demonstrated the Commission's strong resolve to modernise and modify the existing law of obligations. The Preliminary Draft CCRS added new institutes, norms and definitions to the existing rules governing obligation relations. In addition, the Commission proposed amendments to several provisions of the LO.[9] The comparative analysis of the Preliminary Draft CCRS and the LO has clearly shown that the rules and regulations applicable to the law of obligations and proposed in the Preliminary Draft CCRS are different from the existing ones. Therefore, it can be concluded that there is an ongoing reform of the law of obligations within the framework of the codification of Serbian civil law. The regulation of donations is one of the key novelties introduced by the reform. If the Commission's proposal is accepted, the enforcement of the new Civil Code of the Republic of Serbia will mark the end of the implementation of "the old rules of law" governing donations and the final parting from the 1844 Civil Code.

When deciding to proceed with the codification of the civil law, the Government of Serbia concluded that it was necessary to harmonise the legal solutions pertaining to this area of law with "international standards, the European Union law, particularly with the European Civil Code Project."[10] After Serbia had signed and ratified the Stabilisation and Association Agreement (SAA) with the EU, the harmonisation of both the existing laws and the future legislation with the EU *acquis*

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[7] The Decision on Forming the Commission for the Civil Code Drafting, The Official Gazette of the Republic of Serbia, No. 104/2006.

[8] The Commission for the Civil Code Drafting, Rad na izradi Gradjanskog zakonika sa izvestajem komisije o otvorenim pitanjima, 2007, p. 79.

[9] Preliminary Draft CCRS, spec. Razlozi za donosenje zakonika, pp. 687-691.

[10] The Commission for the Civil Code Drafting, (fn. 8), p. 14.

communautaire became Serbia's international contractual obligation.[11] Acknowledging the need identified by the Government, the Commission for the Civil Code Drafting stated in its programme of activities that one of the objectives of the enactment of the Civil Code was to facilitate the harmonisation of Serbian civil law legislation with the solutions included in the European law.[12]

Several European projects of contract law harmonisation have been published in the last couple of decades: 1. The Principles of European Contract Law (PECL) drafted by The Commission of European Contact Law chaired by *Ole Lando*;[13] 2. The Draft European Contract Code written by The Academy of European Private Lawyers, which published Book One, Contracts in General, and commenced working on the second book which contains, for the time being, the rules on sales;[14] 3. The Common Frame of Reference (DCFR), which contains (English version) The Principles, Definitions and Model Rules of European Private Law, developed by the Study Group on a European Civil Code and the Research Group on EC Private Law (Acquis Group).[15] The same project also developed, in cooperation with the Association Henri Capitant des Amis de la Culture Juridique Française and the Société de Législation Comparé, the Common Contract Terminology and the Common Contractual Principles (French version).[16] However,

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11 Article 78 of the Bill on the Confirmation of the Stabilisation and Association Agreement between the European Communities and Their Member States, of the one part, and the Republic of Serbia, of the other part, The Official Gazette of the Republic of Serbia – International Treaties, No. 83/2008.

12 The Commission for the Civil Code Drafting, (fn. 8), p. 695.

13 Lando/Beale (eds.), Principles of European Contract Law, Parts I and II Revised, 2000; Lando et al. (eds.), Principles of European Contract Law, Part III, 2003.

14 European Contract Code (English version), Book One, Contracts in General; European Contract Code (English version) Book Two, www.accademiagiusprivatisti europei.it (1/12/2016).

15 Von Bar et al. (eds.), Principles, Definitions and Model Rules of European Private Law, Draft Common Frame of Reference (DCFR), Outline Edition, 2009, www.ec.europa.eu/justice/policies/civil/docs/dcfr_outline_edition_en.pdf (1/12/2016); von Bar et al. (eds.), Principles, Definitions and Model Rules of European Private Law, Draft Common Frame of Reference (DCFR), Full Edition, 2009.

16 Fauvarique-Cosson/Mazeaud (eds.), Projet de cadre commun de référence, Vol. 6, Terminologie contractuelle commune, 2008; Fauvarique-Cosson/Mazeaud (eds.), Projet de cadre commun de référence, Vol. 7, Principes contracuels communs, 2008.

the models of rules regulating donations can be found only in the DCFR. The model rules are described in Part H of Book IV, "Specific Contracts and Rights and Obligations Arising from Them". In order to establish whether the reformed Serbian rules on donations have been harmonised with the legal solutions in the European Civil Code Project, and whether the Commission has achieved its goal – to propose the Preliminary Draft which is in conformity with the European law – the rules on donations under the Working Version of the CCRS and the DCFR should be compared and analysed. Given the limited scope of this paper, only the rules regulating the definition of a donation have been included in the comparative analysis.

C. Comparative Analysis of the Definition of a Donation in the Preliminary Draft CCRS and the DCFR

The comparative analysis of the definitions of a donation encompasses their constitutive elements: 1. the source of obligation of a donor; 2. objective element, gratuitousness; and 3. subjective element, the intention of a donor to benefit a donee.

I. The Source

The Preliminary Draft CCRS defines donation in the following manner: "Under the contract for donation, the donor shall transfer the ownership or any other right to another party without reward, the donee, or shall benefit the donee in any other manner from his/her own property."[17] According to this definition, a donation is qualified as a contract. The Preliminary Draft CCRS classifies the rules applicable to the contract for donation as being among the special rules applicable to nominate contracts, after sales and loan contracts, and before lease contracts. The systematic approach to the donation of goods is different from the approach used in the 1844 Civil Code of the Principality of Serbia. In this Civil Code the regulation of donations followed the general rules on contracts and preceded the special rules applied to deposit, commodatum, loan, etc.[18]

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[17] Article 798(1) Preliminary Draft CCRS.

[18] Gradjanski zakonik za Knezevinu Srbiju obnarodovan na Blagovesti 25 marta 1844, 2 izdanje*,* 1873, spec. Deo drugi, Glava XVIII. The theory of law treated donation as a

In other words, a donation is the outcome of contract. The obligation of the donor arises from the offer and acceptance by the donee. A unilateral statement by the donor does not create the obligation to transfer the ownership, or any other right, to another party. In this particular aspect the Preliminary Draft CCRS differs from the DCFR which suggests that the rules on donations should apply, with some modifications, not only to contracts, but also to unilateral juridical acts, under which a donor gratuitously undertakes to transfer the ownership right to a donee.[19]

The DCFR stresses that a donation is a contract under which a donor gratuitously and unilaterally undertakes to transfer the ownership of goods to a donee. The transfer of ownership of incorporeal property, such as the right to perform an obligation, right of industrial or intellectual property, or other transferable rights, is also considered to be the object of a donation.[20] Under this criterion, the rules on donation do not apply to contracts for gratuitous services or gratuitous use.[21] Under the Preliminary Draft CCRS, the rules on donations are not applicable to contracts in which one party gratuitously undertakes to perform an act which benefits another party. It is unclear whether a contract to transfer a right more limited in scope than ownership could be questionable or not.

The proposal for the codification of donations in the future Serbian civil law includes an additional criterion. Namely, the rules on donations would apply not only to the undertaking of a donor to transfer the ownership right or any other right to a donee, but also to cases where a donor, upon mutual consent, "uses property" with the intention to benefit another party. This formulation applies to contracts such as those under which one party undertakes to take over another party's debt, or undertakes to perform the another party's debt without reward.[22] The Preliminary Draft CCRS goes even

general legal transaction, different from a contract, see *Djordjevic*, Sistem Gradjanskog (privatnoga) prava, Opsti deo (druga polovina), 1893, p. 151.

[19] DCFR, IV.H.-1:101(1).

[20] DCFR, IV.H.-1:103.

[21] Von Bar et al. (eds.), Principles, Definition and Models Rules of European Private Law, Draft Common Frame of Reference-Full Edition, Vol. 3, 2009, p. 2802.

[22] *Djurdjevic*, Ugovor o poklonu, 2012, pp. 129-131.

further. It states explicitly that the rules applicable to contracts for donation also apply to waivers, where a contractual obligation of one party is no longer binding, without performance and without reward. This is the case when a creditor waives the right to request the payment of the debt by a debtor, to which the debtor consented.[23]

II. Gratuitousness

The second criterion, critical in both proposals, is gratuitousness. It excludes any consideration or reward for transferring ownership rights to another party. Under contracts for donations, the right to transfer ownership is always attributed to one party, while counter performance is not binding upon another party.[24]

However, the DCFR contains a rule which stipulates that contracts for donations may include transactions which are not entirely gratuitous, if the party undertaking to transfer will receive, or is entitled to, some reward, but with an intention inter alia to benefit the other party. The values to be conferred by performance are regarded by both parties as not substantially equivalent.[25] The purpose of this rule is to regulate factual scenarios which contain, apart from the elements of a donation, some elements of onerous contracts. Under the DCFR, such situations are *primarily* regarded as contracts for donation.[26]

The Preliminary Draft CCRS, Chapter XXI "Donation", Section 2, deals with three situations where transactions deviating from the criterion of gratuitousness may occur. The first situation, defined under the heading *mixed donation*, implies the existence of an onerous contract under which both contractual parties have mutually committed to transfer their right in property of unequal value to one another, while the party transferring a greater value intends to benefit the another party. In this case "the difference in values shall be considered a donation."[27]

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23 Article 798(2) Preliminary Draft CCRS.

24 *Vodinelic*, Gradjansko parvo, Uvod u pravo i Opsti deo gradjanskog prava, 2012, p. 450.

25 DCFR, IV.H.-1:202.

26 Von Bar et al., (fn. 21), p. 2819.

27 Article 806 Preliminary Draft CCRS.

Mixed donations correspond to transactions defined in the DCFR as not entirely gratuitous. Under the DCFR, if a donor exercises the right to revoke, the rule on the consequences of revocation applies to the whole contractual relationship.[28] Despite the fact that the Preliminary Draft CCRS does not contain any such rule, it can be concluded from the formulation "the difference in values shall be considered a donation" that the consequences of revocation do not apply to a contractual relationship arising from the whole mixed contract for donation, but only to the element considered to be a donation. Similarly, the Preliminary Draft CCRS offers a different "legal" qualification for the cases where a contract is not entirely gratuitous. Namely, the first text, the Preliminary Draft, adopts a distributive qualification (*qualification distributive*). It implies "the splitting of a contract" (*dépeçage du contrat*) into specific elements and application of different rules to each element.[29] In contrast, it seems that the intention in the DCFR text, was to define the qualification of a contract as exclusive (*qualification exclusive*). This qualification implies that the rules on contracts for donations apply to the whole contractual relationship arising from a transaction which is not entirely gratuitous.

The rule proposed in the Preliminary Draft CCRS, entitled *donation with charge*, applies to a contract for donation which contains a charge, or a provision stipulating that a donor retains for him/herself or any other party some right to the object of donation or requests that a donee perform an action, refrain from committing specific acts or allow somebody else to do something.[30] The donor is authorised to request the performance of the order by the donee or even to enforce the performance if necessary.[31] If the donee fails to perform, the donor has the right to unilateral rescission as well as the right to demand restitution of the object.[32] Under the Preliminary Draft CCRS, the legal consequences for the breach of a charge in the contract for donation do not deviate from other legal consequences stipulated under Serbian law for the non-performance of obligations arising from

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28 DCFR, IV.H.-1:102(3).

29 *Malaurie/Aynès/Gauter*, Droit civil, Les contrats spéciaux, 2009, p. 8.

30 Article 804(1) Preliminary Draft CCRS.

31 *Djurdjevic*, (fn. 22), p. 203.

32 Article 804(2) Preliminary Draft CCRS.

onerous contracts. This means that a donation with a charge deviates from the criterion of gratuitousness. The transaction in question is not entirely gratuitous and it is considered a mixed contract containing the elements of donation and onerous contracts. Nonetheless, the Preliminary Draft CCRS stipulates that the rules applicable to contracts for donation apply to this type of contract as well – the rules on the conclusion of the contract, obligations and liability of a donor, as well as the right to revoke. This provision does not only apply to a situation where the value of assets needed for the performance of obligation exceeds the value of the object of donation. In this case, the rule on the liability of a donor for material and legal defects, in line with the rules on onerous contracts, would be applicable.[33]

The rules on mixed donations and donations with a charge apply to two mixed situations. In both cases there is only one contractual relationship that is comprised of elements of different types of contracts, a contract for donation and an onerous contract. The third situation, regulated in the Preliminary Draft CCRS under *mutual donations*, is a quasi-mixed one. In this case there is agreement that one contractual party undertakes to transfer the ownership to another party, without reward, while another party undertakes to transfer the ownership right over an asset to the first party, also without reward. This transaction qualifies as a donation only if there is a difference in the values of the mutually transferred rights.[34]

In fact, "mutual donation" implies that there are two reciprocal donations, but separate from one another.[35] They have their own grounds (*causa*) i.e. the reason for contractual obligations.[36] This is

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33 Article 808 Preliminary Draft CCRS.

34 Article 805 Preliminary Draft CCRS.

35 *De Page*, Traité élémentaire de droit civil belge (principes-doctrine-jurisprudence), Les libéralités (généralites), Les donations, Tome 8 (Vol. 1), 1962, p. 91.

36 *Causa* in Serbian contract law is the aim of contractual obligations and represents one of the key prerequisites for the validity of contracts under Serbian contract law. The rule on *causa* was included in the LO under the influence of the French Civil Code, see *Orlic*, (fn. 3), p 969. After the reform of French contract law, undertaken under the Ordonance of 10/2/2016, *causa* is no longer among the prerequisites for the validity of contracts, see *Deshayes*, La formation des contrats, Revue des contrats 2016/hors-série, p. 27. However, in the Preliminary Draft CCRS, *causa* remains a necessary prerequisite for the validity of contracts in the future Serbian law (Article 201).

why they should be treated separately with regard to the rules applicable to donations. In this situation, there are not one but two semi-gratuitous transactions (as defined in the DCFR, IV.H.-1:202).[37]

III. Intention of the Donor to Benefit the Donee

Under the DCFR, the third constitutive element of a donation is the intention of the donor to benefit the donee. This element is not included in the Preliminary Draft CCRS. At first glance, this omission may seem unusual and marks a big change in the evolution of the rules on donation in Serbian law. Namely, under the provisions of the previous Civil Code, the act of "giving something to somebody else voluntarily" without requesting or receiving any reward in return was treated as a donation.[38] This formulation was interpreted to mean that unless the intention to donate was unquestionable, it did not qualify as a donation.[39] Ever since the old Civil Code was abolished, with the old rules of law on donation still being implemented, the courts have only qualified contracts which contain the intention of the donor to benefit the donee without reward as donations. This was the case, for instance, in the Supreme Court decision which stated: "If no intention to benefit has been established, if the motive is other than donation, and the other party was aware of the motive, regardless of the fact that the motive was defined as a condition, the motive in these cases shall not be considered irrelevant."[40]

However, the omission of the intention of the donor to benefit the donee in the definition of a donation in the Preliminary Draft CCRS should not be viewed as a turning point and the end of continuity of the legislation to date. Nor should it mean that in the future the

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[37] The rule on mutual contracts in the Preliminary Draft CCRS was probably modelled on the corresponding rule in the Austrian Civil Code (Allgemeines bürgerliches Gesetzbuch für die gesammten deutschen Erbländer der Oesterreichischen Monarchie, § 942, www.ris.bka.gv.at/GeltendeFassung.wxe?Abfrage=Bundesnormen&Gesetzesnummer=10001622 (1/12/2016)).

[38] Article 561 Gradjanski zakonik za Knezevinu Srbiju.

[39] *Peric*, Karakterne osobine ugovora o poklonu, Arhiv za pravne i drustvene nauke, Belgrade 3/1924, p. 269.

[40] Rev. 3136/62 of 17/1/1963, Gz. 4260/61, Zbirka sudskih odluka u oblasti gradjanskog prava, 1972, N°272.

presence of an objective element in a contract would constitute sufficient grounds for the application of the rules on donation. Namely, the intention of the donor (debtor) to benefit the donee (creditor), had been treated in legal theory as grounds for the donor's obligation even before the LO was passed.[41] After the law came into force, Yugoslav legal theory continued to qualify this intention as a standard, institutional purpose of the contract for donation.[42] In other words, this is a legal aim which explains that the transfer of property by the donor to the donee without consideration is only binding on the donor. Apart from legal capacity, mutual consent and the object of the contract, the current general rules of the LO also define *causa* as a general, important element of the formation of any contract, including contracts without reward. The role of the intention to benefit the donee as *causa*, purpose of a contract or aim of a contract for donation is to facilitate the qualification of a contract.[43] Under the Preliminary Draft CCRS, *causa* is the constitutive element of any contract.[44] Therefore, it can be assumed that the Commission for the Civil Code Drafting, unlike the DCFR, and bearing in mind that the definition of *causa* encompasses the intention of the donor to benefit the donee, decided that it was unnecessary to emphasise it as a special element in the definition of a donation.

The intention to benefit the donee, as a subjective element of a donation, has been relativised in almost all legal systems around the world. Apart from the application of rules on donation to situations where gratuitousness is not complete (mixed donation, donation with a charge), there are also situations where a donor undertakes to transfer without the sole purpose of benefitting the donee, but also to achieve other purposes. For this reason, the DCFR contains a rule stipulating that a donor may be regarded as intending to benefit a donee notwithstanding that the donor is under a moral obligation to

41 *Konstantinovic*, Obligaciono pravo prema beleskama sa predavanja profesora Mihaila Konstantinovica, 1959, p. 45.

42 *Cigoj*, Institucije obligacij. Poseban del obligacijskega prava, Kontrakti in reparacije, 1989, p. 65.

43 *Terré*, L'influence de la volonté individuelle sur les qalifications, 2014 (édition originale 1957), p. 227.

44 Article 201 Preliminary Draft CCRS.

transfer or has a promotional purpose.[45] The assumption is that the intention to benefit the donee in these situations is not incompatible with the moral obligation of a donor towards a donee or his intention to promote new products on the market. The rules on donation in the Preliminary Draft CCRS are in this respect compatible with the DCFR rule and its purpose: that the rules on donation should be applicable to all transfers without reward, except those for which the purpose is contrary to the intention to benefit the donee. The Serbian Preliminary Draft contains notions of donation in which this intention is compatible with other purposes, such as showing appreciation for a gratuitous service (remuneratory donation), expressing gratitude for a service performed by a donee which cannot be valued in money (gratitude donation), or offering something for charitable purposes and the public good.[46]

D. Conclusion

The comparative analysis of the rules regulating donations in the Preliminary Draft CCRS and DCFR has shown that in both projects a donation arises from a contract. This is the common core of the sources of contracts for donation under the Draft and the DCFR. This core was expanded in two directions. First, the Preliminary Draft CCRS added other contracts, such as mutual agreement by a creditor and debtor that the creditor will waive the right to request performance by the debtor, while the DFCR introduced an additional source, a unilateral juridical act. Second, the Preliminary Draft CCRS expanded the application of the rules on donations to neutral legal transactions under the Preliminary Draft, such as taking over the payment of another party's debt or taking over the obligation to perform. Gratuitousness, the absence of any counter-benefit, is qualified as an objective element of a donation in both projects. The Preliminary Draft CCRS regulates mixed donations, donations with a charge, mixed, onerous and non-onerous transactions. This is in line with the DCFR which introduces the possibility of applying the rules on donations, under specific circumstances, to transactions which are not entirely gratuitous. Unlike the DCFR, the intention by a donor to benefit a donee, a

[45] DCFR, IV.H.1-203.

[46] Article 815 Preliminary Draft CCRS.

subjective element of a donation, is not explicitly stated in the Preliminary Draft CCRS. However, this does not mean that it is not required. Under Serbian law, intention is encompassed by the notion of *causa* which, under general rules of contract law, must be established in order for a contract to be valid. According to the Preliminary Draft CCRS, in the rule providing terms of remuneratory donations, gratitude donations, courtesy donations and charity donations, the intention to benefit a donee is not incompatible with other purposes of a donor. This is in line with the DCFR rule stipulating that intention is established even if a donor donated something to fulfil a moral obligation in a general sense. To conclude, the results described in this paper are demonstrative of the fact that the reform of the rules on donation in Serbian law is harmonised to a great extent, at least in terms of the definition of a donation, with the DCFR.

Non-Pecuniary Loss in Serbian Tort Law: Time for a Change in Paradigm?

Marija Karanikić Mirić[*]

Abstract

Non-pecuniary damage in Serbian law involves harm inflicted to the internal, psychological and/or emotional sphere of the injured party. This is a purely subjective concept: a mere violation of non-patrimonial rights, or violation of personal goods as objects of these rights, does not constitute moral damage, unless it has caused physical or psychological pain, or fear, to the injured person, and disturbed their mental equilibrium. The same, purely subjective, understanding of moral damage was shared by all constituent states of the former Yugoslavia. Objectivisation of moral damage is a shift in this paradigm, towards the understanding of moral damage as an infringement of a non-patrimonial right of the injured party, irrespective of any pain or fear caused by such infringement. The Croatian legislator has abandoned the enduring subjective concept of non-pecuniary damage in 2005, and reconceptualised it as an abstract violation of personal rights, including the personal rights of legal entities. The Montenegrin legislator has also moved towards a more objective conception of moral damage. Currently, the Commission appointed to draft a new civil code of Serbia is considering a change in the existing subjective model. This paper examines the reasons for such change and offers arguments in support of the idea that the Serbian legislator should decide on a mixed conception of non-pecuniary damage.

A. Introduction

Non-pecuniary (immaterial, moral) damage or loss (*dommage moral*, *préjudice moral*) may be described as a type of legally recoverable damage, which does not involve diminution of the injured party's patrimony or estate. The rules on liability for and compensation of

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non-pecuniary damage may be found in all contemporary European legal systems. They rest on the idea that an infringement of certain moral or immaterial interests merit compensation, regardless of the fact that these interests are inherently unsuitable to be measured or quantified by reference to a market price or cost. However, there are significant differences among the national provisions in this area, concerning the very notion of recoverable immaterial loss, the conditions of liability for it, and the scope of compensation the injured party is entitled to expect.

To this extent, Serbian tort law acknowledges a purely subjective concept of non-pecuniary damage.[1] The legal expression *moralna (neimovinska, nematerijalna) šteta* is used to designate a harm inflicted to the internal, psychological, emotional sphere of the injured party, irrespective of whether they have also suffered any monetary loss of wealth or expense. Both the legislator and the well-settled practice of the courts affirm that the mere infringement of non-patrimonial rights, or violation of personal goods as objects of these rights, does not constitute an instance of moral or non-pecuniary damage, unless these infringements or violations have also caused physical or psychological pain (mental suffering), or fear to the injured party, and disturbed their mental equilibrium. Moreover, a recoverable immaterial damage may exist even if none of the injured party's personal rights were violated, as in the cases of mental suffering of the injured party due to death or a particularly severe disability of their close relative.

In contrast, a purely objective notion of non-pecuniary damage is an understanding of such damage as an abstract infringement of a non-patrimonial right of the injured party, irrespective of any pain or fear caused by such infringement. It suggests that a legally recoverable immaterial loss exists where there is a violation of a personal (non-patrimonial) right, or personal good, or legally protected personal interest, regardless of whether the injured party has suffered pain or fear due to such violation.

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[1] Articles 155 and 200, Code of Obligations of Serbia, Official Gazette of the Socialist Federal Republic of Yugoslavia No. 29/78, 39/85, 45/89 and 57/89; Official Gazette of the Federal Republic of Yugoslavia No. 31/93; Official Gazette of the State Union of Serbia and Montenegro No. 1/2003 (in further text: COSer).

The same, purely subjective, understanding of non-pecuniary damage was shared by all constituent states of the former Yugoslavia.[2] However, after the dissolution of the Federation, in some of the newly formed states the legislators have abandoned the subjective paradigm, and moved toward the more or less objective conceptions of non-pecuniary loss. For instance, as of 2005, the Croatian legislator has abandoned the enduring subjective concept of non-pecuniary damage, and reconceptualized it as an abstract violation of personal rights, including personal rights of legal entities.[3] The Montenegrin legislator opted for a mixed conception of moral damage in 2008, by introducing a new type of non-pecuniary loss, in addition to the existing one. The new type of moral damage in Montenegro consists of violation of personal rights and reputation of a legal entity.[4]

Likewise, the Commission appointed by the Serbian Government in 2006 to draft a new civil code of Serbia is considering a change in the existing, purely subjective paradigm, and has thus far proposed a certain level of objectivisation of the long-standing concept of non-pecuniary damage.[5] The Commission's proposition relies heavily on the mixed conception of moral damage which was, in fact, put to the Yugoslav legislator back in 1969, but lost to the purely subjective

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2 Yugoslav Code of Obligations was enacted by the National Assembly of Socialist Federal Republic of Yugoslavia (SFRY) on 30/3/1978, and came into force six months later, on 1/10/1978. It was amended several times before dissolution of the SFRY. After dissolution of SFRY in 1992, the Code of Obligations was received into the newly formed Federal Republic of Yugoslavia (FRY) and was amended in 1993. The Code was subsequently subsumed into the laws of the member states of the State Union of Serbia and Montenegro in 2003. Following the ending of the State Union in 2006, the Code remained the main formal source of the law of obligations in the Republic of Serbia.

3 Articles 19, 1046 and 1100 Code of Obligations of Croatia, Official Gazette of the Republic of Croatia No. 35/2005, 41/2008, 125/2011 (in further text: COCro). In detail on COCro, see *Josipović/Nikšić*, Novi Zakon o obveznim odnosima i hrvatsko obvezno pravo, Evropski pravnik 4/2008, pp. 61-94.

4 Articles 149 and 207 Code of Obligations of Montenegro, Official Gazette of Montenegro No. 47/2008 (in further text: COMne).

5 Articles 85, 296, 359, 360 and 360 of the Draft Civil Code of Serbia, published in May 2015 and currently under the public debate (in further text: DraftCCS).

ideas of moral damage as physical and psychological suffering and disturbance in the injured party's mental equilibrium.[6]

Where did the mixed conception come from? The Yugoslav Code of Obligations of 1978 was modelled very closely on the Draft Code on Obligations and Contracts (*Skica za zakonik o obligacijama i ugovorima*) published in 1969 (in further text: Skica). Skica was written by *Mihailo Konstantinović* (1897-1982), professor at the University of Belgrade Faculty of Law and one of the country's most influential civil law scholars. It represents an original, well-structured and coherent system. *Konstantinović* conducted thorough comparative research, especially taking into consideration the Swiss Code of Obligations, though Skica comprises some other obvious influences, coming from German, French and Austrian codifications. He also consulted domestic legal traditions, the post-WWII practice of Yugoslav courts, the 1964 Hague Uniform Laws and other international models and sources. The proposition to combine the subjective and the objective elements of non-pecuniary loss was initially made in Skica, and has now reappeared in the Commission's proposal.

The purpose of this paper is to outline the reasons for the incoming change in Serbian law, and to offer arguments in support of the mixed conception of non-pecuniary damage, as a "minimal alteration necessary" to improve the system which has now operated for more than forty years.

B. The Present State of Affairs: The Subjective Conception of Moral Damage

I. The Existing Regime of Liability for non-pecuniary damage

Non-pecuniary damage in Serbian law includes physical and psychological pain and suffering, as well as fear, each of sufficient duration and intensity (Article 155 COSer).[7] The injured party may

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6 The Yugoslav legislator was influenced at the time by the writings of *Obren Stanković*, who thoroughly developed an entirely subjective conception of non-pecuniary damage and wrote extensively about it. His most influential work is *Stanković*, Novčana naknada neimovinske štete, 1968.

7 For a short period of time after WWII, presumably under the influence of the Soviet legal doctrine, Yugoslav legal scholars have questioned the moral, ethical and legal

claim compensation for moral damage under the rules of Serbian tort law irrespective of the grounds of the injurer's liability and, where liability of the injurer is subjective, irrespective of the degree of their fault. After finding that the circumstances of the case at hand, and particularly the duration and the intensity of the pain and fear sustained by the injured party, justify such decision, the court shall award equitable monetary compensation for the following heads of damage: (1) psychological pain (mental suffering) due to: the impairment of life activities, severe disfigurement, violation of reputation, honour, freedom or personal rights,[8] or death or severe disability of a close relative; (2) physical pain; (3) fear; irrespective of compensation for patrimonial damage, and also in the absence of any patrimonial damage (Article 200(1) COSer). In the case of death of a person, the court may award equitable compensation for psychological pain (mental suffering) to the members of the deceased's immediate family: his spouse or cohabitant; parents; children; brothers and sisters who have lived with the deceased in a shared household. In case of particularly serious disability of a person, the court may award equitable compensation for psychological pain to his spouse or cohabitant, parents and children (Article 201 COSer).

The statutory catalogue of the heads of non-pecuniary damage is understood to be exhaustive. Therefore, for instance, the courts do not consider mental suffering due to loss of an item of property to constitute a recoverable non-pecuniary damage, even if the item in

validity of awarding monetary compensation for non-pecuniary losses. In detail *Stanković*, (fn. 6), pp. 26-29. This discussion obviously ended in favour of awarding such compensation and, for several decades now, moral and ethical appropriateness of monetary compensation for pain and suffering has not been seriously challenged. Truth be told, some scholars have kept to the idea that monetary compensation for moral damage should not be allowed, because of the impossibility of assessing the pecuniary value of non-pecuniary losses. *Jakšić*, Obligaciono pravo, 1960, p. 305. More on the notion of non-pecuniary damage in Serbian law, see *Karanikić Mirić*, Part VI Remedies, in: Boone/Blanpain/Hendrickx (eds.), Serbia, IEL Tort Law, 2015, pp. 135-170.

8 It should be noted here that the infringement of personal rights does not represent a head of damage; only the psychological pain caused by such infringement stands for a legally recoverable non-pecuniary loss.

question was a piece of artwork.[9] In addition, a victim of a criminal offence against sexual freedom has a special right to equitable compensation for psychological pain.[10] In deciding on the merits of the claim, and on the amount of equitable compensation for non-pecuniary damage, the courts are bound to take into account the importance of the violated interests, the purpose of the equitable compensation for this type of loss, but are also bound to ensure that the sum awarded does not favour goals otherwise incompatible with its nature and social purpose (Article 200(2) COSer).

The courts in Serbia have repeatedly maintained that indemnity for moral damage can be awarded only if the injured party in question has actually suffered physical or psychological pain or fear of a sufficient duration and intensity. The awarded amount cannot serve its purpose of providing satisfaction to the injured party, but for the actual disturbance in their mental equilibrium. In other words, the purpose of awarding equitable compensation for non-pecuniary damage is to facilitate a recovery of the injured party's moral and psychological equilibrium, and if there was no harm to the internal balance of the party in question, there can be no justification for awarding damages.[11]

The infringement of non-patrimonial rights or legally protected interests normally affects the internal, psychological balance of their holder. However, the infringement, which had no effect on the mental equilibrium of the person in question, cannot qualify as a legally recognized and recoverable damage. In other words, if there was no pain or fear due to the infringement, it is not justified to award indemnity. There may be some other remedies at the injured party's disposal vis-à-vis the infringement of their personal rights,[12] but if there was no harm

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[9] Decision of the Supreme Court of Serbia (in further text: SCS), Rev. I 2749/2004 of 25/11/2004.

[10] Article 202 of COSer (Satisfaction in Special Cases).

[11] Conclusion of the Joint session of the Federal Court, state supreme courts and the Supreme Military Court of 15th and 16th October 1986, Bilten sudske prakse Vrhovnog suda BiH, 1/1987.

[12] For example, in cases of violation of personal rights, the court may order, at the expense of the injurer a decision of the court to be published, or published information to be corrected, or a statement of the injurer to be retracted, or another remedy by which redress may be achieved (Article 199 COSer). As this type of remedy may be

to the party's internal, psychological, emotional sphere, they will not be allowed to claim damages for pain and suffering.

The personal rights, violation of which may inflict pain and suffering to their holder, are not enumerated in COSer. The scope of protection and the behaviour reasonably required from the potential wrong-doers is left to the courts to resolve. The influence of French law, through Skica and other works of *Mihailo Konstantinović*, is obvious in this sphere. In contrast and as of relatively recently, the Croatian legislator has introduced an open statutory list of personal rights (Article 19 COCro). The Commission appointed to draft a new civil code of Serbia has considered doing something similar (Article 85 DraftCCS). Principles of European Tort Law (in further text: PETL) define damage as material or immaterial harm to a legally protected interest (Article 2:101 PETL), which is followed by an indicative, non-exhaustive list of protected interests, and detailed provisions regarding the scope of their protection (Article 2:102 PETL).[13]

Some of the personal rights enjoy express constitutional guarantees in Serbia, such as life, physical and mental integrity, human dignity, privacy, personal freedom and security and inviolability of the home.[14] However, unlike the limited *numerus clausus* of property rights, personal rights are not exhaustively enumerated: they are neither fully listed in the formal sources of law, nor is their content categorically and conclusively determined.[15] In any case, when deciding on the existence of non-pecuniary damage, the courts in Serbia only examine whether the plaintiff has suffered a legally appreciated pain or fear of sufficient duration and intensity as the consequence of the defendant's action or omission, and the plaintiff only has to substantiate the claim that he or she did, actually, experience this type of pain or fear. The plaintiff need not separately prove the underlying breach of any of his personal rights.

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pursued irrespective of whether the violation of personal right in question has resulted in pain and suffering of the injured party, it is also available to legal persons.

[13] More on this *Koziol*, Damage, in: Koch (ed.), Principles of European Tort Law, Text and Commentary, 2005, pp. 27-34.

[14] See Article 23 et seq. Constitution of the Republic of Serbia, Official Gazette of the Republic of Serbia No. 98/2006.

[15] *Vodinelić*, Građansko pravo. Uvod u građansko pravo i Opšti deo građanskog prava, 2012, p. 253.

In the assessment of moral damage, and of the appropriate equitable compensation, the principle of free evaluation of the evidence by the court applies. There are no firm rules according to which certain types of evidence are, or are not, convincing. The court has the freedom of unfettered consideration of all the evidence produced with regard to the existence and the extent of non-patrimonial damage. In spite of this, the assessment is quite mechanical. The official guidelines exist, as to the amount of equitable damages, depending on the intensity and duration of pain and fear. More precisely, there is a document called *approximate criteria for determining equitable compensation for non-patrimonial damage*, adopted by the Civil Chamber of the Supreme Court of Serbia on 8 February 1999. The document contains an outline of the recommended approximate amounts of the highest compensation for different types of non-pecuniary damage. The recommended sums are regularly adjusted to the consumer price index, which measures changes in the price level of a market basket of consumer goods and services purchased by households.[16] The lower courts are not bound to abide by these criteria. However, they do award damages within the recommended sums, with the hope that such decisions will be confirmed on appeal.

II. The Implications of the Existing Rules

A number of theoretically and practically significant consequences derive from the persistent adherence to the purely subjective notion of non-pecuniary damage. First of all, the claims for compensation of non-pecuniary damage may generally not be inherited unless they are settled by a written agreement between the parties, or confirmed by a non-appealable court decision. However, if the claim is settled in writing, or awarded by a court, then the heirs succeed in a contractual right of the deceased, or in his right to enforce a decision of a court,

[16] Just as an illustration: On 30/4/2015, these amounts (expressed in euros) were *for physical pain* (strong 7.376, medium 3.688, slight 1.229); *for fear* (strong 4.917, medium 2.459, slight 615); *for different types of recoverable psychological pain due to* absolute reduction of general lifetime activities 24.590, disfigurement (very severe 12.294, grave 7.376, medium 3.688, slight 1.229), death of a close person (to parent 8.605, to child 8.605, to spouse or co-habitant 6.146, to brother/sister 4.917), severe disability of a close person (to parent 4.917, to child 4.917, to spouse 3.688), injury to reputation and honor (via media 6.147-12.294, in other ways 1.229-6.147).

and not in his claim for compensation of moral damage. Furthermore, the claims for damages can be subject to cession, offsetting and forced execution under the same conditions, i.e. if they are settled by a written agreement, or confirmed by a non-appealable court decision.[17] The main argument for this is purposive: The objective of awarding compensation for physical or psychological pain, or fear, is to restore the injured person's moral and emotional equilibrium, that is, to provide them with the pecuniary resources which will allow them to acquire some source of pleasure or enjoyment of their choice, in order to alleviate to some extent the irreparable non-pecuniary loss. This is not possible if the sum is awarded to someone else and not to the injured person. The Commission appointed to draft a new civil code for Serbia considers whether to (a) eliminate the existing provisions, and introduce the rule on general inheritability and transferability of the claims for compensation of non-pecuniary damage; or, (b) abandon the request that the claim for compensation should be settled *in writing*, and to prescribe that the claims are inheritable and transferable from the time the injured person has initiated the legal proceedings.[18]

Secondly, the purely subjective conception of liability for non-pecuniary damage cancels the possibility of a legal entity suffering this type of loss.[19] The courts in Serbia are firm and persistent in their understanding that a legal entity cannot claim compensation for moral damage.[20] An injury to reputation of a legal person does not

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[17] Article 204 COSer.

[18] Article 365 DraftCCS. For more on the origins and the *rationale* of the existing rules, and the arguments in favor of unrestricted inheritability of claims for compensation of moral damage, see *Karanikić Mirić*, Nasledivost prava na naknadu moralne štete, Pravni život 5-6/2015, pp. 37-56.

[19] Some scholars maintain this should not be regarded as a problem. For example, *Carbonnier*, Droit civil, Tome 2, Les biens, Les obligations, 2004, p. 2273, insists on a penal character of awarding compensation for moral damage to a legal person as a collective entity. He labels non-pecuniary damage suffered by a legal person as *fantasme de fantômes*, a ghosts' fantasy.

[20] Legal position of the Civil Chamber of SCS of 5/2/2001: Legal persons are not entitled to monetary compensation for violation of their business reputation, since this is not a legally recognized and recoverable loss. The Court does not question the right of everyone to advocate legal recognition of such a new head of damage. However, the Court maintains that it is hard to find arguments in science and in life to support this idea.

constitute a legally recognized and recoverable type of non-pecuniary loss, as there can be no legally relevant mental suffering caused by it. Therefore, legal entities are not entitled to equitable compensation for moral damage.[21] This is not to say that the reputation of a legal person does not represent a legally protected interest. On the contrary, it is regarded as an object of non-patrimonial right, and in case of infringement of a non-patrimonial right of either a natural or legal person, the court may order, at the expense of the injurer, a decision of the court to be published, or published information to be corrected, or a statement of the injurer to be retracted, or another remedy[22] by which the purpose of the redress may be achieved.[23] The Commission is considering whether, in the prospective civil codification, the right of a legal entity to equitable compensation of non-pecuniary damage in case of violation of its reputation or any other non-patrimonial right deriving from its legal personality is warranted.[24]

Thirdly, where the non-pecuniary damage is understood as psychological pain, or physical pain, or fear, which were actually sustained by the injured person, indemnity may be sought only by a natural person having a capacity for this type of suffering.[25] As a result, the question of existence and provability of mental suffering emerges in the cases in which the injured party lost consciousness; experienced a prolonged or definite coma; ended up in vegetative state; or was simply sedated by medications and presumably unable to experience

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[21] Decision of SCS, Rev. 611/2001 of 25/12/2002: An infringement of business repute-tion of a legal person represents, indeed, an instance of violation of a legally protected non-pecuniary interest. However, it does not qualify as a category of loss for which compensation can be legally claimed.

[22] For instance, the court may order the text worded by the plaintiff to be published in the media at the expense of the defendant. Judgement of SCS, Rev. 229/2004/2 of 21/4/2004.

[23] Article 199 COSer.

[24] Article 361 DraftCCS.

[25] For a critical view of the practice of the Swiss Tribunal fédéral of awarding compensation for physical pain to a young girl unable to experience any suffering due to a permanent brain injury, with the obvious intention of easing the pain of her close relatives, see *Werro*, in: Thévenoz/Werro (eds.), Code des obligations I, Articles 1-529 CO, 2003, Article 47 COSwiss, para. 5. The Swiss courts now recognize, under Article 49 COSwiss, a direct personal claim of a victim's close relative in this type of situations, see ibid., Article 49 COSwiss, para. 9 et seq.

pain and fear. For instance, the courts maintain that full awareness of the injured party is necessary for experiencing fear. Where the plaintiff loses consciousness due to brain injury, and afterwards has no recollection of the injurious event, he cannot claim compensation for fear.[26] Besides, a person's capability to experience pain and fear may depend on their age, maturity, and general ability to understand the difficulties of the human condition they are now in. In addition, the question may arise as to an unborn child's ability to sustain psychological pain, for instance, due to their father's death or serious disability. Moreover, the fact that the injured person will realise, once they have regained consciousness, that they have lost a certain number of days, months or even years of their life, will undisputedly upset their psychological equilibrium. However, this type of mental suffering does not represent a legally recognized and recoverable kind of moral damage in Serbian law.[27] The courts try to reconcile these situations and similar cases through a broader interpretation of statutory rules, when reasonably possible. For instance, a newborn will have a right to compensation for the future psychological pain caused by the death of a very close relative, as it is evident that with maturity they will acquire the ability to experience such pain.[28] However, the awarded compensation will not deal with moral damage as of the time of the injurious event, but only with the prospective non-pecuniary loss as of the time the child presumably truly comprehends the situation.

C. The Proposed Change in Paradigm

I. The Mixed Conception of Non-Pecuniary Loss

The Commission appointed to draft a new civil codification for Serbia is considering abandoning the long-standing subjective conception of non-pecuniary damage, and returning to the mixed conception, which was put to the Yugoslav legislator back in 1969, but was eventually rejected. Namely, the recently proposed Article 296 of

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[26] Judgment of the Regional Court in Valjevo, Gž. 1259/2007(1) of 13/11/2007.

[27] *Medić*, Značaj vještačenja u parnicama za naknadu nematerijalne štete, Vještak 1/2014, p. 19 et seq.

[28] Conclusion of the Joint session of the Federal Court, (fn. 11).

the Draft CCS corresponds to Article 124 of Skica, and defines moral or non-pecuniary damage as (1) the infringement of a personal right, such as the right to life, health and bodily integrity, right to human dignity, freedom, honour and reputation, privacy, personal and family peace, or any other personal right guaranteed under the Code, as well as (2) the infliction of psychological or physical pain.[29] An open catalogue of personal rights is proposed in Article 85 Draft CCS, and includes the rights to life, health and bodily integrity; freedom; honour and reputation; name; personal integrity; personal image and voice; secrecy of correspondence; private life; psychological integrity; as well as other personal rights guaranteed under the Constitution, international conventions and national laws.

The conception is mixed in the sense that it assigns relevance to both the subjective and objective understanding of non-pecuniary loss. Namely, under this point of view, moral damage may manifest itself as a mere violation of a personal right of the injured party, irrespective of whether any pain and suffering was in fact caused by such violation; but also as an instance of actual pain and suffering caused by the injurer's conduct. The Commission here revisited the ideas of *Mihailo Konstantinović*,[30] which he ultimately embedded in Article 124 of Skica. Still, *Konstantinović* was not the only scholar to propose a mixed conception of moral damage. For instance, *Carbonnier* understands non-pecuniary damage as a violation of a personal non-pecuniary right, such as the right to name, image, honour and the like. However, his notion of non-pecuniary damage also includes violation of certain moral interests or sentiments, which are not considered objects of any of the named personal non-patrimonial rights.[31]

The Montenegrin legislator has also opted for a mixed conception of non-pecuniary damage, but the intervention was truly minimal, only including the infringement of personal rights and reputation of legal entities in an otherwise purely subjective notion of non-patrimonial loss (Article 149 COMne).

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[29] Fear is excluded from the heads of non-pecuniary damage under Article 296 DraftCCS. Presumably it should be subsumed by the notion of psychological pain.

[30] *Konstantinović*, Beleške s predavanja, 1969, p. 84 et seq.

[31] *Carbonnier*, (fn. 19), p. 2272 et seq.

In contrast, the legislative intervention in Croatia in 2008 was substantial and marked a genuine change in paradigm:[32] The non-pecuniary damage is defined as an infringement of a personal right (Article 1046 COCro). The personal rights are itemised so as to include the right to life, physical and mental health, reputation, honour, dignity, name, inviolability of personal and family life, freedom, and the like (Article 19 COCro). The same personal rights are guaranteed to legal entities, except for those rights, which are inherently attached to the biological existence of natural persons. The legislator explicitly affirms the rights of legal persons to reputation, honour, name, trade secrets and freedom of commercial activity. Neither pain nor fear represent instances of moral damage. The psychological pain, physical pain or fear actually suffered are not the occurrences of non-pecuniary damage *per se*. They are understood as criteria or measures for determining the gravity of the infringement of the personal right in question. In other words, pain and fear are among the factors that should influence the amount of the awarded compensation (Article 1100(2) COCro).[33] For the purpose of ascertaining the severity of violation of the personal right at hand, the court may take into account every pain and fear of sufficient intensity and duration, and not only the pain or fear originating from a statutory catalogue of legally relevant causes of distress.[34]

II. The Reasons for Change

Radolović has argued that the subjective concept of moral damage originated in the Yugoslav political-ideological totalitarianism, which prevented the Croatian legislator from fully appreciating and protecting personal rights. He explains the recent shift in the long-lasting subjective paradigm, i.e. the reconceptualization of non-patrimonial damage, as an effort to restore Croatia to a community of civilized

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32 In detail *Baretić*, Pojam i funkcije neimovinske štete prema novom Zakonu o obveznim odnosima, Zbornik Pravnog fakulteta u Zagrebu, Vol. 56, 2006, pp. 464-471.

33 *Klarić/Vedriš*, Građansko pravo, 2006, p. 591. Some authors have criticised this as an unwelcome yielding to the subjective concept of non-patrimonial damage. *Radolović*, Pravo osobnosti u novom Zakonu o obveznim odnosima, Zbornik Pravnog fakulteta Sveučilišta u Rijeci 1/2006, p. 158.

34 *Baretić*, (fn. 32), p. 475.

and democratic nations.[35] However, the purely subjective conception of non-pecuniary damage represents neither a product, nor a distinctive feature of totalitarian systems. The same goes for the subjective elements in a mixed conception of non-patrimonial damage. For instance, in Swiss legal doctrine, *Tercier* defines moral damage (*le tort moral*, *der immateriale Unbil*, *il torto morale*) as physical or psychological suffering experienced by the one whose personality has been infringed.[36] *Engel* writes about the distress that the injurer's wrongful behavior can inflict upon the psychological sphere of the injured party; about the shame, grief, worries and anxiety the injured party may suffer due to the infringement of their honour and reputation.[37] French authors introduce the notion of moral estate (*le patrimoine moral*), which comprises non-pecuniary, personal goods and interests of a person, and has both a societal and an emotive side. The infringement of the emotive side of moral patrimony represents a type of non-pecuniary damage, which manifests itself solely in the injured party's intimate sphere, for instance, as mental anguish caused by death of a close person.[38] The idea of non-pecuniary damage as mental suffering is an old legal construction, which cannot be attributed to the potential totalitarianism of the legal orders in which it was developed or received. Moreover, adherence to the purely subjective notion of non-pecuniary damage does not by itself exclude the possibility of introducing other legal remedies against the infringement of personal rights. And, even where there is a systemic disregard for the protection of personal rights, which coincides with the pain and fear being prescribed as heads of damage, such disregard cannot be attributed to the prevailing understanding of non-pecuniary loss.

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35 *Radolović*, (fn. 33), p. 131.

36 *Tercier*, Le droit des obligations, 2009, pp. 252 and 378. See also *Werro*, (fn. 25), Article 41 COSwiss, para. 9 and Intro Articles 47-49 COSwiss, para. 1.

37 *Engel*, Traité des obligations en droit suisse, 1997, p. 523.

38 *Mazeaud/Chabas*, Obligations: théorie générale, 9th ed. 1998, p. 422 et seq. For the critique of the notion of moral patrimony see *Krneta*, Pitanje mjesta ličnih prava u sistemu građanskog prava, in: Odabrane teme privatnog prava, 2007, p. 261. The French Cour de cassation acknowledged *praeter legem* a claim for compensation of moral damage for the first time in 1833, and has since adhered to a very broad understanding of the legally recoverable non-pecuniary loss. *Galand-Carval*, Non-Pecuniary Loss Under French Law, in: Rogers (ed.), Damages for Non-Pecuniary Loss in a Comparative Perspective, 2001, p. 88.

Keeping all this in mind, the reasons for the repositioning towards a more objective understanding of moral damage should be sought in the above explicated theoretical and practical obstacles commonly generated by the purely subjective conception. As mentioned earlier, within the purely subjective conception of non-pecuniary damage: (1) the questions arise as to the capability for a legal person to suffer this type of loss; (2) compensation may be sought only by those natural persons who are in fact able to experience pain and suffering, which excludes the injured persons in a state of unconsciousness, or those sedated or medicated; (3) transferability of claims for compensation of such moral damage is harder to justify.

III. The Optimal Change for Serbia

With respect to the degree of objectivisation of moral damage, the Commission appointed to draft a new civil code for Serbia has opted for a mixed conception. The new Montenegrin norm introduces the objective conception of the non-pecuniary damage sustained by legal entities, but remains faithful to the subjective conception of the non-pecuniary losses suffered by natural persons (Article 149 COMne). In contrast, the Commission intends to allow non-pecuniary damage to manifest itself as (a) an instance of the actual physical or psychological pain caused by the injurer's conduct, but also as (b) a mere violation of a personal right of the injured party, irrespective of whether any pain and suffering was, in fact, caused by such a violation. The latter possibility relates to both legal and natural persons: the violation of personal rights of natural persons is recognized as a head of damage as well. Furthermore, unlike the Croatian legislator, the Commission has reservations regarding the purely objective conception of non-pecuniary loss. While the Croatian legislator has reduced the significance of physical and psychological pain and fear through the criteria or the measures for determining the gravity of infringement of the personal right in question, the Commission retains physical and psychological pain as possible heads of non-pecuniary damage.

What could be the reasons for this more moderate approach? The background of the mixed conception is presumably familiar to judges, scholars and legal professionals in Serbia. The mixed concept was inspired by Skica, which has been studied and analysed since 1969. A smoother acceptance of the change in the existing rules can be reason-

ably expected, if the legislator opts for a familiar solution.[39] Moreover, the proposed moderate alteration would be sufficient for correcting the existing encumbrances of the system, which has now operated for more than forty years. The statutory rules on liability in tort belong to the very core of civil law, and should not be changed lightly or excessively. It seems reasonable to only make those changes that are evidently needed, and to opt for recognizable concepts, when possible. What the Commission proposes is to adhere to the existing concept of non-pecuniary loss, but also to allow for a violation of personal rights to be recognized as a type of moral damage, regardless of any pain resulting from such infringement. This is clearly not the most elegant solution in terms of legal dogmatics, but it is minimal, pragmatic and sufficient to answer all the difficulties that have been raised so far in Serbian legal theory and practice with regard to the long-standing subjective conception of non-pecuniary loss.

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[39] Some authors report the reluctance of the courts in Croatia to accept the new concept of non-pecuniary damage, and blame it on the fact that such acceptance requires an intellectual effort. *Ćurković*, Predgovor, in: Hercigonja/Kuzmić/Šumelj (eds.), Naknada neimovinske štete – Nove hrvatske orijentacijske medicinske tablice za procjenu oštećenja zdravlja, 2010, p. 1.

Gender Equality Framework in the Republic of Serbia

Ivana Krstić[*]

Abstract

This paper analyses the existing gender equality framework in the Republic of Serbia. Two pieces of legislation are in the focus of the author – the Law on the Prohibition of Discrimination and the Law on Gender Equality, both adopted in 2009. The author claims that these laws mostly comply with international and European standards, but some further improvements are necessary in order to fully get in line with the acquis communautaire. Also, the author claims that the implementation of gender equality framework is still inadequate and requires adoption of further supporting measures in order to combat gender inequality, to tackle gender stereotypes, and to secure equal participation of women in the labour market. Some most typical situations that reflect gender inequality were presented in the paper through the opinions of the Commissioner for the Protection of Equality, an independent body with range of preventive and protecting mechanisms. The author concludes that positive action measures can further support achievement of gender equality, especially in the area of employment, but they must be carefully measured in order to be in accordance with the jurisprudence of the CJEU.

A. Introduction

Equality and non-discrimination are complex concepts that cause discussion regarding their definition and justification.[1] Yet, it can be simply said that the principle of equality means that those who are in equal or similar situations should be treated equally, while those who are in different situations should be treated differently.[2] In other

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1 *McCrudden/Prechal*, The Concepts of Equality and Non-Discrimination in Europe: A practical approach, 2009, p. 1.

2 CJEU, case 106/83, *Sermide SpA*, ECLI:EU:C:1984:394, para. 28. See also, Opinion of AG *Van Gerven* to CJEU, case C-146/91, *Koinopraxia*, ECLI:EU:C:1994:329.

words, it is not permitted to discriminate against someone, based on his/her personal characteristics, unless such discriminatory treatment can be considered as justified.[3]

The prohibition of discrimination is prescribed in many international instruments.[4] The principle that everyone is equal before the law is also one of the general principles of EU law.[5] Moreover, sex/gender equality has been the central and most developed area of social policy in the EU.[6] The CJEU acknowledged in many cases that the general principle of equal treatment between men and women is fundamental to the Community's legal order.[7] Sex equality was proclaimed in the Treaty of Rome in 1957, when the policy was focused on discrimination in employment, but later was widened to include other measures to ensure social progress between the two sexes.[8] Today, the most important directive on sex equality is the Recast Directive 2006/54/EC.[9]

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[3] Objective justification test for discrimination is a proportionate manner of achieving a legitimate aim. See CJEU, case C-189/01, *Jippes*, ECLI:EU:C:2001:420, para. 129; CJEU, case C-149/96, *Portugal v. Council*, ECLI:EU:C:1999:574, para. 91; CJEU, case C-411/98, *Angelo Ferlini*, ECLI:EU:C:2000:530, para. 59.

[4] The most important sources on the prohibition of discrimination are enshrined in the International Covenant on Civil and Political Rights (Articles 2 and 26), the Convention on the Elimination of All forms of Discrimination against Women (Articles 1 and 2), the International Convention on the Elimination of all forms of Racial Discrimination (Articles 1 and 2), as well as in the European Convention on Human Rights (Article 14 and Article 1 of the Protocol No. 12).

[5] This principle has been recognized in many cases. See CJEU, joined cases 117/76 and 16/77, *Ruckdeschel*, ECLI:EU:C:1977:160, para. 7; CJEU, case 283/83, *Racke*, ECLI:EU:C:1984:344; CJEU, case C-15/95, *EARL*, ECLI:EU:C:1997:196, para. 35; CJEU, case C-292/97, *Karlson*, ECLI:EU:C:2000:202, para. 38.

[6] *Etinski/Krstic*, EU Law on the Elimination of Discrimination, 2009, p. 209.

[7] CJEU, case C-13/94, *P. v. S.*, ECLI:EU:C:1996:170. Also, the ECtHR concluded in *Abdulazis, Cabales and Balkandali v. UK* that "the advancement of the equality of the sexes is today a major goal in the member states of the Council of Europe. This means that very weighty reasons would have be regarded as compatible with the Convention." See ECtHR, no. 9214/80, 9473/81, 9474/81, *Abdulazis, Cabales and Balkandali v. UK*, judgment of 28/5/1985, para. 78.

[8] *Etinski/Krstic*, (fn. 6), p. 209.

[9] Directive 2006/54/EC on the implementation of the principle of equal opportunities and equal treatment of men and women in matters of employment and occupation (recast), OJ L 204 of 26/7/2006, p. 23.

After the dissolution of the Social Federal Republic of Yugoslavia in 1991, the legal reform process was initiated in Serbia in many areas of law in order to bring national legislation and practice into line with international and European standards. Serbia has adopted a general anti-discrimination law, as well as a special gender equality law, which mostly comply with European standards. However, despite these major legal changes, the progress in respect to gender equality is still unsatisfactory, mainly as a consequence of slow changes in attitudes, stereotypes and prejudices that are still present in the society. Therefore, this paper indicates that gender equality law is mostly in line with the *acquis communautaire,* but some further improvements are necessary in order to fully get in line with EU standards. Also, the implementation of the gender equality framework is still inadequate and requires adoption of further supporting measures in order to combat gender inequality, to tackle gender stereotypes in relation to expected parental roles, and to secure equal participation of women in the labour market.

B. The Gender Equality Framework in Serbia

I. Constitutional provisions

The Serbian Constitution contains several provisions of relevance for gender discrimination. Article 21(3) contains a general anti-discrimination clause, prohibiting any direct or indirect discrimination based on sex, but as an open clause it also covers gender.[10] The Constitution even proclaims gender equality as one of the constitutional principles and states: "The State shall guarantee the equality of women and men and develop equal opportunities policy".[11]

It also guarantees special protection of women at work and special work conditions.[12] The Constitution stipulates that contracting, duration or dissolution of marriage is based on the equality of man and woman.[13] Moreover, it guarantees the freedom for everyone to

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[10] Constitution, Official Gazette of the Republic of Serbia No. 98/2006 of 10/11/2006, www.srbija.gov.rs/cinjenice_o_srbiji/ustav.php?change_lang=en (1/12/2016).

[11] Article 15 of the Constitution.

[12] Article 60(5) of the Constitution.

[13] Article 62(2) and (3) of the Constitution.

decide whether they shall procreate or not.[14] The Serbian Constitution prescribes special protection to mothers and single parents, as well as special support and protection to mothers before and after childbirth.[15] It also recognizes positive action measures and stipulates in Article 21(4) that the special measures may be introduced with the aim of achieving full equality of individuals or group of individuals in a substantially unequal position compared to other citizens. However, this provision lacks the temporal restriction, which is necessary for the assessment of the proportionality of positive measures.[16] Also, there are some other important provisions contained in the Constitution that do not include sex/gender.[17] The most important is Article 48 that proclaims the respect of diversity. This article prescribes that the State shall "promote understanding, recognition and respect of diversity arising from specific ethnic, cultural, linguistic or religious identity of its citizens through measures applied in education, culture and public information" but does not mention sex and gender identity.

II. General Anti-Discrimination Law

Constitutional provisions are further elaborated in anti-discrimination laws. In 2009, Serbia introduced the Law on the Prohibition of Discrimination.[18] The Law contains a long list of prohibited grounds,

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[14] Article 63(1) of the Constitution.

[15] Article 66(1) and (2) of the Constitution.

[16] Its predecessor, the Charter of Human and Minority Rights and Civil Liberties of the State union Serbia and Montenegro from 2003 (which was a composite part of the Constitutional Charter), in its Article 3(4) allowed the introduction of special interim measures necessary for the realization of equality, and in para. 5 proclaimed that these measures can apply only until their purpose is achieved. See The Charter of Human and Minority Rights and Civil Liberties of the State union Serbia and Montenegro, Official Gazette of the Republic of Serbia and Montenegro No. 06/2003 of 29/1/2003.

[17] *Vujadinovic*, Gender Mainstreaming in Law and Legal Education, Annals of the Faculty of Law, vol. 63, 3/2015, p. 66; *Vujadinovic*, Country Report on Legal Perspectives of Gender Equality in Serbia, Legal Perspectives of Gender Equality in South East Europe, 2012, p. 61.

[18] Law on the Prohibition of Discrimination, Official Gazette of the Republic of Serbia No. 22/2009 of 30/3/2009, http://ravnopravnost.gov.rs/en/legislation/republic-of-serbia-legislation/ (1/12/2016). For more on the implementation of this Law see *Krstic*, Legal Protection against Discrimination in Serbia, in: Kola-Tafaj (ed.), Legal Protection against Discrimination in South East Europe: Regional Study, 2016, pp. 401-437.

including sex and gender identity.[19] The Law also regulates the special cases of discrimination, including discrimination on the grounds of gender. Thus, it stipulates that discrimination of men and women is prohibited in political, economic, cultural, or other aspects of public, professional, private and family life.[20] It also prohibits discrimination based on gender or gender change, as well physical violence, exploi-tation, hatred, disparagement, blackmail and harassment based on gender.[21] Finally, it prohibits public advocating, support and practice conduct in keeping with prejudices, customs and other social models of behavior that are based on stereotypical gender roles.[22] Thus, it underlines the importance of tackling all theories supporting superi-ority of one sex over another, which is an obligation recognized in Article 5 of the UN Convention on the Elimination of all Forms of Discrimination against Women. This Law also recognizes positive measures in Article 14 stating that „measures introduced for the purpose of achieving full equality, protection and progress of an individual or a group of persons in an unequal position shall not be considered to constitute discrimination." The wording of this provision was changed from a draft law in a final version, and the word "temporary" was deleted. This solution is inadequate, especially bearing in mind that the constitutional provision does also not explicitly mention temporariness of positive measures. Some other deficiencies are also identified in the European Commission's progress report on Serbia, which need to be addressed in order to secure full compliance with European standards.[23]

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[19] This long list of prohibited grounds is criticized by some, as it may bring a range of unintended scenarios which may destabilize the effectiveness of the LPD. See, e.g. OSCE/ODIHR Comments on the Draft Law on Prohibition of Discrimination Law of the Republic of Serbia, 2009, para. 10.

[20] Article 20(1) of the Law on the Prohibition of Discrimination.

[21] Article 20(2) of the Law on the Prohibition of Discrimination.

[22] Article 20(2) of the Law on the Prohibition of Discrimination.

[23] This alignment is necessary in terms of the scope of exceptions from the principle of equal treatment, the definition of indirect discrimination and the obligation to ensure reasonable accommodation for employees with disabilities. See European Commission, Serbia 2015 Report, SWD (2015) 211 final of 10/11/2015, http://ec.europa.eu/enlargement/pdf/key_documents/2015/20151110_report_serbia.pdf (1/12/2016), p. 56.

III. The Law on Gender Equality

Several months after the adoption of the general anti-discrimination law, the Law on Gender Equality was adopted with the aim of establishing equal opportunities for both sexes in all areas of social life.[24] The Law defines the terms "sex" and "gender".[25] It also defines direct discrimination, which has a limited application to public authorities, the employer and the provider of services, as well as indirect discrimination, which does not use the wording in the relevant EU directives and does not contain a proportionality test.[26] Moreover, the Law also defines gender-based violence, harassment, sexual harassment and sexual blackmail in line with EU directives, but does not contain any provision on instruction to discriminate.[27] Also, it is important to mention that the definition of discrimination does not include associative and assumed discrimination, although they are explicitly mentioned in the Law on the Prohibition of Discrimination.[28]

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[24] Law on Gender Equality, Official Gazette of the Republic of Serbia No. 104/2009 of 16/12/2009, www.legislationline.org/documents/action/popup/id/16015 (1/12/2016).

[25] According to Article 10(1) and (2), sex relates to the biological features of a person, while gender means "socially established roles, position and status of women and men in public and private lives out of which, due to social, cultural and historic differences, discrimination ensues on the basis of biologically belonging to a sex."

[26] *Krstic*, Country Report on Gender Equality, in: European Commission (ed.), Country Report for Serbia 2016, www.equalitylaw.eu/downloads/3801-2016-serbia-country-report-gender-pdf-1-19-mb (1/12/2016).

[27] All EU directives, including the Recast directive 2006/54/EC, recognize as a form of discrimination instruction to discriminate. It means that the law is also concerned with those who are vicariously liable for the actions of those who are directly involved in the discriminatory conduct. See *Schiek/Waddington/Bell*, Cases, Materials and Text on National, Supranational and International Non-Discrimination Law, 2007, p. 561.

[28] Associative discrimination exists when someone is treated unfavourably on the basis of another person's protected characteristic. See Understanding discrimination by association and perception, www.acas.org.uk/index.aspx?articleid=5362 (1/12/2016). Assumed discrimination exists when discriminatory treatment is based on an assumption about another person, which may or may not be factually correct. See European Network of Legal Experts in gender-equality and non-discrimination, A comparative analyses of non-discrimination law in Europe, 2015, http://ec.europa.eu/justice/discrimination/files/comparative_analysis_nd__2015.pdf (1/12/2016), p. 37.

Article 7 expressly allows positive measures in order to eliminate and prevent the unequal status of women and men and accomplish equal opportunities of both sexes. Importantly, this is the first legal document that prescribes that special measures are of a provisional nature.[29]

The major area, and the focus of this Law, is employment, although there are important provisions that prohibit discrimination in the Labour Law.[30] Thus, according to the Law on Gender Equality, employers are obliged to provide equal opportunities and equal treatment to all employees; they can introduce special measures to increase the participation of the less represented sex, and must keep records on the gender structure of their employees. However, it is unclear whether this provision goes beyond the principle established in the CJEU case-law, as it must be carefully reviewed.[31]

Under Article 13, employers employing more than 50 employees have to adopt a plan for prevention of uneven gender representation among employees, and the plan must be submitted to the ministry in charge of issues concerning gender equality. The Law also recognizes special measures to eliminate gender-based discrimination and the legal protection of those subject to discrimination.[32] Thus, if the less

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29 Article 10(3) of the Law on Gender Equality.

30 Of particular importance are Articles 18 to 21 that define discrimination, prohibit direct and indirect discrimination, determine the scope of application in the area of employment, and prohibit harassment and sexual harassment. Labour Law, Official Gazette of the Republic of Serbia Nos. 24/2005, 61/2005, 54/2009, 32/2013, 75/2014 of 15/3/2005, www.paragraf.rs/propisi/the_labour_law.html (1/12/2016).

31 In several cases, the CJEU was supposed to rule on whether certain provisions of the national law containing binding targets for increasing the proportion of women in sectors of public employment where they were under-represented, could be interpreted so as to be consistent with the Equal Treatment Directive (Council Directive 76/207/EEC, OJ L 39 of 14/12/1976, p. 40). When this question was referred to the CJEU for the first time in *Kalanke* in 1995, the CJEU held that since positive action had become an exception to the general principle of equality, it had to be interpreted restrictively, CJEU, case C-450/93, *Kalanke*, ECLI:EU:C:1995:322. See also CJEU, case C-409/95, *Marshall*, ECLI:EU:C:1997:533; CJEU, case C-158/97, *Badeck*, ECLI:EU:C:2000:163; CJEU, case C-407/98, *Ambrahamsson*, ECLI:EU:C:2000:367; and CJEU, case C-476/99, *Lommers*, ECLI:EU:C:2002:183.

32 Articles 7 and 8 of the Law on Gender Equality. Civil protection is prescribed in Articles 43 to 51 of the Law on Gender Equality.

represented sex in an organizational unit at managing positions and within the management and supervisory bodies is under 30 %, the public power authorities should implement positive measures to correct this. Also, under the Law, trade unions and employers' associations must be represented by at least 30 % of the members of the less represented gender, during the formation of negotiation committees.[33] The Law also prescribes that pregnancy and parenthood cannot be a reason for dismissal from work, or an obstacle to professional improvement or advancement.[34] The Labour Law is more concrete and stipulates that an employer cannot cancel the employment contract of an employee in the course of pregnancy, maternity leave, leave for nursing a child and leave for special care of a child.[35] In addition, it prescribes more favourable provisions in relation to the duration of parental leave for the care of a seriously ill child and a child with a disability than the EU law.[36]

However, pregnancy and maternity discrimination are not explicitly prohibited as a form of direct sex discrimination. In practice, there is still a significant gap between two sexes in the workforce due to traditional parental roles. The Gender Equality Index showed that women are less frequently employed in full-time equivalent jobs than men, they work with flexible working hours less frequently than men, and there is a need to introduce more complex measures in order to minimize market segregation and improve quality of work that enables reconciliation between work and family life.[37] As women are often paid less than their male co-workers, Article 17 stipulates the right to

[33] The National Strategy for Gender Equality stresses the importance of including measures to ensure unionization of women employees, to support women's sections in trade unions and to ensure their active and equal participation in collective bargaining; see http://socijalnoukljucivanje.gov.rs/en/the-national-strategy-for-gender-equality-until-2020-adopted/ (1/12/2016).

[34] Article 16 of the Law on Gender Equality.

[35] Article 187 of the Labour Law.

[36] See Articles 94 to 100 of the Labour Law.

[37] *Babovic*, Gender Equality Index 2016, Measuring Gender Equality in Serbia 2014, Coordination Body for Gender Equality, Social Inclusion and Poverty Reduction Unit, 2016, p. 25.

equal remuneration for the same work or work of equal value.[38] Nevertheless, this provision does not require transparency in wages, which significantly limits the possibility to submit claims to the court.

The Law also prohibits discrimination in relation to health and social care. Moreover, the Law prohibits discrimination based on family and marital status and prescribes special programs and measures for victims of domestic violence that envisage provision of shelters, social, legal and other assistance, and compensation to victims of violence.[39] Finally, the Law prohibits gender discrimination in relation to culture, sports, as well as in political and public life.[40] Moreover, Article 31(1) underlines that gender equality education is "an integral part of pre-school, primary, secondary and university education, as well as an integral part of permanent education".[41]

It further prescribes that special attention is given to teaching curricula and the syllabuses, in order to tackle gender-based roles and liberation from gender-based stereotypes and prejudices.[42] It is of particular importance that the Law prescribes a special procedure for

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38 The Action Plan for the Implementation of the Strategy for Prevention and Protection against Discrimination for the period 2014-2018 requires further elaboration of the principle of equal pay for men and women and the introduction of sanctions for acting contrary to this principle. See Action Plan for the Implementation of the Strategy for Prevention and Protection against Discrimination, Official Gazette of the Republic of Serbia No. 107/2014 of 8/10/2014, www.ljudskaprava.gov.rs/images/pdf/propisi_i_strategije/Akcioni_plan_-_engleski.pdf (1/12/2016), p. 62.

39 Family Law introduced several important measures in order to combat domestic violence as those measures are not prescribed in the Law on Gender Equality. Family Law, Official Gazette of the Republic of Serbia No. 18/2005 of 24/2/2005, http://minoritycentre.org/library/family-act-serbia (17/11/2016).

40 Articles 30 to 42 of the Law on Gender Equality.

41 On the importance of education for women and their gradual entry into public life see *Vujadinovic*, Perspektive rodne ravnopravnosti u sferi prava – slučaj Srbije (Perspectives of Gender Equality in the area of Law – case of Serbia), in: Lilic (ed.), Perspektive implementacije evropskih standarda u pravni sistem Srbije, 2012; *Vujadinovic*, Rod i pravna regulative (Gender and Legal Regulations), in: Lilic (ed.), Perspektive implementacije evropskih standarda u pravni sistem Srbije, 2013.

42 Article 31(2) of the Law on Gender Equality.

civil protection from gender discrimination.[43] But it should be emphasized that this procedure has not been used in practice thus far.

Although this Law is mostly in line with the *acquis communautaire*, some further improvements are expected to be included in a new Gender Equality Law.

C. The Monitoring of Gender Equality

I. The Commissioner for the Protection of Equality (CPE)

The institution of the CPE was established by the Law on the Prohibition of Discrimination as an independent, autonomous and specialized body, which has a wide mandate in the area of promotion and protection from discrimination, including gender discrimination. The establishment of this institution is in line with Article 20(1) of the Recast Equality Directive, which requires Member States to establish a body for the "promotion, analysis, monitoring and support of equal treatment of all persons without discrimination on grounds of sex."[44] The CPE has a range of powers, but from the position of victims of discrimination the most relevant is the ability to receive and consider claims regarding discrimination, and to provide opinions and recommendations in concrete cases, as well as to provide information to the complainant on their rights and possibilities in terms of initiating a court procedure or other type of protection measure.[45]

A complaint must be forwarded within 15 days from its submission to the alleged discriminator who has 15 days to respond. The CPE can propose mediation if both parties agree to it. However, if the dispute is not subject to mediation, the CPE gives an opinion on whether there has been a violation of discrimination within 90 days of receiving a complaint, and informs the person who submitted the

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[43] Articles 43 to 51, and 53 to 55 of the Law on Gender Equality. See the extensive explanation of the procedure in Pajvancic/Petrusic/Jasarevic (eds.), Komentar Zakona o ravnopravnosti polova (Commentary on the Law on Gender Equality), 2010, pp. 103-123.

[44] See also Article 13 of the Council Directive 2000/43/EC of 29/6/2000 implementing the principle of equal treatment between persons irrespective of racial or ethnic origin, OJ L 180 of 19/7/2000, p. 22.

[45] The complaint procedure is regulated in Articles 35 to 40 of the Law on the Prohibition of Discrimination.

complaint and the person against whom the complaint was submitted. If discrimination is determined, a CPE will issue a recommendation to the person against whom the complaint was submitted, suggesting a way of redressing the violation in question. The discriminator is obligated to act upon it and to redress the violation within 30 days, as well as to inform the CPE of the precise measures taken. Otherwise, the CPE will publish its opinion in a newspaper, informing the public about the inaction of discriminator. Although this sanction is very efficient in practice, it would be desirable to amend the Law on the Prohibition of Discrimination in order to allow the CPE to act *ex officio* and to allow them to impose fines on discriminators.

The CPE also has preventive mechanisms, and organizes many promotional activities, such as conferences, round tables, moot courts, seminars, living libraries with the aim to combat gender discrimination. It submits annual reports to the National Assembly, but can also prepare special reports on the position of a certain discriminated group. In May 2015, a comprehensive report on discrimination against women was presented in the form of the public hearing in the Assembly.[46]

II. Gender equality cases before the Commissioner for the Protection of Equality (CPE)

The CPE has frequent opportunities to deal with sex/gender discrimination. In 2015 alone, the CPE received 143 complaints for sex discrimination (22.1 % of all complaints), 21 complaint concerning gender identity (3.2 %), as well as 24 complaints (3.7 %) concerning family status.[47] In a majority of cases, the CPE found discrimination, mostly in the workforce. Also, the practice of the CPE shows that discrimination is most frequent in relation to women, due to their sex and marital and family status, and in the area of employment.[48] In several cases, women complained about online employment forms

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[46] Predstavljen poseban izveštaj o diskriminaciji žena (Special report of the Commissioner for the Protection of Equality on discrimination against women), May 2015.

[47] Regular Annual Report of the Commissioner for the Protection of Equality for 2015, Belgrade, 2016, http://ravnopravnost.gov.rs/en/reports/ (1/12/2016), p. 253.

[48] *Krstic*, (fn. 26), p. 13.

that contained several sensitive questions (e.g. regarding marital status and children), which were not connected to the demands of the job and the area of expertise of the particular company.[49] In general, many women are asked about their family plans in interviews, and many of them are faced with limited access to work and with termination of their employment contract after returning from parental leave.

In another case, the CPE found indirect discrimination in relation to a woman who was employed as a doctor at the Ministry of Interior due to her sex and family status.[50] She was transferred to a lower paid job, due to the fact that she was not able to perform a night shift and field work which lasted for several days, outside of the place of her residence, because she was a single parent of a five year old child. Despite the fact that she had very good references and work results, she was demoted to a lower paid job. The CPE found that among 14 employees who were demoted, 12 were women with small children.[51] In another case, after returning from parental leave, a woman was transferred to a lower paid job, which is a very common practice in Serbia.[52] The employer explained that this decision was based on performance tests done in 2013 and 2014, when she was on maternity leave. Due to this practice, the CPE found discrimination based on sex and marital status, as she was not able to perform the test while on leave.[53]

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[49] Commissioner for the Protection of Equality (Poverenik za zaštitu ravnopravnosti), *M.Z.P.N. v. the Bank*, complaint no. 07-00-33/2014-02, opinion of 10/3/2014.

[50] Commissioner for the Protection of Equality (Poverenik za zaštitu ravnopravnosti), *S.B.P. against the Ministry of Interior*, complaint no. 07-00-488/15-02, opinion of 28/12/2015.

[51] See also Commissioner for the Protection of Equality (Poverenik za zaštitu ravnopravnosti*)*, *N.R. against the Ministry of Interior*, complaint no. 07-00-648/15-02, opinion of 14/1/2016.

[52] Commissioner for the Protection of Equality (Poverenik za zaštitu ravnopravnosti), *V.L. v. V.B.*, complaint no. 07-00-30/2015-02, opinion of 15/6/2015.

[53] See also Commissioner for the Protection of Equality (Poverenik za zaštitu ravnopravnosti), *A.C.M. v. N.A.A.V.*, complaint no. 715, opinion of 7/9/2012; Commissioner for the Protection of Equality, *T.P. v. A. t. doo D*., complaint no. 07-00-238/2014-02, opinion of 26/9/ 2014.

The Serbian Law does not specifically prohibit gender discrimination in premiums of insurance schemes. However, in one complaint submitted to the CPE, a woman claimed that a premium for the voluntary health insurance designed for healthy policy-holders who were between 26 and 30 years, was much higher for women than for men.[54] The CPE found that women did not receive any additional health services, which are covered by their premium in this case, and that there was no reasonable justification for a difference in the amount of premium based on sex. It is very significant that the CPE found application of the Law on the Prohibition of Discrimination in this case, as the Law on Insurance, adopted in 2015[55] does not prohibit the use of sex as a factor in the calculation of premiums for the purpose of insurance. This is also an important opinion as it refers to the jurisprudence of the CJEU.[56]

However, discrimination can also occur against men, especially when treatment is based on gender stereotypes. In one complaint, submitted against the Republic Fund for Health Insurance, it was stated that D.R. had severe osteoporosis.[57] The doctor prescribed him "Forteo" drug in order to treat his condition. This drug was on the list of medicines by the Republic Fund for Health Insurance that can be obtained at the expense of mandatory health insurance, but only for persons who are in post-menopause. In other words, it was accessible to women, and not to men, although they suffer from the same disease. In its observations, the Republic Fund for Health Insurance stated that there are no differences in terms of age or

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[54] Commissioner for the Protection of Equality (Poverenik za zaštitu ravnopravnosti), *M.J. v. Uniqa insurance,* no. 07-00-93/2016-02, opinion of 10/6/2016.

[55] Law on Insurance, Official Gazette of the Republic of Serbia No. 139/14 of 18/12/2014. This Law entered into force in June 2015.

[56] Commissioner relied on the judgement delivered in *Association Belge des Consommateurs Test-Achats ASBL and others v Conseil des ministers*, where the CJEU found that member States are not allowed "to maintain without temporal limitation an exemption from the rule of unisex premiums and benefits", as it works "against the achievement of the objective of equal treatment between men and women." See CJEU, case C-236/09, *Association Belge,* ECLI:EU:C:2011:100, para. 32.

[57] Commissioner for the Protection of Equality (Poverenik za zaštitu ravnopravnosti), *S.R. against the Republic Fund for the Health Insurance*, no. 07-00-166/2016-02, opinion of 26/5/2016.

gender in prescribing and dispensing the drug "Forteo", but that they relate only to medical parameters. In assessing this case, the CPE first found that there is no direct discrimination in this case, as the condition to obtain the above mentioned drug on the expense of mandatory health insurance was not based on "sex". However, as this drug can be obtained free of charge only to those persons who are post-menopause, it was important to examine if this is a case of indirect discrimination. The CPE noted that the Republic Fund for Health Insurance did not explicitly state in its regulations that only women can obtain the medicine "Forteo" at the expense of mandatory health insurance, but the requirement for prescribing and dispensing of this drug linked to post-menopause clearly indicates that no man, if they meet all other requirements, due to its biological and physiological characteristics, can obtain this medicine. Although post-menopause is certainly a medical condition, it also indicates the gender of the person going through this process, and completely prevents males from obtaining the drug at the expense of the compulsory health insurance. The CPE concluded that by the denial of the right of the D.R. to obtain the prescribed drug "Forteo" at the expense of the compulsory health insurance, the National Health Insurance Fund caused indirect sex discrimination. In this case the CPE found no reason to prescribe free medication for osteoporosis only to the health insured who are in post-menopause, thus discriminating against men. This case is important as it involves indirect discrimination, which is still very rare in the Serbian jurisprudence. It is also relevant that the CPE applied the proportionality test in this case, and found discrimination against men in a very important area of life.

D. Concluding Remarks

Today, Serbia is closer to EU standards in relation to gender equality than before it attained its EU candidate status. In 2009, Serbia adopted the Law on Gender Equality, which mostly complies with the *acquis communautaire*. Still, this piece of legislation needs to be amended in order to include some new institutes and to further align Serbia with European standards. Bearing in mind that equality of women is mostly present in relation to employment, it is necessary to include more guarantees against dismissal of pregnant women

and women on maternity leave, as well as to tackle the gender pay gap and inequality in promotion, salaries and pensions, and to provide specific legal provisions on wage transparency.[58]

The adoption of a new piece of legislation with some significant changes was expected to happen at the end of 2015, but was postponed due to some misunderstandings of the Working group that prepared the text. The name of the law was changed twice from the Law on Gender Equality to the Law on Sex Equality and, finally, to the Law on Equality of Women and Men. The Draft Law was withdrawn from the parliamentary procedure in February 2016 and it is expected that comments received from different stakeholders will be carefully considered in order to adopt a good piece of legislation for combating gender discrimination by the end of 2016.

However, a good legislative framework is only a first step in combating gender discrimination. Thus, in January 2016, the Government of Serbia adopted a new Strategy on Gender Equality for 2016 to 2020, as well as an Action Plan for its implementation for the period 2016 to 2018.[59] This Strategy is based on the evaluation adopted in 2015, which showed that desired effects have not been achieved in some key areas: the economic status of women is still poor, including entrepreneurship and economic empowerment, violence against women is widespread, while media content is still full of sexism and misogyny.[60] In order to achieve greater equality between two sexes, it is necessary to change the existing legislation, but also to tackle rooted gender stereotypes by adoption of different measures, mostly already designed in policy documents, and CPE's activities.[61] The role of positive measures can also be invaluable for achieving substantial gender equality. The Law on Gender Equality contains several provisions recognizing positive action measures mainly in the area of

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58 European Commission, (fn. 23), p. 47.

59 Documents in Serbian at www.mgsi.gov.rs/lat/dokumenti/nacionalna-strategija-za-rodnu-ravnopravnost-za-period-od-2016-do-2020-godine-sa-akcionim (1/12/2016).

60 *Krstic*, New Strategy on Gender Equality, European Network of Legal Experts in Gender Equality and Non-Discrimination, www.equalitylaw.eu/downloads/3903-serbia-new-strategy-on-gender-equality-pdf-104-kb (1/12/2016).

61 Serbian National Strategy for Gender Equality (2016-2020), with Action Plan (2016-2018), www.mgsi.gov.rs/lat/dokumenti/nacionalna-strategija-za-rodnu-ravnopravnost-za-period-od-2016-do-2020-godine-sa-akcionim (1/12/2016).

employment. But, it is unclear if automatic preference and the use of a quota system in the area of employment is permitted, as this practice will not be in accordance with the relevant CJEU's case-law. Therefore, positive action measures in the area of employment must be carefully measured, even when the goal is directed towards accomplishing better gender equality.

Concept of "Dual Attribution" as a Way of "Piercing the Veil" of International Organisations

Andrijana Mišović[*]

Abstract

This article analyses the possibility to "pierce the veil" of international organisations in order to determine state responsibility and does so through the lens of different concepts of attribution as the central element of responsibility. The concept of exclusive attribution of conduct excludes the possibility of state responsibility, while the concept of dual attribution, as the name suggests, does not exclude potential responsibility of international organisations, but only lifts the barrier of an organisation's separate personality by opening the possibility of determining the effective control link and potential state responsibility. For this reason, it is argued that dual attribution represents a very unique solution for "piercing the veil" of international organisations since it circumvents a problematic point – the contradiction between the principle of autonomy and separate legal entity of the organisation. On the other side, it provides a legal basis for state responsibility without the need for challenging the institutional framework and the presumption of responsibility of an international organisation for the acts of its organs. The article also analyses provisions of the Draft Articles on Responsibility of International Organizations that seem to allow such dual and multiple attribution. Finally, the article shows why it is important, from the perspective of legal policy, to hold member states responsible for the acts of international organisations.

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A. Introduction

Responsibility for internationally wrongful acts is a topic considered to be at "the very heart of international law",[1] and the proof of its existence.[2]

Bearing in mind that this responsibility has been perceived as a constitutive element of international personality, its primary connection with the states as the only original subjects of international law does not come as a surprise. By recognising legal personality of international organisations, the International Court of Justice has created a certain "diversity of subjectivity", noticing that "subjects of law in any legal system are not necessarily identical in their nature or in the extent of their rights" and that "their nature depends upon the needs of the community".[3]

Legal personality, however, entails certain international obligations. The problem arises in the field of responsibility for violating such international obligations since the transfer of powers from states to international organisations has not been followed by a corresponding system of responsibility.[4] In light of the numerous obstacles to determining the responsibility of international organisations, such as the immunity before national courts[5] and the lack of *locus standi* before the majority of international courts, the prospect of holding member states responsible for the acts of international organisations has

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1 *Reuter*, Le développement de l'ordre juridique international - Écrits de droit international, 1995, p. 574. See according to Pellet, The Definition of Responsibility in International Law, in: Crawford et al. (eds.), The Law of International Responsibility, 2010, p. 5.

2 Ibid.

3 ICJ, Reparation for injuries suffered in the service of the United Nations, Advisory Opinion, ICJ Reports 1949, p. 178.

4 That responsibility of international organisations represents a relatively new problem in the international community, we can see from *Clyde Eagleton's* statement from the 50s that "the UN Charter gave little authority under which it could cause harm to others", which is most certainly outdated today, bearing in mind that the UN and many other organisations are capable of violating international obligations, particularly in the field of international human rights law. See *Le Floch*, Responsibility for Human Rights Violations by International Organizations, in: Virzo/Ingravallo (eds.), Evolutions in the Law of International Organizations, p. 383.

5 *Orzan*, International Organizations and Immunity from Legal Process – An Uncertain Revolution, in: Virzo/Ingravallo, (fn. 4), p. 364 et seqq.

arisen. In other words, this is the notion of "piercing the veil". Although it is a matter that theoretically falls within the ambit of Articles on the Responsibility of States for Internationally Wrongful Acts, it seems that the International Law Commission has left this question open.[6]

Theory and practice are divided with respect to this question. Until recently, we had the problem of factual immunity of member states for the acts committed within the framework of international organisations. However, it seems that in recent case law this approach has changed through the concept of dual and multiple attribution, which is the reason for analysing the possibility of piercing the veil of international organisations through the lens of this new concept.

In order to avoid the confusion between terms, it should be noted that the paper is dealing with "dual attribution" meaning the attribution of certain conduct both to international organisation and to its member states.[7] Strictly speaking this term differs from "multiple attribution", meaning the assignment of plural responsibility to several involved entities.[8] However, for the purposes of this paper they will be used in the same context, namely both dual and multiple attribution will refer to the attribution of the same conduct to the international organisation and member state (one or more of them).

B. Relationship between State Responsibility and Responsibility of International Organisations

As has already been mentioned, it seems that there are two fundamentally different lines of reasoning about the relationship between states and international organisations with respect to the internationally wrongful acts of the latter.

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6 *Kuijper*, Introduction to the Symposium on Responsibility of International Organizations and of (Member) States: Attributed or Directed Responsibility or Both?, International Organizations Law Review 2010, p. 10.

7 This term is, for example, used by *Nollkaemper*, Dual Attribution – Liability of the Netherlands for Conduct of Dutchbat in Srebrenica, Journal of International Criminal Justice 2011, p. 1144.

8 *Bell*, Reassessing Multiple Attribution: the International Law Commission and the Behrami and Saramati Decision, International Law and Politics 2010, p. 503.

The first line is based on the idea that international organisations are separate legal entities different from the states and therefore should bear responsibility for the wrongful acts imputable to them, which is in line with the idea of autonomy of international organisations. If an organisation has a legal personality distinct from that of the member states, and performs acts which if done by states may give rise to responsibility, then, in principle, responsibility should be imputed to that organisation and not to member states,[9] since membership as such does not entail state responsibility for the breach of international law by an international organisation.[10] This reasoning, logically, negates the possibility of dual or multiple responsibility.

According to the second line of reasoning, it is not logical to suppose that a group of States can create an international legal personality and become immune from responsibility toward third States.[11] *Brownlie*, for example, criticised the literature that tends to focus upon the existence or not of a distinct legal personality of an international organisation, by stating that "the appropriate analysis is to treat the organization simply as a part of the factual elements, which, upon analysis, may lead to the responsibility of the member States, or some of them, to a third State".[12] In his opinion, the appropriate legal category in which to study this matter is not the law of international organisations, but the law on State responsibility.[13]

These different approaches are actually developed from two different main ideas: the principle of autonomy of international organisations and the idea of protecting the interest of injured parties. These two legal values have shed different light on the question of attribution, and consequently, as will be seen in the following chapter, have influenced the development of two different concepts of attribution of the conduct.

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9 *Crawford*, Brownlie's Principles of Public International Law, 8th ed. 2012, p. 183.

10 *Hartwig*, International Organizations or Institutions, Responsibility and Liability, in: Max Planck Encyclopedia of Public International Law, 2011, para. 39.

11 *Brownlie*, The Responsibility of States for the Acts of International Organizations, in: Ragazzi (ed.), International Responsibility Today, Essays in Memory of Oscar Schachter, 2005, p. 362.

12 Ibid., p. 360.

13 Ibid.

C. Attribution of the Conduct

Attribution represents the crucial question of international responsibility, keeping in mind that it defines when particular conduct is to be considered as the conduct of the State.[14] The basic rule of attribution is that the conduct of both State organs and persons or entities exercising elements of governmental authority shall be considered an act of that State under international law.[15] Moreover, the conduct of a person or group of persons shall be considered an act of a State under international law if the person or group of persons is in fact acting on the instructions of, or under the direction or control of, that State in carrying out the conduct.[16]

The two above-mentioned lines of reasoning offer reflections on the question of attribution. Namely, in accordance with the idea of autonomy of international organizations which denies the possibility of piercing the veil, if an internationally wrongful act is committed under the direction and control of international organisation, there is no place for the attribution of the conduct to the state. This is the concept of exclusive attribution of conduct to the international organisation. In contrast, inspired by the principle of good faith, the attribution of conduct to the international organisation does not preclude attribution to the member states if they exercised effective control over the conduct in question. This is the concept of dual or multiple attribution.

I. Exclusive Attribution of Conduct to the International Organisation

As has been noticed, the concept of exclusive attribution to the international organisations has been developed in light of the idea of autonomy and separate legal personality of international organisations. This separate personality creates an almost irrefutable presumption that an international organisation is responsible for internationally wrongful acts committed in the exercise of the conferred powers.[17]

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[14] Draft Articles on Responsibility of States for Internationally Wrongful Acts (ASR), with commentaries 2001, Commentary on Chapter II.

[15] Articles 4 and 5 ASR.

[16] Article 8 ASR.

[17] *Pinzauti*, It Takes Two to Tango: States’ Conferral of Powers on International Organizations and Its Implications for the Responsibility of the Organization and Its Members, in:

It seems that this particular line of reasoning was accepted by the ECtHR in the famous *Behrami and Saramti* case. In this case, extensively criticised in academic literature, the Court determined whether the impugned action of KFOR (the detention of *Saramati*) and inaction of UNMIK (the alleged failure to de-mine in the *Behrami* case) could be attributed to the UN. The Court concluded firstly that "the KFOR was exercising lawfully delegated Chapter VII powers of the UNSC so that the impugned action (detention) was, in principle, 'attributable' to the UN".[18] Secondly, "since UNMIK was a subsidiary organ of the UN, the impugned inaction was, in principle, 'attributable' to the UN in the same sense".[19] Hence, by attributing the conduct to the international organisation, the Court was obviously under the impression that it was precluded from attributing the conduct to the member state. As *Crawford* concludes, "there was no acknowledgement or contemplation of the possibility of attribution of the same conduct to multiple persons (states or IO) simultaneously".[20]

This approach is advocating for the finality of the organic link without the need to consider the control and dependence that exists in reality.[21] In other words "once an organ is constitutionally instituted under an international organization, the conduct of the organ should automatically be deemed as acts of the particular international organization and no further investigation of control is at all needed". This means that there is practically no room for overruling the presumption of attributing such conduct to the particular international organisation.[22]

Sarooshi (ed.), Remedies and Responsibility for the Actions of International Organizations, 2014, p. 118.

[18] ECtHR, no. 71412/01and 78166/01, *Behrami and Behrami v. France* and *Saramati v. France, Germany and Norway,* Grand Chamber decision as to admissibility of 2/5/2007, para. 61.

[19] Ibid., para. 62 et seq.

[20] *Crawford*, State Responsibility – The General Part, 2013, p. 351.

[21] *Chen*, Attribution, Causation and Responsibility of International Organizations, in: Sarooshi (ed.), Responsibility, Immunities, and Remedies for the Acts of International Organizations, 2013, p. 61. For more about the "organic link" see *Salerno*, International responsibility for the conduct of "Blue Helmets": Exploring the organic link, in: Ragazzi (ed.), Responsibility of International Organizations, Essays in memory of Sir Ian Brownlie, 2013, p. 415.

[22] *Chen*, (fn. 21), p. 62.

The main problem of this argumentation is the idea that there is no need for fulfilling the effective control test if the act is committed by the organ of an international organisation.[23] Namely, it might be accepted that there is no need to determine whether the control of the international organisation over its organ or agent was indeed effective. However, it is not clear why the "effective control" test should not be applied in order to determine the responsibility of a State for the particular act committed by the entity, which although regarded as formal organ or agent of an international organisation, was in a particular situation under the control of the State.

One possible explanation is that "the very notion of effective control is exclusive rather than cumulative".[24] However, multiple or dual attribution does not have to be contrary to the "exclusivity of the effective control". Namely, it is possible to have an "organic link" on the one side, according to which the conduct is attributable to the international organisation since it is committed by its organ, and the "effective control test" on the other side, according to which the conduct is to be attributed to the member state, which actually had control over the conduct. This is not in contradiction with the notion of "exclusiveness" of effective control, since in such a situation there is only one effective control, and that is the control of the member states, while the attribution to the organisation rests upon another ground entirely – the formal connection.

II. The Possibility of Dual (Multiple) Attribution

The recent case before Supreme Court of Netherlands cast new light on the perception of attribution in this field.[25] The central

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23 Ibid.

24 Of course, attribution of conduct does not exclude the attribution of responsibility, while a single harmful outcome can be the result of several wrongful acts for which several entities may bear responsibility, either as a matter of attribution of conduct or as a matter of attribution of responsibility. *D'Argent*, State organs placed at the disposal of the UN, effective control, wrongful abstention and dual attribution of conduct, Questions of International Law 2014, p. 31.

25 Supreme Court of the Netherlands, no. 12/03324, *The State of Netherlands (Ministry of Defence and Ministry of Foreign Affairs which has its seat in The Hague) v. Hasan Nuhanović*, judgment of 6/9/2013.

question discussed by the Supreme Court was: "Can the conduct of Netherlands' battalion placed at the disposal of UNPROFOR in accordance with the Security Council resolution[26] be attributed to the Netherlands".[27]

The criterion for determining whether the Dutchbat's conduct should be attributed to the UN or to the Netherlands is the effective control over the battalion at the time of the conduct. The only question considered was whether the state had effective control over the disputed conduct, while the question of whether the UN also had such control was left open.[28]

On the basis of Articles 6,7 and 48 of the Draft Articles on Responsibility of International Organizations and its Commentary, the Court found that the conduct does not have to be exclusively attributed to an international organisation, thereby resulting in exclusive responsibility of the international organisation, but instead left open the possibility of dual attribution in the sense that the same conduct can be attributed to both the international organisation and the state.[29] This is in line with the theory that control exercised by an international organisation generally is not exclusive in nature, since "it can exist side by side with that of other organizations, states or even group of private individuals".[30]

This is a landmark case, since it has finally opened the door to litigation against member states in situations where the national troops are functioning under the command of the UN. In spite of the Court's finding that the situation in this case is rather specific,

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[26] Security Council Resolution 836 of 4/6/1993. The resolution called upon member states to contribute armed troops and logistic support to UNPROFOR/UN Protection Force established by the Security Council in 1992.

[27] Supreme Court of the Netherlands, (fn. 25), para. 3.1.

[28] Ibid., para. 3.5.2.

[29] Ibid., para. 3.9.4.

[30] On the other side the State control is considered to be based on the exercise of sovereign powers in its own territory or quasi-sovereign powers exercised abroad and hence is "exclusive" since it in principle excludes the existence of other form of control exercised by other entities. *Pustorino*, The Control Criterion between Responsibility of States and Responsibility of International Organizations, in: Virzo/Ingravallo, (fn. 4), p. 408 et seq.

because there was a transitional period in which the Dutch battalion was actually controlled by the government in the Hague,[31] it seems that this situation does not differ greatly from the level of control that states usually have over national contingents of troops within peace-keeping missions.[32]

According to one very thorough study in this field, national governments retain important command functions alongside the operational control granted to the United Nations and the influence that states have in practice is much bigger that it perhaps appears from the formal picture.[33] For this reason, responsibility of troop contributing states should be expanded by implementing joint and several responsibility wherever feasible within the confines of the “effective control” test.[34]

Some would conclude that this means, practically speaking, that the presumption in favour of the institutional framework of the international organisations can be challenged with an inquiry into the exercise of effective control by the national governments.[35] Consequently, even if the international organisation retains certain control, this does not preclude the responsibility of states and vice versa. Hence, in order to have dual attribution to an organisation and a member state it is necessary that they jointly exercise effective control.

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[31] After 11/7/1995 the mission to protect Srebrenica had failed. On 11/7/1995 the decision was taken in mutual consultation by the UN and the Dutch government to evacuate. During the transitional period after the critical date not only the UN but also Dutch government in the Hague had control over Dutchbat and actually exercised this in practice. SeeSupreme Court of the Netherlands, (fn. 25), para. 3.12.2.

[32] *Nollkaemper*, (fn. 7), p. 1114 comments that this limits the possible relevance of the decision with respect to other possible claims against states that contribute troops to peacekeeping operations.

[33] *Dannenbaum*, Translating the Standard of Effective Control into a System of Effective Accountability: How Liability Should be Apportioned for Violations of Human Rights by Member State Troop Contingents Serving as United Nations Peacekeepers, Harvard International Law Journal 2010, p. 148.

[34] Ibid., p. 192.

[35] *Spagnolo*, The ‘reciprocal’ approach in article 7 ARIO: a reply to Pierre d’Argent, Questions of International Law 2014, p. 40 et seq.

It was already mentioned that the ECtHR has given strong support to the approach of exclusive attribution of conduct to an international organisation. However, it has been noted that this jurisprudence contradicts with the usual practice.[36] Moreover, in a relatively recent case, the ECtHR had the opportunity to provide the answer to the critiques on its previous decisions in this field. In the case of *Al-Jedda v. the United Kingdom* the Court took quite a different position with respect to the relationship between the responsibility of states and international organisations. It stated that "in a multi-State operation, responsibility lies where effective command and control is vested and practically exercised". Moreover, it concluded that "multiple and concurrent attribution was possible in respect of conduct deriving from the activity of an international organization and/or one or more States".[37]

D. Draft Articles on Responsibility of International Organizations

It seems that Draft Articles on Responsibility of International Organizations (DARIO), as the most authoritative set of rules on this matter, leaves open the possibility of dual and multiple attribution. Namely, according to this Draft, attribution of certain conduct to an international organisation does not imply that the same conduct cannot be attributed to a State.[38]

According to Article 7 of the Draft Articles on Responsibility of International Organizations: "The conduct of an organ of a State [...] that is placed at the disposal of [...] an international organization shall be considered under international law an act of the latter organization if the organization exercises effective control over that conduct". The Commentary to this Article further explains that "the criterion for attribution of conduct either to the contributing State [...] or to the

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[36] According to the author this principle has been largely supported for several years and generally accepted. *Lozanorios*, Responsibility of the United Nations for Wrongful Acts Occurred in the Framework of Authorized Operations in Light of the Draft Articles on the Responsibility of International Organizations (DARIO), 2014, p. 122.

[37] ECtHR, no. 27021/08, *Al-Jedda v. The United Kingdom*, Grand Chamber judgment of 7/7/2011, para. 69.

[38] Draft Articles on responsibility of international organizations (DARIO), with commentaries, 2011, Commentary on Chapter II, Attribution of conduct to an international organization, para. 4.

receiving organization is based [...] on the factual control that is exercised over the specific conduct taken by the organ or agent placed at the receiving organization's disposal".[39] In other words "the decisive question in relation to attribution of a given conduct appears to be who has effective control over the conduct in question".[40] Consequently, it seems that if such control exists on the side of a member state, there is no obstacle to finding it responsible.

Furthermore, Articles 58 to 62 of DARIO outline more situations in which states could be found responsible for wrongful acts of international organisations.

According to Article 58 of DARIO the state may be responsible for aid and assistance in the commission of an internationally wrongful act by an international organisation. There are two conditions for establishing such responsibility. First, the State had to do so with knowledge of the circumstances of the internationally wrongful act; and second, if committed by that State the act would be internationally wrongful.[41] However, the second paragraph of this Article states that: "the act of a State done in accordance with the rules of the organization does not as such engage the international responsibility of that State".[42] ILC Commentary on this Article clarifies that this does not imply that the State would be free to ignore its international obligations that may well encompass the conduct of a State when it acts within an international organisation. In such cases the State would not be responsible under the present Article, but rather under the Articles on the responsibility of States for internationally wrongful acts.[43]

Article 59 of DARIO provides that "a State which directs and controls an international organization in the commission of an internationally wrongful act by the latter is internationally responsible". The conditions are basically the same as for aiding and assisting.[44] Finally, according to the Article 60 "a State which coerces an interna-

[39] Ibid., Commentary on Article 7, para. 4.

[40] Ibid., para. 8.

[41] Ibid., Commentary on Article 58, para. 1.

[42] Ibid., para. 2.

[43] Ibid., para. 5.

[44] See Article 59 DARIO.

tional organization to commit an act is internationally responsible for that act", under the same conditions.[45]

Moreover, DARIO regulates the situation of so-called circumvention of obligation by the States creating an international organisation. According to Article 61 "a State member of an international organization incurs international responsibility if, by taking advantage of the fact that the organization has competence in relation to the subject-matter of one of the State's international obligations, it circumvents that obligation by causing the organization to commit an act that, if committed by the State, would have constituted a breach of the obligation".[46]

Finally, according to the Article 62, a State member of an international organization is responsible for an internationally wrongful act of that organisation if it has accepted responsibility for that act towards the injured party; or it has led the injured party to rely on its responsibility.[47]

From the analysis of the abovementioned Articles we can conclude that membership as such does not entail responsibility of member states for the wrongful acts committed by international organisations. In other words, it might be concluded that there is a general rule that member states cannot be regarded as internationally responsible for the internationally wrongful acts of the organisation.[48]

However, if the wrongful act is committed by an organ of a State that, although placed at the disposal of an international organisation,

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45 See Article 60 DARIO.

46 Draft Articles on the responsibility of international organizations, (fn. 38), Commentary on Article 61, para. 6-8: "According to the present Article, three conditions are required for international responsibility to arise for a member State circumventing one of its international obligations. The first one is that the international organisation has competence in relation to the subject matter of an international obligation of a State. [...] A second condition for international responsibility to arise according to the present Article is that there be a significant link between the conduct of the circumventing member State and that of the international organisation. The act of the international organisation has to be caused by the member State. The third condition for international responsibility to arise is that the international organisation commits an act that, if committed by the State, would have constituted a breach of the obligation."

47 Article 62 DARIO.

48 Draft Articles on the responsibility of international organizations, (fn. 38), Commentary on Article 62, para. 3.

still remained under the effective control of that State, it seems that member state responsibility is possible.

Moreover, member states will be found responsible in cases of aid and assistance in the commission of an internationally wrongful act, as well as in the cases of direction and control of the international organisation in the commission of an internationally wrongful act and for a coercing an international organisation to commit a wrongful act. In such situations there is the possibility for joint responsibility of member states and international organisations.

Hence, it seems that DARIO is compatible with the idea of dual or multiple attribution resulting in concurring responsibility. It seems that nothing impedes such responsibility, when both the organisation and the member state committed the same international wrong. Namely, on the one side an international organisation that has its own international legal personality can be responsible for the unlawful acts, and on the other side a member state would incur responsibility, if it is the co-perpetrator of the illicit act, but not automatically by the mere fact of being a member of the organisation.[49]

E. Why Should Member States Be Held Responsible?

After examining legal arguments for determining member state responsibility for the acts of international organisations, it is important to give reasons for pursuing such legal arguments at all. Namely, the question is why should member states be responsible along with the international organisations for their wrongful acts and why is this better than solely holding international organisations responsible? In other words, this part will analyse some fundamental legal policy arguments for advocating dual attribution.

The first of these reasons is that exploring the possibilities of dual attribution potentially opens more avenues of redress for the injured party, since it will be in a position to argue that two (or more) subjects are both responsible for the wrongdoing suffered, rather than just

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49 *Cançado Trindade*, Some Reflections on Basic Issues Concerning the Responsibility of International Organizations, in: Ragazzi, (fn. 21), p. 6.

one.[50] In other words, the purpose is to serve the interests of the injured parties, who may experience difficulty in identifying the responsible entities and the scope of their responsibility.[51] This approach is aimed at the entity, which can actually meet the claims stemming from breaches of international obligations. In other words, as noticed in the *Westland Helicopters Ltd* case, in the absence of any provision expressly or impliedly excluding the liability of states, third parties could legitimately count on their liability for breaches of the obligations committed by the organisation in question. This rule flows from general principles of law and good faith.[52]

The second reason is closely connected with the first one. It is not only true that it is better for the injured party to have more avenues of redress, but also that they might not be able to start the proceedings against the international organisations at all. Consequently, determining the responsibility of member states might be their only chance. Namely, international organisations have limited procedural capacity before international courts. For example, it is not possible to conduct the proceedings against an international organisation before the International Court of Justice or before the European Court of Human Rights. In addition, international organisations enjoy immunities that represent legal barriers for conducting legal proceedings against them before national courts. For example, according to Article 105(1) of the UN Charter: "The Organization shall enjoy privileges and immunities in the territory of each of its Members".[53] This might be the

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[50] *Messineo*, Attribution of Conduct, in Responsibility in International Law, in: Nollkaemper/ Plakokefalos (eds.), An Appraisal of the State of the Art, 2014, p. 61.

[51] *Nollkaemper/Jacobs*, Shared Responsibility in International Law: A Conceptual Framework, Mich. J. Int'l L 2013, p. 363.

[52] ICC, Court of Arbitration, Westland Helicopters Ltd. and Arab Industrialization Organization, United Arab Emirates, Kingdom of Saudi Arabia, State of Quatar, Arab Republic of Egypt and Arab British Helicopters Company, judgment of 5/3/1984, ILR 80 (1989), p. 613.

[53] See also the Immunities Convention that provides in its Article II, Section 2, that: "The United Nations [...] shall enjoy immunity from every form of legal process except insofar as in any particular case it has expressly waived its immunity."

reason why some authors believe that State responsibility represents “an important mechanism in the fight against impunity”.[54]

Thirdly, there is a common sense argument that states should not be able to avoid responsibility by creating an international organisation that may act in a way, which would be unlawful for states.[55] States are perceived as the creators and decision makers behind the veil of international organisations. Consequently, at the very core of the conduct of each international organisation lies a decision made by a particular state or group of states and for this reason they should bear responsibility. Without the possibility of dual or multiple attribution states would be encouraged to be careless while acting in the framework of international organisations.[56]

Finally, there is a problem with compensation, since international organisations usually do not have funds for compensation in order to meet their secondary duty to compensate if found responsible for the wrongful act.

In conclusion, it seems that “piercing the veil” of international organisations by opening the possibilities of dual and multiple attribution has many benefits for injured parties and consequently promotes an equitable solution to these sorts of problems.

However, there is one additional concern that must be addressed when analysing policy argumentation. Namely, the following question necessarily arises: what is the purpose of “piercing the veil” of international organisations and determining member state responsibility for wrongful acts when some acts that might represent the gravest breaches of international law, can hardly be attributed to the state, if we follow ICJ practice? Essentially, by affirming the test of “effective control”, the Court retained a very high standard in terms of attribution of the wrongful act. The solution to this problem might be the concept of due diligence, which seems to have a lot of potential to develop in contemporary international law, since the Court has been

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[54] *Proulx*, An Uneasy Transition?, Linkages between the Law of State Responsibility and the Law Governing the Responsibility of International Organizations, in: Ragazzi, (fn. 21), p. 111.

[55] Ibid., p. 184; *Hartwig*, (fn. 10), p. 184.

[56] *Bell*, (fn. 8), p. 504.

more flexible when referring to responsibility in the context of a due diligence obligation.[57]

When applying this concept to our topic, attention should be given to the opinions according to which if member state responsibility for the wrongful act or acts of an international organisation is to be accepted, the state should not be held responsible for the underlying act, but rather for the dereliction of its duty of due diligence.[58] This precise concept might be interesting for some deeper analysis in the future.

F. Concluding remarks

Recognising international personality of international organisations has provoked numerous discussions in literature about their position in the international legal order. Perhaps the most interesting debate is related to the question of responsibility, which occupies the central position in the system of international law. There is no doubt that international organisations are capable of violating the rules of international law in numerous ways. However, there are numerous legal obstacles to finding them responsible for such violations. For this reason, the attention should be focused on possibilities for determining the responsibility of member states, or in other words, the possibility of "piercing the veil" of organisations.

It has been shown that there are two different approaches regarding the possibility of determining such responsibility. The first is the approach that international organisations are separate legal entities which should bear responsibility for the wrongful acts imputable to them, while the second approach opens the practically possibility of finding member states responsible in accordance with the idea that states should not be allowed to create a new legal personality and escape the responsibility.

Influencing attribution as the central question of responsibility, the approach that favours autonomy of international organisations,

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57 See for example the case concerning Application of the Convention on the Prevention and Punishment of the Crime of Genocide, ICJ, *Bosnia and Herzegovina v. Serbia and Montenegro*, judgment of 26/2/2007, ICJ Reports 2007, para. 430.

58 *Tsagourias/White*, Collective Security: Theory, Law and Practice, 2013, p. 377.

leads to the principle of exclusive attribution of conduct to the international organisations, namely, if the act is committed in the field of activity in which the state is under the power of direction and control of an international organisation, that act can only be attributed to such an organisation. Moreover, it has been contemplated that the very notion of effective control is exclusive rather than cumulative and that in such a constellation there is no room for application of the effective control test in order to determine potential state responsibility.

However, the strict application of the "organic link" as an irrefutable presumption of effective control which is exclusive in its nature and hence precludes dual attribution is somehow an artificial concept, which practically turns a blind eye to situations where member states retain a significant degree of control over the conduct formally committed under the framework of international organisations.

On the other side, following the second line of reasoning opens the possibility of dual and multiple attribution, which means that the responsibility of international organisations does not exclude state responsibility. It appears that this approach has been accepted not only by the International Law Commission from a doctrinal point of view, but also by the national courts in some contemporary cases before them.

Finally, there are numerous legal policy arguments that support this approach. They all boil down to the protection of the interest of the injured parties. However, the entire construction of "piercing the veil" might be futile without the readiness of the international judiciary to attribute particular breaches to the state. For this reason, the flexibility of the due diligence concept might be useful in order to enable "piercing the veil" of international organisation and reach state responsibility.

Choice of Law in Transnational Trade

Enkeleda Olldashi and Enkelejda Koka[*]

Abstract

Transnational trade has become a norm in the world of commerce. Nowadays, business parties contracting for the sale of goods are located in different states, but the good may be delivered to a third state upon agreement. Although business-wise such practice is quite beneficial for transnational trade and the global economy, at times, it can lead to uncertainty in terms of which law may be applicable to the transaction if there is a conflict. Just as commercial norms differ from one state to another, so do international commercial norms implemented at national level. This inconsistent interpretation of commercial norms from one state to another has led to a demand for international legal principles adopting uniform interpretation. The most suitable legal means to address inconsistent interprettation of domestic laws as applied to cross-border contracts is that of harmonisation. At international level, legal principles applicable to cross-border contracts have been harmonised through the CISG and through Rome I Regulation at regional level. This article discusses the "choice of law" provision in light of the CISG and Rome I Regulation, with a particular focus on Albania's implementation of the CISG. The main objective of the CISG and Rome I Regulation are to ensure that the "choice of law" resolves uncertainties that may arise out of diverse national contractual laws. Although this clause ensures certainty as to applicable law, they do not guarantee trustworthiness at the time of conflict. This article questions the choice of law provision in international sales law in terms of certainty and effectiveness for solving disputes. The main purpose of this article is to show that the choice of law provision is contrary to harmonisation of national sales law. It argues that this precise provision impedes harmonisation and is the main reason that debate is generated amongst academics and law-makers on the necessity of further harmonisation at

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the international level. This article analyses the possibility of adopting a new international instrument as a further contribution to harmonisation of international commercial contracts by drawing attention to advantages and disadvantages surrounding new interventions in a legal framework.

A. Introduction

The most important international act coming close to achieving harmonisation is the CISG;[1] an international treaty developed by UNCITRAL (an international organisation) for the harmonisation of national laws concerning the sale of goods. The treaty is the backbone of international trade for State parties. To date, 85 countries are parties to the CISG.[2] The CISG integrates major worldwide legal traditions within a single convention. Its principles apply to a contract for the international sale of goods depending on the contracting party's place of business and provided one of the parties' habitual residences is party to the CISG, or if the parties to the contract expressly choose to apply the CISG.[3] The CISG is not concerned with the validity of the contract but rather lays down the parties' obligations. Overall the CISG has been a successful attempt to facilitate international trade and remove legal trade barriers at the international level. It has achieved uniformity in areas such as: contract formation,[4] buyers and sellers' obligations,[5] remedies,[6] and passing of risk.[7] It also purports to avoid jurisdictional overlap and inconsistent application of national laws on cross-border commercial transactions.[8]

However, extensive debate occurs between academics and experts in the field as to the success of the CISG. There are, for example,

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1 United Nations Convention on Contracts for the International Sale of Goods (CISG).

2 See www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG_status.html (1/12/2016).

3 Article 1 of CISG.

4 Chapter 2 of CISG.

5 Article 58(1) of CISG.

6 Article 50 of CISG.

7 Chapter IV CISG.

8 *Berman*, The Inevitable Legal Pluralism within Universal Harmonization Regimes: the Case of the CISG, Uniform Law Review 2016, p. 13.

various advantages and disadvantages resulting from the Convention. Until the CISG was adopted, parties entering into international commercial contracts were experiencing difficulties in reaching a consensus over the "choice of law" applicable in times of conflict. At the regional level, attempts were made to regulate issues on choice of law. At the EU level, Regulation (EC) No. 593/2008 of 17 June 2008 (Rome I),[9] became an important regional instrument on contractual obligations.[10] The Regulation allows the parties to choose the applicable law governing their international commercial agreement. The choice shall be made expressly or be clearly demonstrated by the terms of the contract and this choice will apply to the whole or to only part of the contract depending on the circumstances of the case.[11] The Regulation also provides that if the parties have not chosen the applicable law in accordance with Article 3 and without prejudice to Articles 5 to 8, the law governing the contract shall be determined as follows: a) a contract for the sale of goods shall be governed by the law of the country where the seller has his habitual residence; and b) a contract for the provision of services shall be governed by the law of the country where the service provider has his habitual residence.[12] Where the applicable law cannot be determined pursuant to the above paragraphs, the contract shall be governed by the law of the country with which the contract is most closely connected. In case of conflict, the Rome I Regulation, allows the parties to choose a non-state body to adjudicate their contract. But by no means can parties choose non-State rules to interpret and adjudicate their contract.[13] The main objective of the Rome I Regulation is to ensure that the "choice of law" resolves uncertainties that may arise out of diverse national contractual laws. Its provisions apply only to EU Member States.[14]

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[9] OJL 177 of 17/6/2008, p. 6.

[10] This Regulation shall apply, in situations involving a conflict of law, to contractual obligations in civil and commercial matters, Article 1 of Rome I.

[11] Article 3 ofRome I Regulation.

[12] Article 4 of Rome I Regulation.

[13] Recital 13 of Rome I Regulation; *Lando/Nielsen*, The Rome I Regulation, Common Market Law Review 2008, p. 1694.

[14] Except Denmark.

B. Choice of Law

Parties are free to choose the law governing their commercial transaction; hence, they should accept the decision made by the adjudicating body at the domestic level. Although these clauses ensure certainty as to applicable law, at the time of conflict they do not guarantee trustworthiness. When the parties conflict over the interpretation of a specific term in their contract, they become distrustful of the laws and judicial systems of the pre-chosen governing law. This situation still leaves them in a dilemma as to the most suitable governing law at a time when they have lost reasonable consensus and communication with one another. The distrust arises out of diverse local commercial practices applied in the chosen governing law, which does not become productive to the opposing party's country, where the conflict has arisen. Another difficulty arising out of this situation is the fact that the parties often choose a neutral jurisdiction without having proper knowledge of its laws.[15] Under such a neutral jurisdiction the parties may be confronted with an unpredictable result that may not be appropriate for their contract and dispute in question.[16]

Often, the party who does not have the bargaining power realises the governing law does not act in their favour. Harmonisation of laws often favours those parties who are well organised and who have bargaining power, which dictates choice of law. The choice of law might lead to forum shopping where the party having bargaining power chooses one jurisdiction that is more advantageous. Some would argue that there is no evil in jurisdictional shopping and that the choice of the parties should prevail in commercial transactions.[17] The main objective of the choice of law is that there is no surprise as to the applicable law; the best way to achieve certainty and predictability in the area.[18] However, is it correct to uphold an individualistic approach on the choice of law through sacrificing fundamental

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[15] *Schwenzer*, Global Unification of Contract Law, Uniform Law Review2016, p. 3.

[16] *Schwenzer/Hachem*, The CISG-Successes and Pitfalls, American Journal of Comparative Law 2009, pp. 457-478.

[17] *Kramer*, Rethinking Choice of Law, Columbia Law Review 90 (1990), p. 313.

[18] *Zhang*, Rethinking Contractual Choice of Law: An Analysis of Relation Syndrome, Stetson Law Review 48 (2015), p. 842.

contractual principles?[19] But at the same time, if one takes away the free will of the parties, what happens to the fundamental principle of contract law with respect to "free will".[20] Equally problematic is judicial inter-pre-tation in the application of international norms. Practices of justiciability differ from one state to another, being largely dependent on political will and interest.[21] In this situation, local laws might prevail over the interpretation of an international norm in support of international interest. Harmonisation of domestic laws at the international level has been designed to prevent these difficulties arising from the choice of law. However, this article argues that harmonisation does not greatly assist in addressing the difficulties referred to above.

UNCITRAL adopted the CISG for the purpose of creating uniform substantive rules to be relied by the parties and adjudicating bodies in the field and to avoid choice of law issues. The Convention allows the parties to choose for themselves whether to apply or expressly exclude the Convention. If the parties are situated in countries that have implemented the Convention, they automatically benefit from its applicability. Even if the parties are not situated in countries that have implemented the Convention, they may expressly choose to apply its substantive rules.[22] The substantive rules of the CISG integrate the norms and principles of contract law from the civil and common law system. They are also supplemented by modern harmonisation principles adopted by UNIDROIT, which has to date approved three editions of complementary Principles of International Commercial Contacts (PICC) to the CISG, representing soft law. The PICC cover a wide range of topics on contract law, which are not directly addressed by the CISG. These principles may be applied when "1) the parties have agreed that their contract be governed by general principles of law, the *lex mercatoria* or the like; 2) the parties have not chosen any law to govern their contract; and 3) parties decide to use these

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19 *Currie*, Survival of Actions: Adjudication versus Automation in the Conflict of Laws, in: Currie (ed.), Selected Essays on the Conflict of Laws, 1963, p. 213.

20 *Symeonides*, Party Autonomy in Rome I andII from a Comparative Perspective, Convergence and Divergence in Private International Law, 2010, p. 513 et seq.

21 *Schwartz/Scott*, The Political Economy of Private Legislatures, University of Pennsylvania Law Review 1995, p. 595.

22 Article 1 (b) of CISG.

principles as assistance for a uniform interpretation of international law instruments; 4) supplement its domestic law; and 5) parties may serve as a model for national and international legislators."[23] The following words may be inserted by parties who wish for the PICC to apply in their contracts: This contract shall be governed by the UNIDROIT Principles.[24]

C. Further Harmonisation

Although the CISG is described by some as successful, it is still not an example of an international instrument that achieves full harmonisation. Not all countries are parties to the CISG and for those countries that are parties they have the choice to opt out of its provisions in part or in full.[25] In addition, the CISG does not cover matters of contract validity nor does it provide a uniform definition on "reasonableness". It is for domestic courts to determine trade norms in light of their domestic standard on "reasonableness".[26] However, the standard of "reasonableness" differs between the civil and common law systems, not to mention at the domestic level. These uncertainties have led many countries to choose to opt out of the CISG. Referring to statistics gathered by *Lisa Spagnolo*, "[f]or the US, somewhere in the range of 55-71 % of lawyers 'typically/generally' opt-out. In Germany that figure is probably around 45 % of lawyers who 'generally/predominantly' opt out. In Switzerland it seems the figure is around 41 %, while for Austrian lawyers, it is around 55 %. Some 37 % or less of Chinese lawyers typically opt out".[27] In light of these statistics one wonders whether the intended goal of the CISG drafters is fulfilled: the uniform adoption of rules that would "take into account the different

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[23] UNIDROIT, Principles of International Commercial Contracts, 2010, Preamble.

[24] *Graziano*, Comparative Contract Law – cases, materials and exercises, 2009, p. 422.

[25] Article 6 of CISG.

[26] Article 7of CISG.

[27] *Spagnolo*, A Glimpse through the Kaleidoscope: Choices of Law and the CISG, Vindobona Journal of International Commerce Law and Arbitration 2009, p. 135; *Coyle*, Rethinking the Commercial Law Treaty, Georgia Law Review 2011, p. 382.

social, economic and legal systems".[28] These statistics prove the argument that the choice of law runs counter to the spirit of uniformity.[29]

In the last three sessions of UNCITRAL, extensive debate has taken place on the adequacy of the CISG and PICC or the question of whether to establish a new legal framework to further harmonise contract law. In 2010, the USA believed that contract law rules could be best harmonised through the reinforcement of existing rules, whereas in 2012, other States requested that new contract law rules be adopted for business-to-business transactions.[30] This request was made at the time UNCITRAL commended the PICC as being complementary to the CISG, providing consistent interpretation of general rules for international commercial contracts.[31] The ones in support of a new intervention argued that the CISG does not adequately address all relevant contract law elements.[32] The CISG left important areas outside of its scope. The PICC, on the other hand, was a soft law instrument in which States could choose to opt-in.[33] In its discussions, the Commission emphasised the fact that any new intervention must not result in a duplication of legislative works at the international level. It also noted that the CISG was adopted specifically for the purpose of harmonisation and unification of international commercial contracts. One may think that if there is indeed a need to further harmonise this area, it is an indication that the CISG is not as successful as commended by the Commission.[34]

However, this article argues that a new convention in the area of sales law would not achieve further harmonisation, especially when considering the existing diversity of domestic contract laws. The more international conventions that govern a specific area, the further we

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[28] Preamble of CISG, para. 3.

[29] *Bridge*, Choice of Law and the CISG: Opting In and Opting Out, in: Flechtner/Brand/Walter (eds.), Drafting Contracts Under the CISG, 2009, p. 68.

[30] Possible Future Work by UNCITRAL in the Area of International Contract Law: Proposal by Switzerland, UN Doc A/CN.9/758 of 8/5/2012.

[31] Report of the UN Commission on International Trade Law, UN Doc A/67/17, 2012, p. 33 et seq.

[32] Proposal by Switzerland, (fn. 30).

[33] Ibid.

[34] Report of the UN Commission, (fn. 31).

move from achieving a uniform interpretation. Instead of filling in gaps, these simultaneous conventions would contribute to the creation of inconsistencies, thus providing room for further gaps. In addition, the optional opt-in and opt-out choices do not guarantee uniformity; on the contrary, these choices prove the ability of diverse domestic laws to prevail over general harmonisation rules. We recommend that any new international convention should be mandatory in its application, to ensure uniformity and consistency of the governing law.

D. Implementation of Private International Law in Albania

In relation to the sale of goods, Albania has ratified a number of international treaties, but the most important international act is the CISG. Albania signed this treaty in 2009, which came into force on the 1 June 2010.[35]Albania has implemented the CISG in its domestic legislation and accommodates the "choice of law" provision. The choice of law shall be made expressly or be clearly demonstrated by the terms of the contract or the circumstances of the case. The parties may choose the applicable law for the whole or part of the contract. The parties may decide to amend the applicable law at a later date, different to the one agreed upon at the beginning of the contract. Later amendments to the applicable law do not affect the formal validity of the contract or the rights of third parties. The existence and validity of the contract or of one of the conditions of the contract are adjusted by the law applicable to that contract.[36]

If the parties have not chosen the applicable law in accordance with Article 45, the governing law of the contract shall be determined as follows:[37]

a) a contract for the sale of goods[38] shall be governed by the law of the country where the seller has his habitual residence;[39]

[35] Law on Private International Law, No. 10428 dated 2/6/2011.

[36] Article 45 of Law on Private International Law.

[37] Article 46 of Law on Private International Law.

[38] Articles 705-756 of the Civil Code of the Republic of Albania.

[39] Article 4(a) of Rome I Regulation.

b) a contract for the provision of services shall be governed by the law of the country where the service provider has his habitual residence;[40]

c) for a contract on real rights (rights provided by the provisions) over immovable property or the right of the users of the immovable property, the applicable law is the law where the property is located;[41]

d) regardless of what is foreseen by letter "c", a residential leasing, agreed upon individual temporary use of an immovable property, for a period not less than six consecutive months, is governed by the law of the country where the lessor has his/her permanent residence, on the condition that the tenant is a physical person, and has the permanent residence in the same country;

e) for a franchising contract,[42] the applicable law is the law of the country where the franchisor has his permanent residence;[43]

f) for a contract for the supply of goods, the applicable law is the law of the country where the supplier has the permanent residence; and

g) for a contract for sale of goods in an auction, the applicable law is the law of the country where the auction is taking place, if it is possible to locate the country.[44]

As a general principle, when the applicable law cannot be determined pursuant to the above paragraphs, the contract shall be governed by the law of the country with which it is most closely connected.[45] The rules of Private International Law provide assistance to the parties in those circumstances when it is not possible to determine the applicable law. Article 47 of this Law specifically regulates the following:

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[40] Article 4(b) of Rome I Regulation.

[41] Article 4(c) of Rome I Regulation.

[42] Articles 1056-1064of the Civil Code of the Republic of Albania.

[43] Article 4(e) of Rome I Regulation.

[44] Article 4(g) of Rome I Regulation.

[45] Article 46 of Law on Private International Law.

a) its interpretation;

b) fulfilment of the obligation, deriving from the contract;

c) within the competences given to the court by the procedural law, the consequences for the lack of fulfilment of the contract, being those in full or partial fulfilment, including the damage evaluations, as far as these derive from the provisions of the law, and do not defeat the limits foreseen by the Albanian law;

d) ways of terminating obligations, prescription of a lawsuit and decadence; and

e) consequences for contract invalidity.

Provisions on fulfilment of obligations are regulated by the law of the state where the obligations should be actually fulfilled.

Although Albania has ratified the CISG, Albanian attorneys prefer to use the choice of law provision to settle disputes in accordance with their own national laws. The majority of private international contracts apply the opting out provision in accordance with Article 6 of the CISG, allowing the parties to exclude the Convention from applying. The problem with this provision is that Albania is known to experience difficulties in terms of its judicial capacity and integrity.[46] The public have lost confidence in Albanian courts and even more so in the business community. It is common knowledge that the Albanian judicial system "suffers from widespread corruption, professional shortages, and structural inefficiencies".[47] One of the strengths of the CISG is Article 7, which provides that "1) in the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of Good Faith in international trade, and 2) questions concerning matters governed by this Convention which are not expressly settled in it are to be settled in conformity with the general principles on which it is

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[46] European Bank for Reconstruction and Development, Commercial Laws of Albania, An Assessment by the EBRD, 2012, p. 2.

[47] *Muižnieks*, Refugee Protection, Migration and Human Rights in Europe: notes from the field, Lecture given by Council of Europe Commissioner for Human Rights, CommDH(2014)1 of 4/3/2014; *Dobrushi*, How Albania Is Reforming Is Troubled Justice System, www.opensocietyfoundations.org/voices/how-albania-reforming-its-troubled-justice-system (1/12/2016).

based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law". In light of the drawbacks resulting from a corrupt judiciary system and professional shortages, the application of the CISG in Albania is weakly implemented. There is no consistent interpretation of the CISG from one judge to another due to intervening factors outside the judiciary system. With the implementation of "private international law" in the absence of choice of law, as long as one of the parties is an Albanian citizen or resident, Albanian private law automatically applies. The way Albanian national laws are applied brings a diverse application of private international law contrary to the parties' interests and thereby defeating the purpose of the CISG.

E. Conclusion

Overall the CISG has been successful at the international level in terms of removing legal trade barriers and facilitating international trade. It has achieved uniformity on terms such as: contract formation, buyers and sellers' obligations, remedies, and passing of risk. Nonetheless, various advantages and disadvantages have arisen as a result of the Convention. The harmonisation of domestic laws at the international level through the CISG assist parties entering into international commercial contracts to reach a consensus over the "choice of law" applicable in times of conflict. However, harmonisation of laws does not necessarily favour both parties. Rather, it often favours those parties who are well organised and who have bargaining power that enables them to dictate the choice of law. Equally, harmonisation does not assist if the parties have the choice to opt out of the CISG. The more "choices of law" the more uncertainty and the more inconsistently the CISG is applied. The choice of law does not contribute to further harmonisation; on the contrary, it distances uniformity.

There are those who call for a new intervention in the area of sales law. The more international conventions that govern a specific area, the more we move away from achieving a uniform interpretation. Parallel conventions would contribute to the creation of inconsistencies and further gaps in international sales law. The optional opt-in and opt-out choice is a characteristic of divergent and individualistic application of jurisdiction shopping. If international institutions step in to further harmonise the area with a new international convention,

its application should be made obligatory, to ensure uniformity and consistency in the governing law. Furthermore, to ensure harmonisation, there must be a strong movement toward adequately training the judiciary to provide consistent interpretation of international conventions. In addition, court judgments must be transparent, with proper legal reasoning to ensure public confidence.

Pledge on Industrial Property Rights in the Republic of Macedonia

Ana Pepeljugoska and Valentin Pepeljugoski[*]

Abstract

The world economy has undergone fundamental transformations in the past years. Some of the most famous companies are based wholly or in part on industrial property. Therefore, it is not surprising to find that intellectual property is a significant and growing component of many commercial transactions. The emergence of today's society and its transformation into a society based on information has enhanced the ability to use intellectual property rights as the object of securities. On the other hand, the relative importance of tangible property has diminished, as intangible property has assumed paramount significance; the "paradigm shift" phenomenon. This article does not provide a comprehensive study of this topic, rather it focuses on certain specific legal issues arising from the interaction between industrial property rights and security law in the Republic of Macedonia. Finally, it outlines some legal gaps in the existing regulation and makes some observations on legislative reform.

A. Introduction

The practice of securing obligations is an ancient one, with roots dating back to the code of Hammurabi.[1] Throughout the centuries,

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[1] The Code of Hammurabi is among the most ancient codes of law in human history. Enacted by King Hammurabi in ancient Babylon c.1780 BC, it comprised 280 laws inscribed upon an eight-foot high stone, to be read in public. Laws 49 and 50 of the Code of Hammurabi regulated loans secured by cultivated land, see *King*, Letters and Inscriptions of Hammurabi, 1900.

tangible property has been regularly used as collateral[2] to secure obligations, and thus lenders have gained considerable experience in appraising land and various types of goods, drafting the loan agreements that encompass them and perfecting the resultant security interests. Over time, legal regimes for secured transactions have been developed and interpreted to further their efficient interaction with the provisions regulating the various categories of tangible property.[3]

The contemporary development of the social-economic environment in the Republic of Macedonia also resulted in the development of significant laws and instruments for the securing of claims. Taking into consideration the fact that Republic of Macedonia originated from a socialist model, that combined market and planned economies, the existence of the securities was not closely connected with industrial property rights.

During the last few years the instrument of a pledge as a security of claim became a typical type of agreement, which also reflected an interest in its application to industrial property rights. Even though, the idea of using industrial property rights as a pledge object seems to be very attractive nowadays, by contrast intellectual property rights have seldom been used as collateral *per se*.[4]

Therefore, this article focuses on certain specific legal issues arising from the interaction between industrial property rights and a pledge as an instrument of security law in general and in the Republic of Macedonia. It additionally provides an overview and analysis of the existing pledge regulations concerning industrial property rights. Finally, the article outlines certain observations with respect to the existing legislation and makes a proposal on the further use of industrial property rights as collateral.

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[2] In this article, the word "collateral" is used as a noun to indicate assets that are the subject matter of a pledge.

[3] *Tossato*, Security interests over intellectual property, Journal of intellectual property law & practice 6 (2011), p. 93.

[4] A notable exception concerns transactions under which security is taken over all the assets of a company; however, even in these cases, the inclusion of intellectual property rights appears to be incidental, for the sake of completeness rather than the recognition that it can yield a front line source of finance for the recovery of the debt, see *Tossato*, (fn. 3), p. 93.

B. The "Classical Concept" of the Pledge in the Republic of Macedonia

The regulatory framework of the pledge, as a legal institution, in the Republic of Macedonia is governed by the Law on Ownership and Other Real Rights.[5] The pledge is categorised as a "real right" and defined in Article 225 of the Law on Ownership and Other Real Rights. In this respect the right of the pledge shall be a real right over a third party's object delivered as security for the claim of the pledgee, by giving a certain thing or right as a pledge (pledging) for the benefit of the pledgee. The pledgee is then authorised to use the third party's thing in a manner which, after the due date, enables them to request collection of their claim from the value of that thing or right (by selling the pledged thing), before the creditors who have not established the right of pledge of that thing or right, as well as before the pledgees who have subsequently acquired the right of pledge of that thing, regardless of the change in ownership. As a general matter, the pledge obligation is not a fundamental, but supplementary (accessory) in relation to the fundamental one, with the primary objective of securing the claim in case of default.[6]

In accordance with Article 228 of the Law on Ownership and Other Real Rights, the right of pledge may be established over movable and immovable property and rights.[7] The right of pledge may be established on the basis of a contract (contractual pledge right), court decision (court pledge right) and law (legal pledge right). The contractual pledge is closely connected with the securing of industrial property rights. In this respect it shall be acquired by concluding a contract of pledge and by registration in the appropriate public records in the case of an immovable pledged thing, and in the case of movable pledged things or pledged rights, the pledge shall be acquired by concluding a

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5 Official Gazette of the Republic of Macedonia No. 18/2001, 31/2008, 92/2008, 139/2009, 35/2010.

6 See http://pattrade.ru/eng/services/10/ (1/12/2016).

7 Unlike the Law on Ownership and Other Real Rights of the Republic of Macedonia, the Model Law on Secured Transactions, drafted by the European Bank for Reconstruction and Development (2004) and the UNCITRAL Legislative Guide to Secured transaction (2007) use the term "single securities right" with respect to securities connected with all types of things and rights.

contract of pledge and by handing over the thing in possession of the pledgee (unregistered pledge), or by making a con-tract of pledge and by making an inventory of the pledged thing, without handing over the thing in possession of the pledgee (registered pledge).[8]

In order to facilitate access to financing based on industrial property, the Republic of Macedonia, following the trends in the region, supplemented the regime of securing obligations. Therefore, the specificities of the pledge on industrial property rights today, are additionally governed by the *lex specialis* – Law on Contractual Pledge[9] and Law on Industrial Property,[10] which shall be addressed further below.

C. Main Features of the Pledged Industrial Property Rights with International Focus

The umbrella term "intellectual property" encompasses both industrial property rights, copyright and related rights and, lastly, unfair competition. The scope of the industrial property rights determined by the modern doctrine and practice includes the set of rights stipulated in Article 1 of the Paris Convention for the Protection of Industrial Property.[11] Namely, the subjects of protection of the industrial property rights are: patents, utility models, industrial designs, trademarks, trade names, geographical indications and unfair competition.[12] However, the Agreement on Trade-Related

[8] Article 226 of the Law on Ownership and Other Real Rights.

[9] Official Gazette of the Republic of Macedonia No. 5/2003, 4/2005, 87/2007, 51/2011, 74/2012, 115/2014, 98/2015, 215/2015, 61/2016.

[10] Official Gazette of the Republic of Macedonia No. 21/2009, 24/2011, 12/2014, 41/2014, 152/2015, 53/2016.

[11] The Paris Convention dates from 1883 and has been amended in Madrid 1891, Brussels 1900, Washington 1911, Hague 1925, London 1934, Lisbon 1958, Stockholm 1967 and 1979.

[12] The Law on Industrial Property of the Republic of Macedonia provides protection of the following industrial property rights: patents, industrial designs, trademarks and geographical indications. The unfair competition is regulated by the Law against unfair competition (Official Gazette of the Republic of Macedonia No. 80/1999) and the protection of the topography of integrated circuits is regulated by the Law on protection of topography of integrated circuits (Official Gazette of the Republic of Macedonia No. 5/1998, 33/2006, 136/2011, 53/2016).

Aspects of Intellectual Property Rights (TRIPS) also implements the rights of know-how, trade secrets and topography of integrated circuits.[13] The main characteristic of industrial property rights is the possibility to group them in two major groups, depending on whether they are registered in order to enjoy protection or not. Included in the group of registered industrial property rights are: patents, utility models, industrial designs, trademarks, trade names, geographical indications, domain name and topography of integrated circuits. In the second group are: know-how, trade secrets and trade dress. These rights are only protected through the mechanisms for protection against unfair competition.[14]

It should be understood that industrial property rights are a special kind of "property",[15] the nature of which is largely determined by a non-material component and the personality of the holder of the rights. With respect to the features and content of the nature of the industrial property rights in the scope of the Law on Industrial Property, the rights derived from the collective mark[16] and geo-

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13 *Pepeljugoski*, Zashtita na pravata od industriska sopstvenost od nelojalna konkurencija, 2004, p. 19.

14 It is highly disputed in the theory whether non-registered industrial property rights can be the subject of a pledge. The prevailing opinion in this regard, provided by former Judge (Representative of the Republic of Macedonia) of the European Court of Human Rights, *Margraita Caca Nikolovska*, is that in such cases the risk that the pledgee undertakes is higher and the Pledge Agreement should not be signed where the industrial property rights are not applied or recognised by the State Office for Industrial Property, see Zdruzenie na zastapnici za zashtita na pravata od industriska sopstvenost na Republika Makedonija, Industriskata sopstvenost pottik za stopanski razvoj na Republika Makedonija, 1996, pp. 83-97.

15 The industrial property right, defined as a right over certain intellectual creation with *erga omnes* effect, is a common characteristic of all property (ownership) rights. However the industrial property right refers to the intellectual creations as such and not the physical object (*res*) in which the intellectual creation is incorporated. In light of this the industrial property right related to the intellectual creation is independent of the property (ownership) right of the object where these rights are embedded, see *Anastasovska/Pepeljugoski*, Pravo na intelektualna sopstvenost, 2012, p. 20.

16 The definition of the World Intellectual Property Organization provides that: Collective marks are usually defined as signs which distinguish the geographical origin, material, mode of manufacture or other common characteristics of goods or services of different enterprises using the collective mark. The owner may be either an association

graphical indications[17] cannot be pledged due to the fact that they are deemed as non-transferable rights under Article 258 of the Law on Industrial Property of the Republic of Macedonia.

Despite these limitations, the industrial property rights are mainly considered as personal property and therefore can be used as pledge collateral for securing a claim.[18] However, only a right that is owned by the pledger may be a subject of the pledge, including a future right. This raises several concerns as to when the industrial property rights become the subject of the pledge: at the date of its application, as of the registration date or from their recognition?

Pursuant to Article 19 of the Law on Industrial Property, industrial property rights are acquired by recognition of the rights and entering of such rights into the appropriate Registries and thus are valid from the day of filing an application with the State Office for Industrial Property.[19] The interpretation of this provision provides the clear conclusion that industrial property rights can be the subject of a pledge even in the "application" stage. However, in such cases the pledgee should be aware that the right may not be recognised at a later date. Another due consideration is the duration of industrial property rights, especially if we take into account the fact that the owner of the right cannot cancel it without obtaining written approval by the pledgee[20] holding the appropriate collateral registration.[21]

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of which those enterprises are members or any other entity, including a public institution or a cooperative, see www.wipo.int/sme/en/ip_business/collective_marks/collective_marks.htm (1/12/2016).

[17] The definition of the World Intellectual Property Organization provides that: A geographical indication (GI) is a sign used on products that have a specific geographical origin and possess qualities or a reputation that are due to that origin. In order to function as a GI, a sign must identify a product as originating from a given place. In addition, the qualities, characteristics or reputation of the product should be essentially due to the place of origin. Since the qualities depend on the geographical place of production, there is a clear link between the product and its original place of production, see www.wipo.int/geo_indications/en/ (1/12/2016).

[18] Article 4 of the Law on Contractual Pledge.

[19] *Anastasovska/Pepeljugoski*, (fn. 15), pp. 232-233, 262-267 and 272-275.

[20] See High Court of Justice, *Van Gelder, Apsimon and Co., Ltd v. The Sowerby Bridge Flour Society, Ltd.*, decision of 1/2/1890, Reports of Patent, Design and Trade Mark Cases 1890, Vol. VII, No. 24, p. 208 et seqq., where the Court of Appeal in England had to

Nonetheless, in assessing the conveyance of industrial property rights as securities, one should use the analogy of exclusive licenses, which provide effective solutions to compensate for the potential drawbacks of a pledge. In this regard the existing legislation also provides for the possibility of asking the pledgee to pay the taxes for maintenance of the rights, should the holder fail to pay them in time.

In the Republic of Macedonia, the pledge of industrial property rights is classified as non-possessory pledge.[22] The reasoning behind this norm can be found in the fact that the industrial property rights are pure intangibles[23] and may be exercised and fully enjoyed by an indefinite number of subjects simultaneously.[24] The right to a non-

decide whether the plaintiff patent holder still had title to bring infringement proceedings, having transferred his industrial property rights by way of mortgage. During the trial, it was shown that the Patent Office Registrars had developed a special practice to distinguish assignees acquiring title to a patent by virtue of a regular transfer from those who had acquired title under a mortgage; the latter were not registered as "assignees" but simply as "mortgagees". The ruling distinguishes clearly between proprietor and mortgagee, defining the formalities necessary for providing notice to third parties. This principle is also incorporated into Article 40 of the Law on Contractual Pledge, in the that case anybody violates the right to pledge over the pledged collateral through a non-valid entry in the Pledge Register, the pledgee shall be entitled to protect him/herself against the violation through legal means anticipated for protection of rights that are being entered in the Pledge Register.

21 Article 43 of the Law on Industrial Property.

22 Unlike the provision of Article 16(1) of the Law on Industrial Property that expressly includes industrial property rights, the provision of Article 16(2) of the Law on Industrial Property, which defines the possessory pledge, provides that the right to a possessory pledge over claim or other right shall be established by concluding a pledge contract and transfer of the claim or other type of right. It is therefore our position that the right of patent as an industrial property right, can also be subject to the possessory pledge. See *Pepeljugoski*, Patentno Pravo, Zdruzenie na pravnici na Republika Makedonija, 2011, pp. 176-183.

23 Pure intangible is "a right which is not in law considered to be represented by a document", as opposed to "documentary intangibles", which are documents embodying title to goods, money or securities such that the right to these assets is vested in the holder of the document for the time being and can be transferred by delivery of the document with any necessary endorsement. The existence of registration documents for certain IP rights (such as patents and trademarks) does not affect their qualification as pure intangibles, see *Goode*, Commercial Law, 4th ed. 2010, p. 51.

24 *Pepeljugoski*, (fn. 22), p. 177.

possessory pledge over a claim or other type of right (intellectual rights and other related rights) shall be established by concluding a pledge contract, making inventory and description of the pledged claim or the other right and registration of the pledge in the Pledge Register.[25] In addition Articles 88, 174 and 218 of the Law on Industrial Property necessitate the registration of the contractual pledge as well as registration in the registries that are in the scope of the State Office for Industrial Property.[26] The justification for this double registration is closely connected with the third party effectiveness of the security right.

The pledgee and the pledger are allowed to conclude the pledge contract in writing, apart from the possessory pledge contract which can be concluded in any form, and can give the pledge contract the status of executive document prior to or after its entry in the Pledge Register, only if it is verified or composed by a notary and if it contains a statement of the agreed parties stating their consent for their pledge contract to have the status of an executive document.[27]

According to Article 23 of the Law on Contractual Pledge, the pledge contract shall contain in particular: information on the contractual parties, the legal basis for the claim that is being secured with the pledge and its amount, the due date of the claim, the time and place of conclusion of the contract, the consent of the pledgee that the pledger requires entry of the right on pledge or mortgage in the Pledge Register *(clausula intabulandi)* etc.

It is preferable, as explained above, that the pledge contract concerning the registered industrial property rights be in writing and that it reflect the clear intention of the parties to establish the security right. One of the essential elements of this contract is the detailed

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25 Article 16 of the Law on Contractual Pledge.

26 Upon official request for information gathering, we have obtained information that the State Office for Industrial Property of the Republic of Macedonia does not have any indication as to the registered pledge on any industrial property right in the territory of the Republic of Macedonia in the moment of writing of this Article. However, the bylaws in the field of industrial property, such as Article 25 of the Rulebook on Patents (Official Gazette of the Republic of Macedonia No. 21/2009) provides explicit obligation to record any change, including pledge, of the right of patent.

27 Article 22 of the Law on Contractual Pledge.

description of the industrial property right concerned.[28] In addition the pledged right (in our case the industrial property right) should be evaluated by an official evaluator.[29] Since there is no universally accepted calculation formulae, and depending on the purpose of valuation, there are different forms of value that may be attributed to the pledged right: market, investment, insurable value etc. In the case of intangible assets as collateral the total pledge value should be considered. As a rule, the realisation of collateral means its sale. Hence, the pledge value can be equated with the market value.[30] On the other hand, in the case of long run financing one should pay attention to the investment value of IP,[31] There are three main approaches to the valuation of industrial property objects: the income approach which focuses on the consideration of the income-producing capability of the industrial property object; the market or comparative approach which is based on comparing the prices of sales of comparable industrial property objects in the market; and the cost approach which seeks to evaluate the industrial property object by calculating the cost on development and protection of industrial property.[32] The income approach is considered to be the principal method and is primarily applied for the valuation of

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[28] *Pepeljugoski*, (fn. 22), p. 178.

[29] Ibid.

[30] The market value is the possible price in money, equivalent to the amount at which a seller would sell and buyer would buy the underlying asset on the day of valuation on the assumption that both act of their own free will, both have enough information, knowledge and competence for this transaction and the deal is made in the competitive market, see *Kurkus/Antonova*, Valuation of intellectual property as pledge objects: Theoretical Aspects, in: Hennies/Raudjärv (eds.), XIII Majanduspoliitika Teaduskonverents, 2005, p. 251.

[31] The investment value is a value of IP from the position of competitor-investor, who has his own estimations and assumptions about return on planned investment, see ibid.

[32] According to the consolidated and audited financial statements of the company for the year 2011, the value of the intangible assets of Novartis International AG was nearly 62 billion of USD. This is 52.7 % of the total book (or accounting) value of the company, www.stock-analysis-on.net/NYSE/Company/Novartis-AG/Analysis/Goodwill-and-Intangible-Assets (1/12/2016).

industrial property rights.[33] The other two are used to supplement the income method.[34]

The pledgee, whose claim is secured by the right to pledge, may, based on the existing right to pledge and within the limits of the claim, establish a pledge from the pledged collateral for the benefit of a third party (sub-pledge) even without the consent of the pledger.[35]

In the case that the pledger decreases the value of the pledged collateral or in any other way deteriorates its condition; the pledgee can require the pledger to restore, within a reasonable time frame, the pledged collateral to its original state. By contract the pledgee can also require the court to order the pledger to restrain from such actions, and if he/she fails to do so, the pledgee can require the collection of the claim secured by the pledge even prior to the due date.[36]

The Law on Contractual Pledge does not define specific reasons for termination of the pledge on industrial property rights. Rather, it enumerates in Article 41 that all the general reasons for termination of right to pledge shall be: loss of the possession of the pledged collateral in case of non-registered pledge, in the case that the loss occurred in a lawful manner; fulfilment of the obligation by the pledger (termination of the claim); legally valid waiver of the securing asset; merger of the pledgee and the pledger into one entity; destruction of the pledged collateral due to force majeure unless the pledged collateral is insured; sale of the pledged collateral for the purpose of realisation of the right to pledge;[37] termination of the legal entity which is the pledgee, and which has no legal successor; unilateral termination of the pledge contract under conditions determined by law; agreed termination of the pledge contract; lapse of the

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33 *Harrison/Sullivan,* Profiting from intellectual capital: Learning from leading companies, Journal of Intellectual Capital 1 (2000), pp. 33-46; *Stojkov*, An Introduction to valuation of intellectual property assets, 2011, pp. 1-30.

34 *Kurkus/Antonova*, (fn. 30), p. 252.

35 Article 25 of the Law on Contractual Pledge.

36 Article 26 of the Law on Contractual Pledge.

37 The Law on Contractual Pledge further defines the procedure for realization of the pledge right in Chapter V.

time limit and other cases determined by law. The pledge shall be terminated by its deletion from the Pledge Register, upon request by either of the parties.[38] One should also take into account the reasons for termination of the industrial property right used as a collateral, that are usually provided in the legal acts regulating the industrial property rights.[39]

The realisation of the pledge on an industrial property right occurs in cases when the pledger fails to fulfil the due obligation, thus entitling the pledgee to request its collection.[40] Therefore, when a pledged claim is due for payment the pledgee shall be obliged to collect it. Only after a pledged claim has been settled shall the right to pledge be transferred to the collateral with which the claim has been settled.[41] Should the pledger fail to perform his/her obligation when due, the pledgee shall be entitled to collect his/her claim from the assigned claim. After settling his/her claim, a pledgee shall be obliged to deliver the surplus in money or other subjects to the pledger.[42]

Taking into consideration what was mentioned above with respect to all types of industrial property rights, the law draws a distinction between the creation of the pledge as a security right and its effectiveness as against third parties. The drafters' main purpose of this distinction was to achieve three key objectives, namely, to establish a security right in a simple and efficient way, to enhance the certainty and transparency and to establish clear priority rules.[43]

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[38] Article 42 of the Law on Contractual Pledge.

[39] Article 87 (termination of patents), Article 173 (termination of industrial design), Article 217 (termination of trademarks) of the Law on Industrial Property.

[40] In accordance with Article 59 of the Law on Contractual Pledge, if in the pledge contract the contractual parties have not chosen one of the commercial manners of sale of the pledge nor have they chosen an authorised entity for enforcement of the realisation of the pledge, the pledgee shall have the right to choose the authorised entity (notary, enforcement agent, agency for sale of movables and immovable, broker over the stock-exchange and other entities anticipated by this Law) who will enforce the realisation of the pledge.

[41] Article 79 of the Law on Contractual Pledge.

[42] Article 80 of the Law on Contractual Pledge.

[43] UNCITRAL Legislative guide: Supplement on Security Rights in Intellectual Property, 2011, p. 35.

However, both the Law on Contractual Pledge and the Law on Industrial Property contain provisions that vaguely relate to the pledge on industrial property rights. In this respect, one can only apply these general provisions in the industrial property scenario by analogy. Such an approach towards industrial property rights is also present in the praxis of the commercial banks and financial institutions that do not have a clear perspective nor the will to use the industrial property rights as collateral.[44]

In an international context, the Russian Legislator went one step further and recently introduced a new way of disposition of rights under Articles 1232, 1233 of the Civil Code – which is called a pledge of intellectual property (including pledge of copyright and related rights). The pledge, which is assigned to "*the ways of obligations securing*", is called to grant the creditor additional assurance of his rights and legitimate interests, whereas it actually means that the creditor (pledge holder) has the right to get reparations from the cost of the pledged property.[45] In China and Japan, the pledge financing of industrial (and intellectual) property rights refers to a way of financing enterprises using the rights as a pledge for loans from commercial banks, a possibility which is given by Article 75 of the China's Security Law.[46] To promote intangible assets pledges such as industrial property rights pledge, the United States established the federal small business administration (SBA) to provide guarantees for technological SMEs, that many enterprises may obtain the chance of financing. For small loans SBA provides an 80 % guarantee and for big loans provides a 75 % guarantees and loan maturities can last for 25 years.[47] Additionally, the legislation of the EU Member States

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[44] As a confirmation of this standpoint the internal statistics of the Pledge Registry indicate that the most common type of pledge in the Republic of Macedonia is the pledge on registered and non-registered vehicles. For the year of 2016, there was only one case of pledge on trademark. In principle there are less than five cases of pledge of industrial property rights per year.

[45] See http://pattrade.ru/eng/services/10/ (1/12/2016).

[46] *Yang et al.*, The Role Analysis of Government in Intellectual Property Rights Pledge and Financing of Technological Small and Medium-sized Enterprises, International Journal of Business and Social Science 5 (2014), p. 75.

[47] Ibid.

widely accepts the concept of pledge of registered industrial property rights.[48] Some EU Member States, such as France, Italy, Portugal, Spain and Sweden, even provide for the pledge of intellectual property rights in broader terms, including copyright and related rights.[49]

In this context, the Serbian Law on Trademarks (Articles 8, 53, 56) and Law on Industrial Design (Articles 13, 52, 54) also grant the possibility of establishing a pledge over industrial property rights. In addition the pledge needs to be registered in front of the Registry in the scope of the IP Office.[50] The possibility of pledging a registered industrial property rights is also provided in the legislation of Kosovo, as a general administrative procedure.[51] In Bulgaria, the design rights can be used as collateral or as an object of a pledge to secure financial support.[52] Furthermore, the rights streaming from industrial design are considered as assets in the case of a firm's bankruptcy.[53] The Slovenian law prescribes the eligible types of industrial property rights, mostly patents and trademarks, which can be pledged. In light of this, the substantial value of industrial property rights is often used by banks as an element of company rating.[54]

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48 See http://us.practicallaw.com/0-501-7458#a209538 (1/12/2016).

49 Institute for Information Law Amsterdam, Study on the conditions applicable to contracts relating to intellectual property in the European Union, Final Report, 2002, p. 158.

50 *Tešić*, Obezbedjenje na pokretnim stvarima i potrazivanjima (Republika Srbija), 2015, p. 226.

51 Article 18 of the Law on Trademarks of Kosovo (Official Gazette of the Republic of Kosovo No. 10/24 of August 2011); Article 23 of the Law on Industrial Design of Kosovo (Official Gazette of the Republic of Kosovo No. 40/31 of December 2015); Article 32 of Law on Patents of Kosovo (Official Gazette of the Republic of Kosovo No. 12/29 of August 2011).

52 Articles 3 and 13 of the Industrial Design Law of Bulgaria.

53 Europe Economics, The Economic Review of Industrial Design; Final Report MARKT/2013/064/D2/ST/OP, 2015, pp. 33 and 112.

54 *Leutgeb*, Intellectual Property Rights as Collateral for Bank Loans an aws-Pilot-Scheme, 16-17/4/2015, Maribor, slide 6, http://aecm.eu/wp-content/uploads/2016/09/OTS-Maribor-programme-2015-04-16.pdf (1/12/2016).

D. Conclusion

Although some commentators worldwide argue that the current legislative framework that allows industrial property rights to be object of security, is tainted by numerous difficulties, which ultimately render it a legally uncertain and economically inefficient form of debt financing.[55] Others believe that the use of these rights as collateral can be a relatively easy task.[56]

In our view the knowledge of the character and real value of industrial property rights in the Republic of Macedonia is still at a very basic level. Although the industrial property rights' pledge policy has existed for a long time, the associated pledge and financing have not become the main source of corporate loans because of the variability and intangibility of these rights. In addition, the legislative analysis in this article shows that the legal framework does not provide straightforward solutions that cover the pledge on industrial property rights, nor are they expressly referred to in the legal texts or commentaries.[57] In this respect, taking security over a single industrial property right can be a relatively easy mission, or conversely securing a large portfolio of industrial property rights can result in great difficulties. Such a context burdens the legal certainty of the process of establishing a pledge on industrial property rights, thus making it efficient and applicable only under certain conditions.

Despite the inconsistencies, this article has shown that the status of industrial property rights in the Republic of Macedonia and in the regional and international context, as it is, still provides solid preconditions for the pledging of industrial property rights. This brings us to

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55 *Tossato*, (fn. 3), p. 104. Further on this point see *Townend*, Intellectual property as a security interests: Technical Difficulties presented in the law, Intellectual Property Quarterly 1997, p. 166 et seqq.

56 *Bromfield/Runeckles*, Taking security over intellectual property: A practical overview, European Intellectual Property Review 28 (2006), p. 348.

57 For instance the Commentary on the Law on contractual page, in regards to the possibility of establishing a pledge on industrial property rights points to the substantive provisions of the Law on Industrial Property instead of making direct reference to the industrial property rights as a collateral of pledge. For further info see *Chavdar/Pulejkova*, Zakon za dogovoren zalog – so komentari, objasnuvanja I predmeten registar, 2003, p. 21.

the conclusion that a slight reform of the rules governing the securities on industrial property rights would be greatly beneficial in the near future. Even though the current legislative framework provides background solutions, it is our position that the Republic of Macedonia should undergo specific industrial property related reform, regulating the pledge (and other types of securities) on industrial property rights. The reasoning behind this is the fact that the current general system of security law seems to function properly in regard to the other objects that can be used as collateral, rather than in regard to industrial property rights. It is therefore in our view apparent that the creation of the perfect framework is rather impossible; however, several major steps would improve the standing of the industrial property rights in this context.

The government should focus on the process of pledge registration, evaluation and market transaction, formulate operation rules and standards as well as make them applicable and operable. The first step of the specific reform filed is to provide single Pledge Registry, whereby all pledge rights, including industrial property rights, will be listed. In addition, this Pledge Registry will be interconnected with the State Office for Industrial Property and will function in close collaboration. This would additionally require amendment of the Law on the One-Stop-Shop System and Keeping a Trade Register and a Register of Other Legal Entities.[58] Special attention should be given to the possibility of publishing all pledges on industrial property rights in the Official Bulletin ("*Glasnik*") of the State Office for Industrial Property in order to enable their true effect towards third parties. Secondly, the reform should be aimed at presenting the potential advantages that pledges on industrial property may bring to domestic companies that have rich industrial property portfolios. In this context, the legislation will be tailored by taking into account the practical and theoretical knowledge of securities law and industrial property law. Further, this should be followed by expanding the list of certified and skilled official evaluators/experts for appraising the value of the industrial property

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[58] Official Gazette of the Republic of Macedonia No. 84/2005, 13/2007, 115/2007, 150/2007, 140/2008, 17/2009, 28/2010, 17/2011, 53/2011, 70/2013, 115/2014, 97/2015, 192/2015, 53/2016, 114/2016.

rights. Finally, the experience of the developed countries and the guidelines provided by international organisations, such as UNCITRAL,[59] should be taken into account. This is especially so due to the fact that the usage and association of this "international" mechanism has produced remarkable results and enhancement of value worldwide, proven through the high percentage of participation of industrial property rights as the object of securities, in the total world trade and economy. It is also possible to absorb more stakeholders into the establishment procedure of local administrative regulations and to let all commercial institutions, and especially SMEs, participate in the consultation process to ensure the effectiveness, comprehensiveness, timeliness and pertinence of the policy.

[59] UNCITRAL, (fn. 43), pp. 35-124.

Discouraging Unnecessary Litigation through the New Croatian Legal Aid System and Law Clinics

Barbara Preložnjak and Juraj Brozović[*]

Abstract

Access to justice is a core fundamental right and a central concept in the broader field of justice. Exercising this right efficiently through the legal aid system is one of the most important tasks of modern societies. While access to justice typically means having a case heard in a court of law, it can more broadly be achieved or supported through primary legal aid. In the last few years the issue of gaining the right to primary legal aid has become widely discussed and criticized in Croatia. In this paper, we express the view that primary legal aid can encourage early resolution and discourage unnecessary litigation while at the same time enabling effective protection of citizens' civil rights.

A. Introduction

Unnecessary litigation is a serious threat to the legal system. It harms both the litigants and society in general. By engaging in such proceedings, litigants lose precious time and money. On the other hand, others are unable to exercise their right of access to justice within a reasonable time, as the courts become overburdened. In such form, unnecessary litigation[1] represents a direct negation of the concept of access to justice. It is thus no surprise that legislators put a

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[1] There is no universal definition of unnecessary litigation. For the purposes of this paper, the term "unnecessary litigation" shall refer to any litigation, which could have been "prevented by the exercise of reasonable care" – *Berheimer et al.*, Rules for the Prevention of Unnecessary Litigation, American Bar Association Journal 3 (1917), p. 36 et seqq.). It should thus be understood in a much broader sense than the term "vexatious litigation".

lot of effort into removing its dreadful consequences, by reforming their civil justice legislation.[2] Although such reforms are to be welcomed, it seems that a mere change in legislation cannot effectively influence the habits of the people. It is not a surprise. If one does not have a detailed and precise insight into his or her legal rights and duties, as well as possibilities, how can one be expected to see any other solution apart from litigation? It is only natural that people seek the court's assistance in protecting their interests. The problem arises when people do not evaluate their situation correctly and try to protect interests, which are not in accordance with the legal order. The situation is similar when there is an alternative to going to court and people are unaware of it.

Those problems could be solved with the help of prior legal advice. When such advice is received early enough it is said to be a useful tool for overcoming socially undesirable behaviour.[3] Not only do people with access to advice reach socially desirable decisions, but they also reach the ones, which are most favourable to them.[4] If unnecessary litigation is viewed as socially undesirable behaviour, which is not favourable to anyone's interest, one could argue that expanding access to legal advice could be a way out of unnecessary judicial proceedings. Such encouragement would certainly be in accordance with the well-established case law of ECtHR, according to which legal advice constitutes a part of the right to a fair trial.[5]

So where could clients get the necessary legal advice? The cost of such advice seems like an insurmountable obstacle in cases where people do not have sufficient funds and where the legal aid system is

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2 For example, a lot of effort was put in recent years to promote alternative dispute resolution methods. For the review of recent reforms in that field within Europe, see European Commission for the Efficiency of Justice (CEPEJ), European judicial systems – Edition 2014 (2012 data): efficiency and quality of justice, 2014, pp. 147-155.

3 *Kaplow/Shavell*, Legal Advice about Information to Present in Litigation: Its Effects and Social Desirability, Harvard Law Review 102 (1989), p. 567 et seqq. There are, however, other authors who criticize their approach and methodology, see e.g. *Nesson/Kaplow/ Shavell,* On Legal Advice in Litigation, Harvard Law Review 103 (1990), p. 2082 et seqq.

4 Ibid.

5 According to the ECtHR, entitlement to a fair trial "also comprehended a right to make an informed decision as to whether to sue or not." ECtHR, no. 4451/70, *Golder v. UK*, judgment of 21/2/1975.

not efficient.[6] The other possibility is to enhance support for the non-governmental organisations providing legal aid, as well as for law clinics. The former have become especially popular, [7] as they contribute to society while simultaneously improving the quality of legal education.

Can the law clinics lead the way for such an important social task? In order to answer that question one must first examine the role of the law clinics in the legal aid system and their capacity to contribute to the reduction of unnecessary litigation, on both a macro and micro level. In doing so, we will use the Croatian example.

B. Advisory Framework for Implementation of Modern Primary Legal Aid Systems

The issue of ensuring efficient protection of human rights through the system of legal aid is one of the most important tasks of modern societies and it has been a powerful and key concept on the political agenda of the judicial systems in Europe.[8] The idea of the necessary and active role of societies in providing protection for equal human rights by enabling access to justice stems from the beginning of the 20th century and the first international conventions on human rights. Despite the initial positive aim of protecting important human rights, legal practices indicated that, in global and regional terms, approaches to providing equal access to justice differed. That necessarily led to the need to establish standards of criteria as a framework within which modern societies would build their systems of protecting equal access to justice. The European Convention of Human Rights (ECHR) undoubtedly influenced the creation of such a system, defining the minimum legal standards that a legal system has to meet in order to create an

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6 The efficiency of legal aid systems was analysed by CEPEJ, (fn. 2), pp. 69-88, but also by some private initiatives, see *Barendrecht et al.*, Legal Aid in Europe: Nine Different Ways to Guarantee Access to Justice?, HiiL Inovating Justice, 2014.

7 For the brief overview of the development of clinical legal education, see *Romano*, The history of legal clinics in the US, Europe and around the world, in: Bartoli (ed.), Legal clinics in Europe: for a commitment of higher education in social justice, 2016, p. 27 et seqq.

8 *Hess*, EU Trends in Access to Justice, in: *Van Rhee/Uzelac*, Civil Justice between Efficiency and Quality: From Ius Commune to CEPEJ, 2008, p. 189 et seqq.

adequate legal basis for the creation of a modern and efficient system of legal aid. With the help of the European Court of Human Rights (ECtHR), the ECHR was used to develop the legal doctrine of enabling access to justice through the system of legal aid, which was presented within the right to a fair trial.[9] This is most evident in the ECtHR case *Airey v. Ireland*, which implied the obligation of the state to provide legal aid in order to access justice not only in criminal cases but also in civil.[10] The *Airey* case gave the countries clear guidelines for interpreting the mandatory provision of legal aid in circumstances such as: the importance of the matter for the individual, the complexity of the matter, the ability of the individual to represent themselves legally and to cover the expenses of the procedure on their own.[11] Therefore, effective legal aid systems are part of the core areas of the right of access to justice. With the ECtHR guidelines that keep reminding the countries of the importance of normative and practical establishment of the efficient protection of citizens' rights to access to justice, the countries are obligated to recognize the needs of their citizens and enable all citizens to exercise their equal rights to protection of subjective rights to the greatest extent possible.

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[9] See Article 6(1) Convention for the Protection of Human Rights and Fundamental Freedoms as Amended by Protocols No. 11 and No. 14 (opened for signature 4/11/1950, entered into force 3/9/1953).

[10] *Uzelac/van Rhee*, Introduction, in: Van Rhee/Uzelac (eds.), Access to Justice and the Judiciary: Towards New European Standards of Affordability, Quality and Efficiency of Civil Adjudication, 2009, p. 2.

[11] Apart from the previously mentioned ruling of the ECtHR, the following court rulings are applied as a special source of law regarding the right to legal aid: ECtHR, no. 6694/74, *Artico v. Italy*, judgment of 13/5/1980 (member states are generally obligated to ensure the right to equality before the law); ECtHR, no. 8398/78, *Pakelli v. FRG,* judgment of 25/4/1983 (the petitioner seeking legal aid has the right to use the lack of material means without having to prove it beyond reasonable doubt); ECtHR, no. 8966/80, *Goddi v. Italy*, judgment of 9/4/1983 (the right to legal aid is violated if the official solicitor is not granted sufficient time to prepare); ECtHR, no. 12744/87, *Quaranta v. Switzerland*, judgment of 23/4/1991; ECtHR, no. 19380/92, *Benham v. U.K.*, judgment of 10/6/1996; ECtHR, no. 25280/94, *Perks et al. v. UK*, judgment of 12/10/1999 (the existence of the interest of justice); ECtHR, no. 11932/86, *Granger v. UK,* judgment of 28/3/1990; ECtHR, no. 18711/91, *Boner v. UK,* judgment of 28/10/1994 (member states are obligated to ensure legal aid in all stages of the procedure); and ECtHR, no. 13611/88, *Croissant v. Germany*, judgment of 25/9/1992 (if the state asks for reimbursement of authorized funds spent on the official solicitor, the right to legal aid is not violated).

Therefore, it is of utmost importance for each country to establish an efficient system of primary legal aid, which will enable an equal and free right to legal information and advice to the greatest extent possible by focusing on the actual needs of the citizens.[12] Specifically, this means that the countries constantly monitor the needs of their citizens, which includes regular empirical research to identify changes in the citizens' needs and to adjust the system of primary legal aid accordingly, especially considering the circle of subjects aid is given to, the scope of legal advice, the type of legal aid services available and the appropriate funding of primary legal aid services.[13] Following previously mentioned guidelines for establishing the modern primary legal aid system, legal aid schemes are supposed to be generous in defining their target population with the aim being to provide practical and effective access to legal information and advice by eliminating economic obstacles, especially for those in an economically weak position.[14] Providing practical and effective access to primary legal aid means taking into account an individual's capacity to understand their legal problem and also their capacity to undertake legal measures for efficient protection of rights in various legal problems by accessing not only the court but to other legal services as well.[15]

C. Croatia on the Path to a Modern Legal Aid System – A Background Picture of Croatian Primary Legal Aid

Modern legal aid should be liberal when it comes to the provision of brief legal advice and it should cover all types of legal problems in society.[16] International research show that legal literacy is limited and that ordinary and poor people face huge amounts of simple legal

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12 *Johnsen/Stawa/Uzelac*, Evaluation of the Croatian Legal Aid Act and its Implementation (International Expertise), 2010, p. 11.

13 Ibid., p. 10; *Flood/Whyte,* What's Wrong With Legal Aid? Lessons From Outside the UK, Civil Justice Quarterly 25 (2006), p. 85.

14 *Johnsen/Stawa/Uzelac*, (fn. 12) , p. 29; *Manning*, Development of a Civil Legal Aid System, in: Sachs/Rekosh (eds.), Issues for Consideration, Making Legal Aid a Reality A Resource Book for Policy Makers and Civil Society, 2009, p. 65.

15 *Johnsen/Stawa/Uzelac*, (fn. 12), p. 7 et seq.

16 *Johnsen/Regan*, How to Use an International "Best Policy" Model in the Analysis and Improvement of Finnish Legal Aid, in: *Van Rhee/Uzelac*, (fn. 8), p. 155.

problems that they are unable to handle effectively by themselves but that can be solved quickly by a competent adviser.[17] Such legal aid services should be informal, efficient and accessible.[18] They should include services such as: legal advice and information in face-to-face interviews or over the telephone; minor assistance including explanation of documents, drafting simple wills or other simple legal documents; public education and training about legal rights and obligations; publications about relevant, recurring and simple legal issues, etc.[19] In addition, the court is not the best solution for most problems that people are nowadays facing. Some of the problems could be better handled through negotiations or alternative dispute resolution (ADR).[20] Administrative procedures might be a better alternative for others.[21] Further, primary legal aid should be open for all serious problems outside the courts with criteria similar to those outlined in *Airey*.[22]

Croatia also subscribed to the obligation of guaranteeing equality to all citizens in terms of access to justice, by becoming a signatory of the ECHR. Despite the fact that Croatia intends to follow contemporary societies in terms of the implementation of political and legal ideals of realisation of access by judicial and other state authorities, which decide on matters of implementation and protection of citizens' substantive rights, it was falling behind.[23] The reasons behind this were political and legal barriers, which prevent primary legal aid from being established to offer the opportunity for all citizens to have an equal right to obtain access to justice. In the attempt to establish an efficient legal aid system, the existing one has become a matter of frequent discussions and critique by representatives of the legislative branch, the civil sector and academia.[24] Before 2013, the Croatian legislator did not recognise the importance of an efficient legal advice

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17 *Johnsen/Stawa/Uzelac*, (fn. 12), p. 22.

18 Ibid.

19 *Johnsen/Regan*, (fn. 16), p. 155.

20 *Johnsen/Stawa/Uzelac*, (fn. 12), p. 23.

21 Ibid.

22 Ibid.; *Manning*, (fn. 14), p. 62 et seq.

23 *Aras/Preložnjak*, Intentional Killing of Efficiency by Overzealousness in the Pursuit for Truth, The Example of Croatian Legal Aid System, Stvarni pravni život 3 (2012), p. 293.

24 Ibid., p. 294.

system for everyday legal problems. The need for a citizen to comply with the legally prescribed preconditions in order to realise the right to legal aid and the bureaucratic nature of the procedure dealing with such compliance have often deprived the applicant of timely legal protection which was in direct collision with the very purpose of legal aid.[25] The granting of primary legal aid also depended on the type of legal problem.[26] So, for example, beneficiaries could obtain primary legal aid only regarding status matters; rights from pension and invalidity insurance, rights from the social welfare system and employment rights.[27] This represented a serious limitation on the efficient implementation of citizens' right of access to justice since it results in a great number of citizens not complying with the formal conditions.[28] The legal problem criteria was too narrowly shaped to secure everyone proper access to legal advice outside of the court so the scheme needed to be changed.

The new Croatian Legal Aid Act relaxed the merit criteria for primary legal aid, the application of which no longer depends on the type of legal problems but rather covers all types of legal problems.[29] Primary legal aid is comprised of general legal information, legal advice, the preparation of submissions to government agencies, ECtHR, international organisations, representation in proceedings before government agencies and legal assistance in the peaceful resolution of the dispute out of court.[30] This represents a big step toward the modern legal aid system for the Croatian legal aid system. The participants emphasise that primary legal aid, and in particular legal information and advice before and outside of formal court, administrative and other legal proceedings, has a special importance

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25 *Johnsen/Stawa/Uzelac*, (fn. 12), p. 48; *Aras/Preložnjak*, (fn. 23), p. 294.

26 Article 5(2)(a)-(c) and (e) Legal Aid Act, Official Gazette of the Republic of Croatia No. 62/08, 44/11, 81/11 of 30/5/2008 (hereinafter: CLAA'08).

27 Ibid.

28 *Aras/Preložnjak*, (fn. 23), p. 294.

29 Article 10 Legal Aid Act, Official Gazette of the Republic of Croatia No. 143/13 of 2/12/2013 (hereinafter: CLAA'13).

30 Article 9 CLAA'13.

for an effective legal system that equally protects the rights of all citizens.[31]

D. Current State of Litigation in Croatia and Possible Outcomes of Increasing Funds for Primary Legal Aid

As is the case with many South-East European countries, Croatia is characterised by a large number of cases.[32] The reasons for this can be traced to the socialist legal tradition, which still hugely influences Croatian law and judicial system,[33] but also to the general lack of political willingness to analyse a problem deeply and to solve it.[34] Bearing in mind that Croatia only has approximately 4.2 million inhabitants, the statistics clearly show that the judicial system is overburdened.[35] Table 1 shows the number of litigious cases in municipal courts in Croatia over the years:

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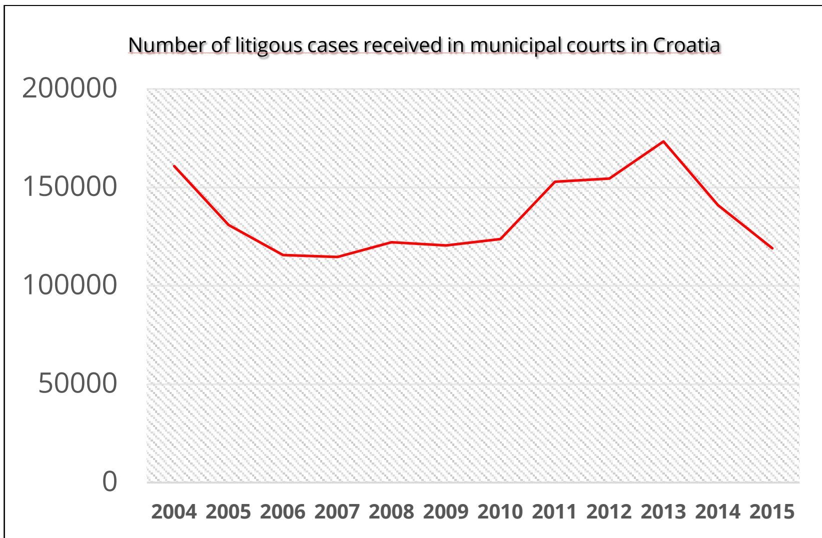
[31] Conclusions of the Round-table "Reform of legal aid system – the future of legal advice?" organised by the Zagreb Law Clinic in co-operation with the UK Embassy, the Ombudsman Office and Centre for Human Rights on 14/11/2011 (unpublished), p. 2; *Uzelac/Preložnjak*, The Development of Legal Aid Systems in the Western Balkans, A Study of Controversial Reforms in Croatia and Serbia, Kritisk Juss 20 (2012), p. 271.

[32] For the Croatian perspective, see *Uzelac*, Delays and Backlogs in Civil Procedure, A (South) East European Perspective, Revista de Processo (RePro, Sao Paolo) 238 (2014), pp. 42-47.

[33] *Uzelac*, Survival of the Third Legal Tradition?, Supreme Court Law Review 49 (2010), p. 377 et seqq.

[34] *Uzelac*, Croatia: Omnipotent Judges as the Cause of Procedural Inefficiency and Impotence, in; *Van Rhee/Yulin*, Civil Litigation in China and Europe, 2014, p. 198 et seq.

[35] In 2012, Croatia had total of 1.097.909 civil cases ("other than criminal cases"), which is only two times less than the situation in France and three times less than the situation in Germany. CEPEJ, (fn. 2), p. 195. In comparison, according to the individual country reports (www.coe.int/t/dghl/cooperation/cepej/profiles (1/12/2016)), Croatia has 4.262.140 inhabitants, France 65.585.857 inhabitants and Germany 80.233.100 inhabitants. When one adds the number of judges into the picture, the situation becomes even more clear because Croatia has four times more judges than France and two times more judges than Germany. CEPEJ, (fn. 2), p. 155.



It seems that the great economic crisis of 2008 strongly affected the number of cases received by Croatian courts. It was not until 2015 that the number of cases fell below the previous number (app. 120.000 per year). Although it can hardly be argued that the decrease can be attributed to the increase in financing of the legal aid system, it can certainly be an important factor in the future.

If the system of primary legal aid functions properly, it can influence the habits of the citizen with respect to the initiation of civil proceedings. For example Zagreb Law Clinic now solves more than 2.500 cases per year,[36] which means that 2.500 citizen get the necessary information which they can use to choose whether to engage the court system or not. Moreover, those who decide to do it are also informed about the alternatives to the court proceedings, which could increase the popularity of mediation and other ADR methods. If organised carefully, the law clinics themselves could engage in mediation proceedings as mediators, as has already been done in some clinics.[37] This would

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[36] Full statistics are available on the official web site of Zagreb Law Clinic, http://klinika.pravo.unizg.hr/broj-i-vrsta-predmeta (1/12/2016).

[37] See e.g. the Mediation Clinic of Columbia Law School, http://web.law.columbia.edu/clinics/mediation-clinic (1/12/2016).

allow the law clinics to go beyond a purely educational context and to impact the society as a whole.[38]

Unfortunately, so far Croatian governments have not recognised the full potential of the law clinics and NGOs. The clear majority of funds available to the free legal aid providers have been distributed to the providers of secondary legal aid, i.e. lawyers. Before CLAA'13, funds available to the primary legal aid providers were up to ten times smaller than the funds available to the secondary legal aid providers. Although the situation has changed in favour of primary legal aid, since in 2014 and 2015 the available funds were even greater than the funds for secondary legal aid, in 2016 the Croatian legal aid system returned to the situation that existed before CLAA'13.[39] It can be expected that such lack of financing will affect the habits of people and enhance the problem of overburdened courts in Croatia even further.

E. How can law clinics discourage unnecessary litigation?

I. Client-centred approach

Respecting the autonomy of the client is the cornerstone of the modern attorney-client relationship.[40] Although a client-centred approach can represent the ethical ideal for the lawyers as well, such an approach is not generally accepted in the legal community.[41]

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[38] Some argue that the social significance of law clinics should prevail over its educational purposes. *Nicholson*, Legal Education Or Community Service? The Extra-Curricular Student Law Clinic, Web Journal of Current Legal Issues, No. 3, 2006, p. 17, noted: "[...] if every law school had a properly funded clinic, the problem of unmet legal need would virtually disappear."

[39] Only 25 % of the funds is available to the primary legal aid providers. Detailed statistics are available on the official website of Croatian Ministry of Justice, https://pravosudje.gov.hr/pristup-informacijama-6341/strategije-planovi-i-izvjesca/izvjesce-o-ostvarivanju-prava-na-besplatnu-pravnu-pomoc-i-utrosku-sredstava/6723 (1/12/2016).

[40] *Mendez*, Deflating Autonomy, American Inns of Court, 2014, p. 1 et seqq.

[41] *Lawton*, Who Is My Client? Client-Centered Lawyering with Multiple Clients, Clinical Law Review 22 (2015), pp. 147-155. On the contrary, it was widely criticised when it was introduced back in 1970's, see *Burtch*, The Lawyer As Counselor, Virginia Lawyer 58 (2010), p. 28.

While it might work in real *pro bono* cases, it could hardly function in systems such as that in Croatia, where lawyers engaged in free legal aid get a reduced fee for their services.[42] This means that the lawyer will charge for his or her services, regardless of the success of his or her client. Therefore, lawyers cannot be expected to be neutral advisors informing the client about all the legal possibilities, even when the best one excludes their further engagement. This is the reason why only law clinics and NGOs can achieve the objective of decreasing unnecessary litigation.

Law clinics can achieve such goals by putting the client in the centre.[43] This means that the client is informed in detail how the law regulates his or her position and how he or she can use the law to achieve his or her goals. If the client cannot do this, the reasons are also thoroughly explained.[44] The advisors should always be careful to avoid bias[45] and remain neutral.[46] Of course, the communication methods used by the clinics will play a major role in terms of enabling the client to make his or her own decision.[47] In other words, it is not only important to solve the case, but also to actually communicate the

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42 According to the Regulation on the fees for secondary legal aid in 2015 (Official Gazette of the Republic of Croatia No. 20/15 of 23/2/2015), the lawyers are granted 50 % of the lawyer fees they would charge if the case was not financed within legal aid system. Although the new Regulation was not enacted, it was announced that the fees would not change in 2016.

43 The best way for law clinics to truly contribute to the ideal of access to justice is to put clinical advice in the centre, as opposed to their educational goals, see *Aiken/ Wizner*, Teaching and Doing: The Role of Law School Clinics in Enhancing Access to Justice, Fordham Law Review 73 (2004), p. 1006.

44 *Kerrigan/Murray*, A Student Guide to Clinical Legal Education and Pro Bono, 2011, p. 115.

45 *Webb et al*., Lawyer's skills, 18th ed. 2011, p. 142. One of the biggest challenges for the students is "the passionate conviction about the client's experience and their own sense of injustice about it." See *Curran*, University Law Clinics and their value in undertaking client-centred law reform to provide a voice for clients' experiences, Journal of Clinical Legal Education 12 (2007), p. 116.

46 Such an ethical concept can be described as "neutral partisanship", see *Kerrigan/ Murray*, (fn. 44), p. 64. The focus on client autonomy however should not be at expense of other people, see *Cohran*, Which Client-Centered Counselors?: A Reply to Professor Freedman, Hofstra Law Review 40 (2012), p. 366.

47 *Lawton*, (fn. 41), p. 149.

advice to the client. Regardless whether the advice is given in written or oral form, it should always be adjusted to the needs of the client.[48]

II. Challenges in clinical advice

Giving full information to the clients can seem a bit challenging. Informing the clients about too many technical issues can be counterproductive because clients can hardly be expected to understand complex legal procedures. This can, of course, be solved by greater quality of advice, as well as better advising and communication methods,[49] but the clients will always remain lay people whose only concern is to solve the issue before them.[50]

Moreover, can the information really be considered comprehensive if the advisor cannot give an honest opinion and estimation of the expected results of certain action? Although the client is definitely the one who should decide in the end, that does not mean the advisor cannot opt for one of the alternatives, by explaining that it one option has a higher likelihood of success. However, while doing so, the advisor should explain in detail why they think the other options are not likely to be successful, leaving the client to decide if they find those reasons convincing and convenient for his or her situation.[51]

Even when the party is about to render a completely unreasonable decision, it is questionable if the advisor should intervene and advise the client not to do it. It is actually the question of who the advisor should serve – the client or the legal order. It is in the public interest to stop the potentially vexatious litigant from initiating the proceedings, but the advisor cannot make a decision for the client. The advisor should stay within the limits and inform the client about all the negative inferences of any of his or her decisions.[52]

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48 *Kerrigan/Murray*, (fn. 44), p. 116.

49 According to *Higgins/Tatham*, Successful Legal Writing, 1st ed. 2006, p. 1, the ability to communicate is “the most important skill which marks out a good lawyer”.

50 *Kruse*, Fortress in the Sand: The Plural Values of Client-Centered Representation, Clinical Law Review 12 (2006), p. 374 cited in *Lawton*, (fn. 41), p. 149.

51 *Kerrigan/Murray*, (fn. 44), p. 115 et seq.

52 Of course, this does not apply to situations where such behaviour might harm others, especially vulnerable citizens such as children, see ibid., pp. 64-65 and 116.

Finally, the advisor has a big responsibility towards the client. It is sometimes his or her own feeling of justice[53] that stops the client from making a rational decision. This is especially true in civil law systems where legislators are the ones deciding what is appropriate and just, while judges have rather modest, almost passive and purely instrumental roles.[54] It is, therefore, the advisor's duty to not only inform the client about the law, but to also explain the reasons behind those rules.[55] Only such information can be considered full and be in the best interest of the client.

F. Conclusion

Overburdened courts can hardly meet the expectations of citizens to have their cases heard and solved within a reasonable time. It is thus of the utmost importance for the modern legislators to deal with this issue. Law clinics have shown that they can be a useful tool to achieve this purpose. With relatively small funds, law clinics can advise many clients and inform them about their legal rights and duties, while improving legal education at the same time. Unlike common legal professionals, such as lawyers, they can truly act as neutral third-party counsellors and help citizens to make the wisest decision in solving their legal issues; their own decision that will take into account all the advantages and disadvantages of different solutions. Increasing the funds of the law clinics can only increase this potential.

The Croatian legal aid system has started off with quite a number of problems. The lack of sufficient financing of the providers, combined with small number of legal problems, which could have been covered within the legal aid scheme did not allow for the proper functioning of the system. It was not until 2013 that Croatia enacted the new Legal Aid Act, which, to a great extent, reflects the guidelines of the ECtHR as stated in the *Airey* Case. However, a legal aid system cannot itself

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53 Although such interconnection definitely deserves careful study, the role of emotions has been completely ignored in research studies, see *De Cremer/van den Bos*, Justice and Feelings: Toward a New Era in Justice Research, Social Justice Research 20 (2007), p. 2.

54 *Merryman*, The Civil Law Tradition: An Introduction to the Legal Systems of Europe and Latin America, 2 ed. 1984, pp. 52-55.

55 *Kerrigan/Murray*, (fn. 44), p. 115.

achieve the goal of increasing access to justice. It is the better functioning of the whole judicial system that is needed to truly make a change. The problem of overburdened courts can be solved only by a combination of organisational, technical and economic reforms, in accordance with best comparative practices.

As for the Croatian legal aid system, discouraging unnecessary litigation could indeed represent its new focus. It seemed that the trend in recent years was moving in this direction, however recent budgetary restrictions do not give cause for belief that many citizens will indeed have the opportunity for their case to be assessed by a neutral counsellor. This will probably affect the number of incoming litigious cases and thus prevent those who really need the court's assistance to get such assistance within a reasonable time frame.

Shareholders Right to Vote on Directors' Remuneration Policy – Proposed EU Law v. Current Serbian Law

Vuk Radović[*]

Abstract

A company's general meeting of shareholders should maintain indirect control over directors' remuneration. Among the many modalities of exercising such control, the impact it has on the directors' remuneration policy in a company is particularly significant. This paper provides an analysis of solutions laid down in the Proposal for the amendment of the Shareholders Rights Directive that deal with the shareholders' right to vote on the remuneration policy, and of relevant provisions of Serbian law regulating this field.

A. Regulation concerning Directors' Remuneration in EU and Serbian Law

In acknowledgement of the fact that the remuneration of members of the board of directors is one of the most controversial and problematic areas of corporate governance, the European Commission adopted three recommendations concerning remuneration since 2004, two of which were related to the general regime for the remuneration of board members, while the third focused solely on the financial sector.[1] Existing remuneration regulations were concluded with the adoption of a special directive introducing specific rules concerning the remuneration policy in financial institutions, designed to discourage

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1 Commission Recommendation of 14/12/2004 fostering an appropriate regime for the remuneration of directors of listed companies (2004/913/EC), OJ L 385 of 29/12/2004, p. 55; Commission Recommendation of 30/4/2009 complementing Recommendations 2004/913/EC and 2005/162/EC as regards the regime for the remuneration of directors of listed companies (2009/385/EC), OJ L 120 of 15/5/2009, p. 28; Commission Recommendation of 30/4/2009 on remuneration policies in the financial services sector (2009/384/EC), OJ L 120 of 15/5/2009, p. 22.

excessive risk-taking.[2] Based on this, one could conclude that the general regime for the remuneration of directors at the EU level is regulated by non-binding regulatory instruments (recommendations), meaning that member states retain full freedom to regulate this field by applying rules they themselves find optimal.[3] However, one cannot dispute that the recommendations made a significant impact on national legislation. Some regulatory solutions have even become widely accepted.[4] One of the issues that has not been harmonized is related to the manner in which the general meeting of shareholders can and should influence the directors' remuneration policy. This is why it is not surprising that the European Commission introduced detailed and precise provisions on the shareholders right to vote on the remuneration policy in its proposed amendments to the Shareholders Rights Directive (hereinafter Proposal), with a view to enabling shareholders to exert influence on the individual remuneration of directors in a company through its remuneration policy.[5]

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2 Directive 2010/76/EU of the European Parliament and of the Council of 24/11/2010 amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for re-securitisations, and the supervisory review of remuneration, OJ L 329 of 14/12/2010, p. 3.

3 By adopting recommendations on remuneration instead of a directive on this matter, the European Commission made way for application of the flexibility principle at the country level. See *Zanardo*, Does the Application by Member States of the Commission Recommendations on Corporate Governance Issues Depend on the Diversity of Ownership and Corporate Governance Systems, Bocconi Legal Studies Research Paper No. 1320195, 2008, p. 8. More about justifications for flexible approach adopted by remuneration recommendation see *Kumpan*, Performance and Remuneration of Company Directors – Legal Approaches in Germany, the EU, and the U.S., Foreign Life of Law [Strani pravni život] 2008, p. 92.

4 About application of these recommendations see Report on the application by Member States of the EU of the Commission Recommendation on directors' remuneration, SEC(2007) 1022 of 13/7/2007; Report on the application by Member States of the EU of the Commission 2009/385/EC Recommendation (2009 Recommendation on directors' remuneration) complementing Recommendations 2004/913/EC and 2005/162/EC as regards the regime for the remuneration of directors of listed companies, COM (2010) 285 final of 2/5/2010.

5 Proposal for a Directive of the European Parliament and of the Council amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement and Directive 2013/34/EU as regards certain elements of the corporate governance statement, COM (2014) 213 final of 9/4/2014, Article 9a.

Within the Serbian legal framework, general provisions on directors' remuneration are incorporated into the Companies Act.[6] Only four issues are briefly regulated by these provisions: 1. the competence of the general meeting of shareholders to adopt the remuneration policy, 2. the competence of the general meeting of shareholders to grant remuneration in the form of shares and other company securities, 3. prohibition of remuneration in the form of participation in profit sharing, and 4. basic principles concerning variable remuneration. These provisions are succinct and do not represent a satisfactory legal framework for remuneration regulation. For this reason they have been significantly supplemented by the Corporate Governance Code of the Serbian Chamber of Commerce adopted in 2012 (hereinafter CG Code) which has been influenced to a great degree by two general EC remuneration recommendations.[7] Even though CG Code is a non-binding regulatory instrument, and there are no existing mechanisms for its implementation, the importance of this document is growing. Many companies are either following the recommendations contained in this Code (at least nominally), or are adopting their own corporate governance code, taking into consideration the solutions of the CG Code.

The first part of this paper will make some general observations about the control function of general meeting of shareholders in the process of determining directors' remuneration. The second part is the main focus of this paper and explores in detail the general meeting of shareholders' right to vote on the remuneration policy. In that respect, the solutions contained in the Proposal are compared with *de lege lata* Serbian provisions. The final part provides several concluding remarks. The aim of this paper is to emphasize the importance of shareholders' right to vote on the remuneration policy, to explain the content and logic of the rules proposed by the European Commission, and to analyse whether current Serbian regulation is in accordance with those proposals.

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6 Law on Business Organizations, Official Gazette of the Republic of Serbia No. 36/2011, 99/2011, 83/2014 and 5/2015, Article 328(1), (10) and Article 393.

7 Corporate Governance Code of Serbian Chamber of Commerce, Official Gazette of the Republic of Serbia No. 99/2012, Part I, principles 9, 35 and 36.

B. General Observations on the Control Function of General Meeting of Shareholders

The past few years have seen the rise of a world trend of increasing the role of general meetings of shareholders in the process of determining directors' remuneration.[8] However, ways in which this should be done still remain a matter of controversy as well as a theoretical dilemma.

Traditionally, it has been believed that dissatisfied shareholders can express their disapproval of a company's remuneration policy in several ways. Firstly, they can sell their shares on the market, i.e. refrain from investing in companies that provide excessively high remuneration for their executive directors.[9] However, the decision to sell shares can only be effective if a large number of shareholders opt to do so due to their collective concern about a flawed remuneration policy. In addition, experience has shown that institutional investors do not use this opportunity to a sufficient degree, while only a small number of other shareholders leave the company as a result of its remuneration policy.[10] Secondly, shareholders may vote for the removal of existing board members from their positions, which would represent a direct sanction for the irresponsible implementation of the company's remuneration policy.[11] Thirdly, under certain conditions prescribed by law, shareholders may even demand judicial protection (e.g. by bringing individual or derivative action against a board member for failure to act in accordance with legally-defined duties).[12] Fourthly, the general meeting may decide not to approve an increase of the share capital or acquisition

[8] *Hill*, Corporate Scandals Across the Globe: Regulating the Role of the Director, in: Ferrarini et al. (eds.), Reforming Company and Takeover Law in Europe, 2004, p. 265.

[9] *Loewenstein*, The Conundrum of Executive Compensation, Wake Forest Law Review 2000, p. 25.

[10] See *Thomas/Martin*, Litigating Challenges to Executive Pay: an Exercise in Futility, Washington University Law Quarterly 2001, p. 570.

[11] Past experience in disperse shareholding systems has shown that the practice of relieving board members of their duties by shareholders is more of a myth than a reality. More about ways of improving this shareholders right see *Bebchuk*, The Myth of the Shareholder Franchise, Virginia Law Review 2007, pp. 675-732.

[12] About limited effect of derivative actions initiated against board members in public corporations see *Thomas*, International Executive Pay: Current Practices and Future Trends, Vanderbilt Law and Economics Research Paper No. 08-26, 2008, pp. 50-54.

of own shares and other securities, subsequently disabling the payment of share-based variable remuneration.

Up until several decades ago, there was no need for more direct involvement of the general meeting in the remuneration setting process. However, the use of new forms of remuneration gave rise to numerous problems for which general meetings had no answer. The main effect of these new forms of remuneration was to substantially intensify conflicts of interest between directors and shareholders. Corporate governance does not denounce the fact that the board of directors must remain the pivotal corporate body responsible for setting executive remuneration within the company. However, the idea that shareholders (general meeting) represent a crucial secondary line of control is promoted with increasing frequency.[13] Since traditional mechanisms have shown to be inadequate in the new environment, efforts have been made to find more efficient ways of involving the general meeting in the process of setting board member remuneration.[14] Unlike traditional methods, contemporary ways are more directly related to remuneration, because the general meeting's decision has a direct impact on the type and level of board member remuneration.

Considering the different contemporary ways in which an annual general meeting can control board member remuneration, the Proposal for the amendment of the Shareholders Rights Directive opts to guarantee two shareholder rights: the right to vote on the remuneration policy (Article 9a), which is the subject of this paper, and the right to vote on the remuneration report (Article 9b).

C. Right to Vote on the Remuneration Policy

In comparative corporate practice, the general meeting of shareholders is taking an increasingly greater role in dealing with the issue of board member remuneration via the company's remuneration policy. If we disregard, for a moment, disclosure of the remuneration

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13 *Ferrarini/Moloney*, Executive Remuneration and Corporate Governance in the EU: Convergence, Divergence, and Reform Perspectives, in: Ferrarini et al. (fn. 8), p. 305.

14 Compare *Watter/Maizar*, Structure of Executive Compensation and Conflicts of Interests – Legal Constraints and Practical Recommendations under Swiss Law, in: Thévenoz/ Bahar (eds.), Conflicts of Interest – Corporate Governance & Financial Markets, 2007, p. 76 et seq.

policy (e.g. in financial reports, on the company's website, etc.) which enables the general meeting to exert influence on board member remuneration indirectly, there are three basic ways to ensure that shareholders affect the company's remuneration policy directly: by singling out the remuneration policy as a separate item of the agenda, by having the general meeting vote on the remuneration policy with possibilities that the decision has either a binding or non-binding character, and by placing the remuneration policy under the competence of the general meeting.

According to the Proposal, shareholders have the right to vote on the remuneration policy as regards directors (Article 9a(1) para. 1). In order to ensure that this does not boil down to an insignificant right that may be thwarted and circumvented in practice, it has been proposed that the shareholders' vote has a binding character, the obligation to bring individual remuneration into compliance with the remuneration policy has been introduced, the minimum content of this document has been prescribed and the obligation to have it published has been established.

I. Binding Shareholders Vote

In principle, the shareholders' vote on the remuneration policy may be of an advisory or binding character. Considering this matter through the prism of comparative law, the vote's advisory character is predominant. In short, this implies that the decision reached by the shareholders is non-binding both on the company and the directors, regardless of the level of shareholder support. According to some authors, the advisory (non-binding) vote establishes a genuine balance between the shareholders' control and the directors' prerogatives.[15] However, one must keep in mind that empirical data indicates that the general meeting's advisory vote is not an efficient mechanism for the transmission of shareholder views to members of the board of directors in circumstances where there is a dissonance between the

[15] See *Arnold*, Monkeys, Golden Handshakes and CLERP9: a Review of the Recently Passed Reforms to Directors' Remuneration, Company and Securities Law Journal 2004, p. 549.

interests of board members and shareholders, and an under-developed market for corporate control.[16]

Most EU member states have not accepted the recommendation that the general meeting vote on the remuneration policy should be obligatory. The rule that the remuneration policy is an integral part of financial reports is still predominant, so that the vote on the policy is taken as part of the vote on the reports. One must not disregard the fact that, in many countries, the general meeting is part of the process of setting remuneration for some or all members of the board, but without the recommendation to demand a separate vote on the remuneration policy.

The European Commission's Remuneration Recommendation introduces the principle of shareholder voting on certain issues that are directly related to the remuneration of board members, with the prospect of having the principle eventually turn into best corporate governance practice. In that respect, the general meeting vote on share-based remuneration plans and the influence of the general meeting on the remuneration policy of a company were particularly emphasized. As far as the general meeting's vote on share-based remuneration plans is concerned, the predominant tendency among EU member states is to introduce this new mode of control by the general meeting, and the norms used in formulating these rules generally have the character of imperative legal provisions. When it comes to the general meeting's influence on the remuneration policy, a lower level of harmonization has been achieved, partly because of the flexible approach put forward by the Remuneration Recommendation.

In contrast to the prevailing trend, the Proposal introduces a rule by which the remuneration policy must be subject to shareholder approval (Article 9a(1) para. 1, first sentence). Hence, shareholder approval becomes a necessary precondition for the validity of the decision on the remuneration policy. Therefore, whenever a new remuneration policy is being adopted or an existing one is being changed, the general meeting needs to give its approval. Although the actual wording of the Proposal rather leads to the conclusion that

16 See more *Levit/Malenko*, Nonbinding Voting for Shareholder Proposals, Journal of Finance 66 (2011), pp. 1579-1614.

shareholders give their approval for a decision that has already been adopted (subsequent approval), there seems to be no reason not to allow the general meeting to give its approval for a decision that is yet to be adopted (prior approval).

The remuneration policy has to be submitted for approval by the shareholders at least every three years (Article 9a(1) para. 1, last sentence). Shareholders are thus assured that they will be in a position to have a say about the company remuneration policy in cycles of at least three years, regardless of the fact that there may not have been any changes. Once adopted, a remuneration policy needs to be reviewed at certain intervals. The fact that the general meeting has approved the remuneration policy at an earlier point in time does not mean that it will pass with the same vote several years later. The shareholder structure may have changed in the meantime, and the opinion of the new shareholders on the directors' remuneration may be different than that of their predecessors. Furthermore, even if the shareholders have remained the same, altered circumstances may render the previously adopted remuneration policy inadequate. Hence, the board of directors is expected to be active in terms of continually updating this document. Good corporate governance practice demands prior harmonization of views on these issues with the largest shareholders.

Serbian law differs in this field from the proposed EU solution. Namely, according to the Serbian Companies Act, a company's general meeting decides on the remuneration policy (the law stipulates "rules for setting remuneration") for members of the board of directors in a one-tier system and members of the supervisory board in a two-tier system. With this type of rule, Serbia has opted for the most far-reaching mode of exerting shareholder's influence on the company's remuneration policy, because the decision on the directors' remuneration policy falls under the competence of the general meeting. Although similar, this mode of shareholders' involvement differs from the situation where the general meeting casts a binding vote on the remuneration policy as stipulated by the Proposal. According to Serbian law, the remuneration policy is considered as adopted when the general meeting makes a decision, because only it has the authority to do so. In the binding decision system, the remuneration policy falls under the competence of some other company body, while the general meeting discusses and votes, i.e. gives its approval,

at a prior or subsequent point in time. In practical terms, shareholders could, within the framework of Serbian law, propose and pass the remuneration policy themselves. With this solution, the general meeting of shareholders is obviously being favoured, while the proposed EU solution strives to establish a balance between directors and shareholders.

Yet another difference arises from the above-mentioned provisions, and involves the application to different directors in the corporate structure. Namely, the Proposal links the remuneration policy to all directors, while Serbian law explicitly limits this document in the two-tier system to members of the supervisory board, thus excluding executive directors as members of another corporate body. Moreover, the supervisory board is permitted to adopt a remuneration policy for executive directors.

Pro futuro, Serbian law should be amended in two ways:

1. the adoption of the remuneration policy should be under the competence of the board of directors in the one-tier system, i.e. the supervisory board in the two-tier system, and subject to prior or subsequent approval by the general meeting, and

2. the company's remuneration policy should be uniform for all directors. In this case, uniformity does not imply having the same criteria for all board members (e.g. members of the supervisory board and executive directors), because that would, by its very nature, be wrong. When developing a remuneration policy, it is necessary to take all relevant interests into account, and the policy itself needs to be comprehensively formulated for the entire company. The Serbian regulatory approach, that the general meeting decides on the remuneration policy only for members of the supervisory board in a two-tier system, does not represent good practice as it results in having the supervisory board adopt a remuneration policy for all other company directors. The existence of two remuneration policies may impede the cohesion of the compensation system within a company and diminish the importance of the shareholders.

According to the Serbian CG Code, the remuneration policy and every one of its more significant amendments need to be separate items on the annual general meeting agenda. This rule offers the general meeting guarantees that the adoption of the remuneration

policy will not be part of a broader agenda item, meaning that a more focused discussion and vote will be dedicated to this matter. Furthermore, the Code recommends that discussions on the company remuneration policy be a mandatory item on the agenda of every annual general meeting. Unlike the previous recommendation, which is based on the assumption that this document or its amendments are being adopted, this recommendation applies regardless of who does the adoption of the remuneration policy, and whether an already formulated remuneration policy exists in the company. Shareholders should be given the opportunity to discuss the company remuneration policy once a year. The annual general meeting's ultimate decision is of an advisory character.

II. Compliance of Individual Remuneration with the Remuneration Policy

The Proposal stipulates that companies may pay their directors' remuneration only if it is in compliance with the remuneration policy (Article 9a(1) para. 1, second sentence). A hierarchical relationship has thus been established between the remuneration policy as a general company document on the one side, and individual directors' remuneration as individual documents on the other. This gives the remuneration policy great significance, since its provisions can directly influence remuneration *in concreto*. The ultimate degree of this influence will depend on the way in which the remuneration policy has been formulated. One should not neglect the fact that the remuneration policy must be in compliance with the company's main general documents, such as the articles of incorporation and by-laws, which may be significant on the rare occasion when these documents contain directors' remuneration rules.

In view of the fact that companies shall only pay remuneration to their directors if it is in accordance with a remuneration policy, another conclusion arises – the remuneration policy is a mandatory company document, and a precondition for payment of individual remuneration. Hence, it becomes impossible for companies to make this shareholder right redundant by simply not having a remuneration policy, since in that case individual remuneration would not have to be aligned with company specific requirements.

The Proposal also includes a justifiable exception to the above mentioned rule affording companies the right to decide to pay remuneration to an individual director outside the approved policy in case of recruitment of new board members (Article 9a(1) para. 2). However, in that case, the remuneration package of the individual director has to receive prior shareholder approval. As an alternative, the Proposal allows for the possibility of setting the remuneration provisionally pending approval by the shareholders.

Serbian law does not have an explicit provision on the conformity of individual remuneration with the adopted remuneration policy, which does not mean that it cannot be established through the interpretation of general provisions of the law on the hierarchy of company documents. Keeping along the lines of the Proposal, there is justification to introduce the obligation of having such a document, as well as to stipulate the possibility of making an exception in case of recruitment of new board members.

III. Minimum content of remuneration policy

The remuneration policy may be understood as a previously defined framework for determining individual director remuneration. It is geared towards the future, because it sets the course that is to be taken by a specific company with regard to the level and structure of board member remuneration. Hence, in setting remuneration, the competent company body needs to make sure that it remains within the limits of a previously adopted and disclosed remuneration policy. In that respect, the question arises as to what should be the mandatory (minimum) content of the remuneration policy, keeping it in mind that a more specific and precise remuneration policy diminishes the level of discretion afforded to managerial bodies in setting individual remuneration.

The Proposal prescribes the minimum content of the remuneration policy (Article 9a(3)). Considering the solutions offered, one may conclude that the European Commission does not find it sufficient to define the elements of the remuneration policy in principle, but rather demands that companies incorporate very specific solutions into this document, such as the maximum amount of total remuneration that can be paid, relative proportion of the different components of fixed and variable remuneration, vesting periods for

share-based remuneration, retention of shares after vesting, conditions under which the company can reclaim variable remuneration as well as the main terms of the contracts of directors, including their duration, notice periods and payments linked to termination of contracts. This regulatory approach proposed by the European Commission is completely justified.

Special attention is given to information related to variable remuneration. The formulation of so-called performance criteria is the focal issue of variable remuneration. It involves economically relevant indicators, the improvement of which justifies payment of such remuneration. Companies may use numerous performance factors, which are mostly classified as financial or non-financial. Financial factors primarily include accounting indicators such as annual income, net income, profit, earnings per share, capital yield, etc. Non-financial factors may be divided into two groups. The first group includes numerous individual performance indicators (e.g. value of goods sold, value of contracts for which payment has been collected, etc.). The second group is heterogeneous and encompasses all other non-financial success indicators such as consumer satisfaction, full computerisation of a company until a certain date and the introduction of an environmental protection system. All the above justifies the Proposal's stipulation that the policy shall indicate the financial and non-financial performance criteria that will be used for variable remuneration. Additionally, the policy should explain how these criteria contribute to the long-term interests and sustainability of the company, and define methods that will be applied in order to determine to what extent the performance criteria have been fulfilled.

For an overall understanding, the remuneration policy should include a segment explaining the process preceding its adoption. If possible, it should particularly include information on the role of the remuneration commission, names of independent consultants whose services have been used in defining the remuneration policy, as well as the role that has been played by shareholders, if any.

When amendments to the remuneration policy are being proposed, justification should be provided for each significant change. The extent to which consideration has been given to the views of shareholders on the policy and reports in the previous years should also be shown in the amended remuneration policy. This helps illustrate the extent

to which the shareholders' advisory vote concerning the remuneration report is being integrated into the future remuneration policy.

The Serbian Companies Act and CG Code stipulate that the remuneration policy be adopted by the company's general meeting, but do not define its content in greater detail. Taking into account that there has been no remuneration policy adoption practice in Serbia before this point in time, that companies neither have the necessary experience nor knowledge of the scope of this concept and the logics of its existence, and that good corporate governance practice in this field is just being developed in comparative law, minimum content of the remuneration policy needs to be prescribed in future. In developing this content, Serbian companies should be advised to take the provisions of the Proposal into consideration.

IV. Transparency of the Remuneration Policy

According to the Proposal, the remuneration policy is a publicly disclosed document (Article 9a(4)). To this end, it is stipulated that it must be made available on the company's website for as long as it is in effect. Unlike the Proposal, Serbian law has no specific rule related to the publication of the remuneration policy. A certain level of public availability stems from fact that this document is adopted by the general meeting of shareholders. However, in contrast to the Proposal, which allows the broader public to have access to the remuneration policy, the Serbian concept of transparency is more narrow and is based on providing shareholders with information on issues that are being decided on at the general meeting.

D. Conclusion

Considering the solutions contained in the Proposal regarding the shareholders' right to vote on the remuneration policy, one may conclude that European legislators intend to shift this field from the domain of "soft law" to that of "hard law". Taking into account that this topic has not been harmonized among the EU member states, it is somewhat surprising that the European Commission has proposed a solution that matches the concept of maximum harmonization to a greater extent than the expected minimum harmonization concept.

The author of this paper supports this position, but points out that it could also pose an obstacle to the adoption of the Proposal.

In Serbian law, insufficiently precise rules have been employed to regulate this matter. Subsequently, in practice, the remuneration policy, which is adopted by the general meeting of shareholders, mostly repeats legal norms and contains abstract formulations, which neither limit the discretion of the decision-making body in any way, nor provide any useful guidelines for determining individual remuneration. Hence, the author believes the proposed EU solutions should also be applied by Serbian companies as good corporate governance practice, particularly those solutions that are related to the minimum content of the remuneration policy and its transparency.

Discriminatory Entrance Fee, the German Federal Constitutional Court and the Absent Court of Justice of the EU – A Commentary

Desirée C. Schmitt and Thomas Giegerich[*]

Abstract

The authors comment on a recent decision of the German Federal Constitutional Court (FCC) concerning indirect discrimination against citizens of other EU Member States. The Court held that a limited liability company established under private law but wholly owned by the government was bound by the fundamental rights enshrined in the German Basic Law (BL) and the market freedoms enshrined in the TFEU. A contract concluded by that company in violation of the freedom to receive services was void. The Court also reaffirmed that the obligation under Article 267(3) TFEU translates into a fundamental right under the BL and can thus be enforced by a constitutional complaint to the FCC. By sternly reminding the German courts of their obligation to properly apply EU law and to use the reference procedure, the decision underlined the friendliness of the BL towards EU law and the FCC's readiness to cooperate with the CJEU.

A. Introduction

Filing a constitutional complaint with the German Federal Constitutional Court (FCC) for an amount in dispute of merely € 2.5 shows a certain endurance but also an almost insatiable thirst for justice. But as the past has taught us, legal disputes over a very small amount of money (see for instance the judgment of the European Court of Justice

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in case *Costa v. E.N.E.L.*[1]), can produce important and far-reaching judgments. The case under review, FCC case 2 BvR 470/08, which was decided by a Chamber of the FCC's Second Senate on 19 July 2016, may turn out to be such a case.

Particularly, the decision concerns an indirect discrimination against citizens of other EU Member States. The Court held that a limited liability company established under private law but wholly owned by the government was bound by the fundamental rights enshrined in the German Basic Law (BL) and the market freedoms enshrined in the TFEU. A contract concluded by that company in violation of the other party's freedom to receive services was found to be void. The Court also reaffirmed that the obligation under Article 267(3) TFEU translated into a fundamental right under the BL and could thus be enforced by filing a constitutional complaint with the FCC. By sternly reminding the German courts of their obligation to properly apply EU law and to use the reference procedure, the decision underlined the friendliness of the BL towards EU law and the FCC's readiness to cooperate with the CJEU.

B. Facts of the Case[2]

The applicant was an Austrian national living in Austria. He went to a leisure pool in Bavaria, which was operated by a limited liability company established under German private law but wholly owned by a public law corporation whose members were a Bavarian county and five of its municipalities. Whereas the applicant had to pay the full entrance fee, inhabitants of the aforementioned five German municipalities were given a discount of about one third of the regular price (approximately € 2.5). The applicant felt discriminated by that practice and brought an action against the operator demanding the repayment of the price difference and confirmation that he would henceforth only have to pay the reduced entrance fee.

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1 CJEU, case 6/64, *Costa v. E.N.E.L.*, ECLI:EU:C:1964:66. The amount in dispute was 1925 Italian lira, which is less than one Euro.

2 See FCC, case 2 BvR 470/08, decided by a Chamber of the FCC's Second Senate on 19/7/2016, para. 2 et seq.

The action before the local court (*Amtsgericht*), as well as the appeal to the higher regional court (*Oberlandesgericht*), were unsuccessful. In his constitutional complaint, the applicant asserted that there had been infringements of his fundamental constitutional rights to equality (Article 3(1) BL) and to his lawful judge (Article 101(1) sentence 2 BL) because the lower courts had applied EU law in an arbitrary manner and failed to make a reference to the Court of Justice of the EU (CJEU).

C. Decision of the FCC

The FCC is not a general court of last resort but a special court charged with the implementation of constitutional law. Accordingly, it reviews lower court decisions only as to whether their interpretation and application of statutory law was arbitrary and thus unconstitutional.[3] The FCC found that this was the case here. The lower courts had infringed both Article 3(1) BL and Article 101(1) sentence 2 BL by permitting the operator of the leisure pool to discriminate against inhabitants of other EU Member States with regard to the entrance fee. The Court therefore reversed the challenged judgments and remanded the case to the local court. The FCC's reasoning will be discussed briefly in the following.

I. Infringement of Article 3(1) BL

1. Fundamental Rights Enshrined in the BL Bind Companies Effectively Run by Public Authorities

As a preliminary matter, the question arose whether the operator of the leisure pool was bound by the fundamental rights enshrined in the BL at all. According to Article 1(3) BL, only the federal and state governments with all their branches and not private actors as such are obligated to respect the fundamental constitutional rights. The FCC stated that, although the operator of the leisure pool was a private limited liability company, it was wholly owned by a public law corporation, which was completely controlled by public authorities (the county and five of its municipalities). This made the private

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3 Settled case law, see ibid., para. 23.

company in fact part of the public authority of the State of Bavaria and directly subject to the BL's fundamental rights catalogue.[4] The organizational form used to run the pool could not free the county and municipalities from the constraints of the BL. It was also irrelevant whether the State or one of its subunits exercised classical forms of public authority in the operation of the pool or rather acted in the form of private law and for commercial purposes.[5] Therefore, the private company that was operating the leisure pool was directly bound by the fundamental constitutional rights.[6] The lower courts had disregarded the fairly simple truth that a public authority is not allowed to evade their constitutional obligations by choosing private law forms of organization and action.

2. Discrimination because of Unjustified Differential Treatment

Since people not living in the five municipalities that are effectively controlling the operation of the leisure pool have to pay a higher entrance fee than the locals, they are treated unequally.

Unequal treatment only violates Article 3(1) BL if it cannot be justified by objective grounds.[7] The place of residence alone cannot as such provide sufficient justification, whereas objective reasons that are linked to it may have a justifying effect.[8] The FCC mentions e.g. the need for promoting local development possibilities, the burden of additional expenses created by the admission of non-inhabitants and the interest in reserving local budgetary resources for the fulfilment of local governmental functions vis-à-vis the residents.[9] But none of those possible grounds of justification for varying the entrance fee according to the residence of the customers were actually fulfilled in

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4 Ibid., para. 25 et seq.

5 Ibid., para. 29 et seq. The so-called "escape to civil law" without any obligations by the BL is forbidden.

6 FCC, case 2 BvR 470/08, para. 34.

7 Ibid., para. 38.

8 Ibid., para. 39 with references to the case law of the FCC.

9 Ibid.

the present case. Rather, the marketing strategy of the pool was aimed at attracting foreign visitors[10] and the public law corporation was even created to promote tourism in the first place.[11] The leisure pool should also be made attractive to visitors from outside the region.[12] Moreover, the reduced entrance fee applied only to the inhabitants of the five municipalities and not the much larger number of inhabitants living in the other parts of the county beyond those municipalities, although the county as such was also a member of the public law corporation owning the operator of the pool.[13]

Therefore, there was no objective ground justifying the differential treatment, which accordingly constituted discrimination contrary to Article 3(1) BL.

3. Discrimination due to Infringement of Article 56 TFEU

Furthermore, the FCC found that the decision of the higher regional court also constituted an infringement of Article 3(1) BL because it misapplied the prohibition of (indirect) discrimination on grounds of nationality included in Article 56 TFEU. There was indirect discrimination contrary to Article 56 TFEU because the group of persons benefitting from the reduced entrance fee consisted almost entirely of Germans whereas citizens of other EU Member States were almost completely excluded. That misapplication of Article 56 TFEU consisted of the court's refusal to treat that Union law prohibition as a sufficient ground in the sense of § 134 German Civil Code (GCC) for voiding the contract which the applicant had concluded with the company when entering the pool and which provided the sole basis for his obligation to pay the higher entrance fee.[14]

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[10] Ibid., para. 42.

[11] Ibid.

[12] Ibid., para. 43

[13] Ibid.

[14] Ibid., para. 44 et seq.

The higher regional court had argued that the violation of the prohibition of discrimination under Article 56 TFEU did not nullify the contract because it was only addressed to the company and not also to the applicant.

The FCC, however, found that this reasoning was contrary to the object and purpose of § 134 GCC and Article 56 TFEU because it perpetuated the discrimination and the ensuing interference with the plaintiff's freedom to receive services.[15] Even though the prohibition of discrimination contained in Article 56 TFEU was only directed to one of the contracting parties, its violation nevertheless had to render the contract void in conformity with § 134 GCC because this was the only way to effectively achieve the purpose of Article 56 TFEU.[16] The Union law prohibition of discrimination would become ineffective if discriminatory contracts were nevertheless treated as valid under national law.[17] This was so obvious that the contrary decision of the higher regional court was utterly unreasonable and thus arbitrary.

4. Result

Consequently, the FCC determined that there was a violation of Article 3(1) BL by the lower courts for two reasons: because of the lack of any justification for the unfavourable treatment of non-inhabitants of the five municipalities and because of the misapplication of § 134 GCC read together with Article 56 TFEU. It is worth noting that the FCC took up that second reason even though this was unnecessary to decide the case. Apparently, the FCC found the disregard of EU law by the lower courts so disturbing that the friendliness of the BL (and the German legal order as a whole) towards EU law had to be underlined once more.

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15 Ibid., para. 45 et seq.

16 Ibid.

17 Ibid.

II. Infringement of Article 101(1) sentence 2 BL

In the second part of the decision, the FCC held that the judgment of the higher regional court also infringed the applicant's right to his lawful judge (Article 101(1) sentence 2 BL).

1. The Right to a Preliminary Ruling by the CJEU Enshrined in the BL

European Union law is silent when it comes to the question of whether a private person can enforce an obligation to make a reference to the CJEU. The FCC, however, has voluntarily transformed this obligation into a fundamental constitutional right under the BL, which can be enforced through the constitutional complaint procedure.[18] The pertinent case law of the FCC is an expression of the Court's friendliness towards EU law.[19]

If the requirements of Article 267(3) TFEU are fulfilled, national courts are obliged to request a preliminary ruling from the CJEU. If a German court fails to fulfil its reference obligation, the affected party in the main proceedings can plead that his or her right to the lawful judge was infringed. According to the settled case law of the FCC, the CJEU constitutes the lawful judge in the sense of Article 101(1) sentence 2 BL to the extent of the reference obligation pursuant to Article 267(3) TFEU.[20] But the failure to fulfil that obligation does not as such suffice to qualify as a violation of Article 101(1) sentence 2 BL. Rather, the failure to make a reference to the CJEU must have been "simply incomprehensible and obviously untenable".[21] This is particularly the case when a last-instance court does not even consider making a reference according to Article 267(3) TFEU although it has doubts concerning

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[18] Cf. *Schröder*, Die Vorlagepflicht zum EuGH aus europarechtlicher und nationaler Perspektive, EuR 2011, p. 808 et seq.; *Finck/Wagner*, Eine schrittweise Annäherung des BVerfG an den unionsrechtlichen Maßstab der Vorlagepflicht nach Art. 267 III AEUV beim gesetzlichen Richter?, NVwZ 2014, p. 1286 et seq.

[19] See *Giegerich,* Zwischen Europafreundlichkeit und Europaskepsis – Kritischer Überblick über die bundesverfassungsgerichtliche Rechtsprechung zur europäischen Integration, ZEuS 2016, p. 19 et seq.

[20] FCC, case 2 BvR 470/08, para. 52 et seq.

[21] Ibid., para. 54.

the right answers to the pertinent EU law questions at stake but instead tries to develop EU law all on its own.[22] This is especially true when the national court has not sufficiently examined if there is relevant EU law to be applied in the pending case, including pertinent case law of the CJEU.[23] The FCC finds that the higher regional court committed this very mistake in two ways (see 2. and 3.).[24]

2. Is a Public Enterprise Bound by the Fundamental Freedoms of the Internal Market?

First, the FCC stated that the higher regional court should have further examined the question of whether a public enterprise fully controlled by public authorities such as the operator of the pool was directly bound by the fundamental freedoms of the internal market, including the freedom to receive services across Member States' borders.[25] In view of the case law of the CJEU concerning the binding effect of the fundamental freedoms and in particular the prohibition of discrimination on grounds of nationality for companies fully controlled by the state as well as the impact of Article 106 TFEU, the FCC indicated that the defendant in the civil court proceedings was bound by the fundamental freedoms in the present case.[26]

3. Can a Preference Granted to Inhabitants of the Municipalities be in Accordance with the Fundamental Freedoms?

Secondly, the FCC rebuked the higher regional court for not further examining the question of whether the differential pricing mechanism was compatible with Article 56 TFEU.[27] The FCC referred to the case law of the CJEU dealing with entrance fee systems

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[22] Ibid., para. 55.

[23] Ibid., para. 56.

[24] Ibid., para. 57.

[25] Ibid., para. 58.

[26] Ibid.

[27] Ibid., para. 59.

privileging local residents and thereby indirectly discriminating against nationals from other Member States who mostly do not fulfil the residency criterion on which that privilege is based. In such cases, the CJEU has stated that economic purposes cannot justify restrictions of the fundamental freedoms and that fiscal grounds of justification require a specific connection between taxation and tariff advantages, which are simply not present in the case at hand.[28]

D. Evaluation

The decision of the FCC amounts to a slap in the face for the lower courts, in particular the higher regional court.

Both the local court and the higher regional court had refused to accept that the operator was directly bound by the fundamental rights provisions of the BL.[29] This was untenable and incomprehensible. It is a unanimous opinion among scholars[30] and settled case law[31] that public enterprises are so bound, even when choosing a private form of organization and operation. The decisive factor is the dominant influence of public authority on the operation of the business, which was clearly the case here.

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[28] Ibid. with reference to CJEU, case C-388/01, *Dogenpalast*, ECLI:EU:C:2003:30, para. 22 et seq.

[29] FCC, case 2 BvR 470/08, para. 35 et seq.

[30] *Hillgruber*, in: Epping/Hillgruber (eds.), Beck'scher Online-Kommentar Grundgesetz, 29nd ed. 2016, Art. 1, para. 70 et seq.; *Herdegen*, in: Maunz/Dürig (eds.), Grundgesetz-Kommentar, 76th suppl. 2016, Art. 1(3), para. 28; *Giegerich*, Gemeindeunternehmen zwischen Kompetenz, Konkurrenz und Kohärenz: Privatisierung, Reform des kommunalen Wirtschaftsrechts und Widerspruchsfreiheit der Rechtsordnung, in: Tradition und Weltoffenheit des Rechts, Festschrift für Helmut Steinberger, 2002, p. 432 et seq., fn. 45, 47 with further references; *Fenger/Lindemann*, The Fraport Case of the First Senate of the German Federal Constitutional Court and its Public Forum Doctrine: Case Note, German Law Journal 15 (2014), p. 1105 et seq.; *Gurlit*, Grundrechtsbindung von Unternehmen, NZG 2012, p. 249 et seq.

[31] See above all the FCC landmark case 1 BvR 699/06, *Fraport*, judgment of 22/2/2011, para. 45 et seq. See also the German Federal Supreme Court, case V ZR 227/14, judgment of 26/6/2015, para. 9.

The same holds true with regard to the fundamental freedoms of the internal market. The CJEU had already ruled on several comparable cases,[32] which the higher regional court should have taken into account. It was utterly untenable for the higher regional court to disregard that case law without making a reference to the CJEU concerning possible remaining questions of EU law that needed to be clarified.

Moreover, the higher regional court claimed that there were objective grounds to justify the differential treatment of non-inhabitants of the five municipalities involved in the control of the company operating the pool, but did not elaborate on the facts in this regard.[33] As the FCC has shown, that claim was simply not true. Even the public-law corporation behind the operator of the leisure pool had argued before the courts that it had been founded with the aim of attracting tourists and making profit.[34] On that basis, there was obviously no justification for the preferential treatment of inhabitants of the five municipalities. This should have been clear to the higher regional court – especially because there is settled case law of the FCC on this issue.[35]

The higher regional court also refused to accept that Article 56 TFEU read together with § 134 GCC required a finding that the contract was void for reasons of illegality.[36] Instead it asserted that EU law did not provide for such a sanction in this case.[37] Moreover, it stated that it was for the national courts alone to determine whether EU law required discrimination-free pricing and included a subjective right to such pricing.[38] Again, no reference to the CJEU was made even though the

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32 CJEU, case 155/73, *Sacchi*, ECLI:EU:C:1974:40, 430; CJEU, joined cases 188/80-190/80, *Transparency Directive*, ECLI:EU:C:1982:257, 2575, 2579; CJEU, case C-260/89, *ERT*, ECLI:EU:C:1991:254, para. 10 et seq.; CJEU, case C-281/98, *Angonese*, ECLI:EU: C:2000:296, para. 30 et seq.

33 FCC, case 2 BvR 470/08, paras. 11 and 37.

34 Ibid., para. 42.

35 See the cases mentioned in ibid., para. 39.

36 Ibid., para. 47.

37 Ibid., para. 49.

38 Ibid., para. 50.

case law of the CJEU clearly pointed in the opposite direction. In our opinion it is important that the violation of Article 56 TFEU renders the contract void by virtue of § 134 GCC. In accordance with the FCC's decision, this is the only way to make the freedom to receive services in other Member States and the prohibition of discrimination on grounds of nationality enshrined therein effective.[39] No less is required from the national courts by Article 4(3) TEU.

E. Conclusion

To conclude, the lower courts utterly misapplied the law in the instant case to the extent that one can speak of a denial of justice both with regard to German constitutional law and EU law. It is therefore no wonder that the FCC has chosen strong language to drive that point home to them.

However, this decision also constitutes an, admittedly slender, silver lining in the relationship between the FCC and the CJEU. By sternly reminding the German courts of their obligation to properly apply EU law and in particular to take preliminary references under Article 267 TFEU seriously, it strengthens the role of the CJEU. After the FCC's decision in December 2015 concerning the European Arrest Warrant, which was rather taxing on the relationship with the CJEU,[40] the present decision can be seen as an attempt to reconcile. Its effects extend to all areas of directly applicable EU law, which the German courts are called upon to apply. If they do so in an arbitrary manner and fail to make a reference to the CJEU, the defeated parties can have the court decisions quashed by filing a constitutional complaint with the FCC. Simple mistakes in the application of EU law

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39 See for further references to this opinion *Fischer*, Zur Durchsetzbarkeit des gemeinschaftsrechtlichen Diskriminierungsverbots vor nationalen Gerichten, EuZW 2009, pp. 208, 210; *Tietje/Hölzel*, Grundfreiheiten und Zivilrecht – Die Ignoranz deutscher Gerichte gegenüber dem Unionsrecht, Policy Papers 2009, No. 32, p. 5.

40 FCC, case 2 BvR 2735/14, judgment of 15/12/2015. See *Müller*, Vertrauen ist gut, Kontrolle ist besser: Einordnung des neuen EuGH-Urteils zum Europäischen Haftbefehl in das grundrechtliche Mehrebenensystem in Europa, ZEuS 2016, p. 345 et seq.

by a German court are, however, not sufficient to make such a constitutional complaint successful.

There is one fly in the ointment, however: It took the FCC more than eight years to determine that the constitutional complaint was "manifestly well founded". This delay regrettably constitutes a manifest violation of the applicant's right under Article 6(1) of the European Convention on Human Rights to have his civil rights determined by a court within a reasonable time.[41] In any event, we owe a debt of gratitude to the Austrian leisure pool fan whose endurance and thirst for justice enabled the FCC to render this interesting decision and promote the effective implementation of EU law in Germany.

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[41] See ECtHR, no. 47169/99, *Voggenreiter v. Germany*, judgment of 8/1/2004; ECtHR, no. 58911/00, *Leela Förderkreis e.V. et al. v. Germany*, judgment of 6/11/2008.

Guarantees against Political Risks offered by Bosnia and Herzegovina and Montenegro to Incoming Foreign Investments

Nataša Vujinović[*]

Abstract

Political violence, expropriation and other deprivations of property rights as well as risks connected to currency conversion and transfer of exchanged currency represent traditional perils investors face when considering investing in foreign countries. In order to attract foreign investment and assure their security thereafter, host countries stipulate various guarantees and provide for different levels of protection of foreign investments and investors on domestic territories. The paper at hand strives to offer a brief overview of the guarantees against political risks which Bosnia and Herzegovina and Montenegro provide for incoming foreign investments. As both countries follow the internationally widespread approach of offering such guarantees both in their national legislation as well as in their bilateral investment treaties, the presented analyses will discuss these guarantees on both levels in each of the two countries and compare them, trying to point out their faults and drawbacks.

A. Introduction

Political risk in terms of investment law refers to the likelihood that extraordinary and unexpected measures negatively influencing foreign investment will be undertaken by the host state,[1] i.e. the possibility of an intervention of a government or other authorities of a country resulting in depriving an investor of his rights and reducing the value of his investment.[2] However, not only acts but also omissions and not

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1 *Hober/Fellenbaum,* in: Bungenberg et al. (eds.), International Investment Law, 2015, p. 1519, para. 5.

2 *Cvetković,* Rizici podobni za izdavanje garancije MIGA, Pravo i privreda no. 5-8/2002, p. 726.

only government and political institutions but also minority groups and separatist movements may cause political acts that can be classified as political risks.[3] Thus, in various terms a broader definition could be offered classifying political risk as "the probability of disruption of the operations of companies by political forces and events, whether they occur in host countries or result from changes in the international environment."[4] In academia political risks are subsumed into three basic and relatively broad categories: risks connected to political violence (war, coup d'état, revolution, rebellion, riot, insurrection, terrorism, sabotage or civil strife), risks of expropriation and other deprivations of investor's property rights including interference with contractual rights and risks connected to currency conversion and transfer.[5]

The existence of political risks, and threats thereof, for foreign investors were identified on a state level quite a while ago. Through various instruments of (international) law, mainly categorised into international agreements, customary international law and general principles of law,[6] certain levels of protection for foreign investments and investors have been attempted and set.

At the very outset, general principles of law and customary international law contained certain minimum standards protecting investors.[7] Although initially generally accepted among the developed countries, after the Second World War the discrepancies stemming from different positions of these and developing countries emerging in the global economy, led to inconsistent and heterogeneous recourse to these standards.[8] Therefore, the protection and legal certainty available through these means did not reach a satisfactory level.

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3 MIGA, World Investment and Political Risk 2011, www.miga.org/documents/WIPR11.pdf (1/12/2016), p. 21.

4 Ibid.

5 See *Hober/Fellenbaum*, (fn. 1), p. 1519, para. 5; *Linn Williams,* Political and Other Risk Insurance: OPIC, MIGA, EXIMBANK, and Other Providers, Pace Int'l L. Rev. 5 (1993), p. 59.

6 Article 38(1) Statute of the International Court of Justice. The systematisation employed by *Sornarajah*, International Law of Foreign Investment, 3rd ed. 2010, p. 79 et seqq.

7 For more information see *Dolzer/Schreuer*, Principles of International Investment Law, 2008, p. 15 et seqq. See also *Sornarajah*, (fn. 6), pp. 82-87 and 128-130.

8 *Dolzer/Schreuer*, (fn. 7), p. 14; *Comeaux/Kinsella,* Protecting Foreign Investment Under International Law: Legal Aspects of Political Risk, 1997, p. 100.

In order to overcome these discrepancies as well as the failures of establishing a multilateral treaty and still secure the necessary legal protection for their investors abroad, developed states started concluding bilateral investment treaties (BITs).[9] A BIT is a bilateral investment agreement concluded between two countries in which each of the contracting countries guarantees certain protection to investors and foreign investments from the other,[10] thereby establishing the legal framework under international law, terms and conditions for invest-ments by nationals and companies of the one state in the other and reducing the risks that the host state would, using its sovereign rights, endanger foreign investment.[11] The developing countries, on the other hand, enter into such BITs in order to ensure that they recognise certain standards of protection of foreign investment and thereby attract foreign investment and secure their inflow.[12] Furthermore, host countries have not only been guaranteeing protection to foreign investors and investments in BITs but have also stipulated consider-able standards of protection in their internal national legal acts, beginning from constitutions and extending to laws and state contracts.[13] Thus, foreign investors and investments are normally granted certain standards of protection against political perils both within the BITs between home and host country as well as by host countries internal legislation.

Moreover, some multilateral treaties, such as the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention),[14] the North American Free Trade

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9 *Sornarajah*, (fn. 6), pp. 174 and 183; *Kronfol*, Protection of Foreign Investment, A Study in International Law, 1972, p. 35. For a comprehensive explanation on historical developments of international investment treaties consult UNCTAD, World Investment Report 2015: Reforming International Investment Governance, 2015, pp. 121-127.

10 *Comeaux/Kinsella*, (fn. 8), p. 101.

11 *Đundić,* Odredbe o eksproprijaciji u dvostranim ugovorima o zaštiti stranih investicija, in: Kostić-Mandić (ed.), Međunarodno privatno pravo i zaštita stranih investora, 2008, p. 100.

12 *Sornarajah*, (fn. 6), p. 173; *Dolzer/Schreuer*, (fn. 7), p. 16. The claim that the existence of BITs influences the investment flows is however contested. See *Sornarajah*, (fn. 6), p. 187.

13 For more information see *Kronfol*, (fn. 9), pp. 40-45.

14 For more on the ICSID Convention consult *Dolzer/Schreuer*, (fn. 7), pp. 222-224; *Griebel*, Internationales Investitionsrecht, 2008, pp. 116-138. See also *Blackaby et al.,* Redfern

Agreement (NAFTA)[15] or the Energy Charter Treaty (ECT),[16] tackle certain aspects and regulate some issues concerning foreign investments. Both the ICSID Convention and the Energy Charter Treaty are in force in Bosnia and Herzegovina (BIH)[17] and in Montenegro[18] respectively. Yet again, none of the aforementioned treaties are solely dedicated to the area of foreign investment nor do they address the variety of its issues or political risks specifically. Rather they sporadically and only occasionally regulate the investment-related issues connected to their scope of application, as in the cases of the ECT and NAFTA as sector and regional agreements, or they only regulate procedural aspects of investment law, namely dispute resolution as in the case of the ICSID Convention. The endeavours to establish multilateral agreements regulating foreign investment have a relatively long history[19] but have not, until now, been fruitful.[20]

As no multilateral investment agreement is in existence, the customary international law protection proves insufficient and as on

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and Hunter on International Arbitration, 2009, pp. 465-468 for more on the historical background of its creation.

15 For more on NAFTA's provisions on investments and it's protection standards consult *Sornarajah*, (fn. 6), p. 253 et seq.; *Comeaux/Kinsella*, (fn. 8), pp. 117-120; *Dolzer/Schreuer*, (fn. 7), p. 28 et seq. Further information on NAFTA's contribution to dispute settlement is available in *Bjorklund*, in: Bungenberg et al., (fn. 1), pp. 261-283.

16 For more on ECT consult *Happ*, in: Bungenberg et al., (fn. 1), pp. 240-261; *Dolzer/Schreuer*, (fn. 7), p. 27 et seq.

17 Bosnia and Herzegovina signed the ECT on 14/6/1995 and it entered into force on 16/8/2001, www.energycharter.org/who-we-are/members-observers/countries/bosnia-and-herzegovina/ (1/12/2016). The ICSID Convention was signed on 25/4/1997 and entered into force on 13/6/1997, www.icsid.worldbank.org/apps/ICSIDWEB/about/Pages/Database-of-Member-States.aspx?tab=AtoE&rdo=BOTH (1/12/2016).

18 The ECT entered into force in Montenegro on 7/12/2015 and the ICSID Convention on 10/5/2013.

19 For further information on the historical attempts to make a multilateral treaty including a code of foreign investment see *Brown*, in: Bungenberg et al. (fn. 1), pp. 161-175; *Brown*, Commentaries on Selected Model Investment Treaties, 2013, p. 6 et seq. For the period until 1970s see *Kronfol*, (fn. 9), pp. 30-35.

20 For the reasoning behind the failures to establish multilateral treaties see *Sornarajah*, (fn. 6), p. 183. On the latest OECDs proposal on a Multilateral Agreement on Investment and its failure see comprehensive analyses in ibid., pp. 257-262; *Karl*, in: Bungenberg et al. (fn. 1), pp. 342-360.

the international scene BITs alone offer certain reliable standards of protection for foreign investments against political risks, the paper will focus on protection against political risks offered in BITs as well as national legislation of Bosnia and Herzegovina and Montenegro to analyse the available standards of protection. The two South Eastern European countries are very interested in attracting as much foreign capital as possible. Foreign investments are a significant element of the economy of the two countries.[21] However, they are quite prone to risks.[22] Nevertheless, both countries seem determined to guarantee protection for foreign investment. Although both are on their path towards accession to the European Union, the paper aims to analyse the international and national level of guarantees offered, with no intention to address the *acquis communautaire* or to analyse the Bosnian and Herzegovinian and Montenegrin guarantees in this context. Bosnia and Herzegovina will be addressed first, starting with protection in its national legislation and thereafter in its BITs, followed by the same approach with respect to Montenegro.

B. Guarantees against Political Risks Stipulated in National Legislation of Bosnia and Herzegovina

As previously mentioned, the protection of foreign investments guaranteed through a country's national legislation is widely practiced in host countries.[23] Bosnia and Herzegovina is no exception in this sense.

Before elaborating on the protection offered in national legal acts and for the sake of understanding several levels on which guarantees are provided, some light shall be shed on state organization of BIH.

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[21] BIH had 244 million EUR inflow of foreign direct investment in 2015, a record high 1.3 billion EUR in 2007 and altogether from 1994 until December 2015 6.2 billion EUR foreign direct investment. For further statistical information see data provided by the Foreign Investment Promotion Agency of BIH, www.fipa.gov.ba/informacije/statistike/investicije/default.aspx?id=180&langTag=en-US and www.bhas.ba/saopstenja/2016/INV_2015_BS.pdf (1/12/2016). As for Montenegro, in 2014 it had 498 million EUR inflow of foreign direct investment and its record over one billion EUR in 2009. Data provided by the MIPA (Montenegrin Investment Promotion Agency), www.mipa.co.me/en/-fdi-statistics/ (1/12/2016).

[22] For BIH see UNCTAD, Investment policy review, Bosnia and Herzegovina, 2015, www.unctad.org/en/PublicationsLibrary/diaepcb2015d1_en.pdf (1/12/2016).

[23] *Kronfol*, (fn. 9), p. 40.

BIH consists of two entities: Federation of Bosnia and Herzegovina (FBIH) and Republic Srpska (RS).[24] The FBIH consists of federal units, known as cantons.[25] The Law on Federal Units (Cantons) establishes the cantons, their number and territory.[26] The FBIH consists of ten cantons, the names of which are determined according to the cities where the cantonal authorities have their seats.[27] Republic Srpska on the other hand is a territorially unified legal entity.[28] By the constitutional amendments of 26 March 2009 a third political and territorial unit was established within BIH: Brčko District of Bosnia and Herzegovina (Brčko District) – a local self-government unit under the sovereignty of Bosnia and Herzegovina, the territory of which represents a condominium of FBIH and RS.[29] With such a complicated state organization, it should be highlighted that foreign trade policy falls, along with some others, within the competence explicitly conferred on the state level of Bosnia and Herzegovina.[30] All other state functions and powers, which are not within the exclusive competence of BIH, according to the Constitution, belong to the entities.[31]

Having addressed the state structure of BIH, the guarantees offered to foreign investment against political risks shall be analysed. Firstly, the constitutional level of protection in all organisational units of Bosnia and Herzegovina is to be examined. Thereafter, some light will be shed on the statutory level of protection within the same units.

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24 Article 1(3) Constitution of Bosnia and Herzegovina, The General Framework Agreement for Peace in Bosnia and Herzegovina, Annex 4.

25 Chapter I, Article 2 Constitution of FBIH. Official Gazette of FBIH No. 1/94, 13/97, 16/02, 22/02, 52/02, 60/02, 18/03, 63/03, 9/04, 20/04, 33/04, 71/05, 72/05, 32/07 and 88/08.

26 See Law on Federal Units (Cantons), Official Gazette of FBIH No. 9/96.

27 Articles 4 and 5 Law on Federal Units (Cantons).

28 Article 1(1) Constitution of RS, Official Gazette of RS No. 21/92, 28/94, 8/96, 13/96, 15/96, 16/96, 21/96, 21/02, 26/02, 30/02, 31/02, 69/02, 31/03, 98/03, 115/05, 117/05 and 48/11.

29 Amendment I to the Constitution of BIH of 26/3/2016, Official Gazette of BIH No. 25/09.

30 Article 3(1) and (2) Constitution of BIH.

31 Article 3(3)(a) Constitution of BIH; Article 3 Constitution of RS; Chapter I, Article 1(1) Constitution of FBIH. For detailed explanations on the actual competence division between the state and entity levels consult *Steiner/Ademović and Leroux-Martin,* in: Steiner/Ademović (eds.), Constitution of Bosnia and Herzegovina, Commentary, 2010, www.kas.de/wf/doc/kas_19629-1522-1-30.pdf?100531103256 (1/12/2016), pp. 573-611.

With respect to the constitutional protection for foreign investment, the Constitution of BIH as the highest legal act in the country does not directly address foreign investment and the inflow of foreign capital. It should be borne in mind that the Constitution of Bosnia and Herzegovina is an annex to the General Framework Agreement for Peace in Bosnia and Herzegovina, initialled in Dayton on 21 November 1995 and signed in Paris on 14 December 1995, concluded in order to end the disastrous four-year war. Thus, its contents and main objectives differ from constitutions adopted in usual and normal circumstances. Still, the Constitution of BIH states in its Preamble the desire to "promote the general welfare and economic growth through the protection of private property and the promotion of a market economy". In spite of certain more detailed later provisions, e.g. the right to property,[32] the aforementioned proclamation of the Preamble of the BIH Constitution is essential in nature, setting the foundation for a constitutional framework for new economic policies of the emerging country.[33] This provision opened the door for foreign investors to invest in a country with a modern economic system, private property concept and market economy, which is a prerequisite for inflow of foreign investment and which was previously not the case, thereby already making the country interesting for future foreign investment and enabling the upcoming legal framework for the protection of foreign investment in BIH.

Furthermore, the constitutions of RS and FBIH as well as the Statute of Brčko District provide some further protection. Namely, the Constitution of Republic Srpska provides certain general guarantees: equal legal treatment to all forms of ownership,[34] which may however be limited or revoked by law subject to fair compensation.[35] Moreover, the Constitution of RS contains further specific provisions concerning foreigners and their investments. That being said, foreigners may acquire ownership rights and rights based on the investment of capital according to law, which may not be limited or

32 Article 2(3)(k) Constitution of BIH.

33 *Steiner/Ademović*, (fn. 31), p. 53.

34 Article 54 Constitution of RS.

35 Article 56(1) Constitution of RS. Furthermore, Article 56(2) Constitution of RS foresees limitations of the disposal of assets during war, immediate threat of war or emergency.

deprived by law or any other legal act.[36] In addition to this, the right to conduct commercial and business activities as well as any rights arising from such activities are guaranteed,[37] specifically the right to transfer profits and invested capital out of the entity.[38] Still, the Constitution of RS foresees the possibility to restrict areas in which a foreigner would be allowed to establish an enterprise in exceptional cases and in the public interest.[39]

The Constitution of FBIH, on the other hand, follows to a certain extent the approach of the state constitution by not actually addressing foreign investment and only proclaiming the right to property in general.[40] When it comes to cantonal constitutions within the FBIH, constitutions of all ten cantons refrain from addressing any of the issues relevant for political risk protection and limit themselves to establishing the competences and structure of cantonal authorities.[41] With respect to the Brčko District, its Statute as the highest legal act of local self-governance, which also foresees that the Constitution and all relevant laws and decisions of BIH are directly applicable in

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[36] Article 57(1) and (2) Constitution of RS.

[37] Article 57(3) Constitution of RS.

[38] Article 57(4) Constitution of RS.

[39] Article 57(5) Constitution of RS.

[40] Chapter II, Article 2(1)(k) Constitution of FBIH.

[41] See Constitution of Unsko-Sanki Canton, Official Gazette of Unsko-Sanski Canton No. 1/95, 2/97, 9/99, 5/00, 3/03, 11/03 and 1/04; Constitution of Posavski Canton, Official Gazette of Posavski Canton No. 1/96, 3/96, 7/99, 3/00, 5/00 and 7/04; Constitution of Tuzlanski (Tuzlansko-podrinjski) Canton, Official Gazette of Tuzlansko-podrinjski Canton No. 7/97, 3/99 and Official Gazette of Tuzlanski Canton No. 13/99, 10/00, 14/02, 6/04, 10/04; Constitution of Zeničko-Dobojski Canton, Official Gazette of Zeničko-Dobojski Canton No. 1/96, 10/00, 8/04 and 10/04; Constitution of Bosansko-Podrinjski Canton Goražde, Official Gazette of Bosansko-Podrinjski Canton Goražde No. 5/97, 6/97, 6/98, 8/98, 10/00 and 5/03; Constitution of Srednjobosanski Canton, Official Gazette of Srednjobosanski Canton No. 1/97, 5/97, 6/97, 2/98, 7/98, 8/98, 10/2000, 8/03, 2/04, 14/04; Constitution of Herzegovačko-neretvanski Canton, Official Gazette of Herzegovačko-neretvanski Canton No. 2/98, 4/00, 7/04; Constitution of Zapadnohercegovački Canton, Official Gazette of Zapadnohercegovački Canton No. 1/96, 2/99, 14/00, 17/00, 1/03, 10/04, 17/11; Constitution of Canton Sarajevo, Official Gazette of Canton Sarajevo No. 1/96, 2/96, 3/96, 16/97, 14/00, 4/01, 28/04, 6/13; Constitution of Canton 10 – Hercegbosanski Canton, Official Gazette of Hercegbosanski Canton No. 3/96, 9/00 and 10/05.

the district,[42] guarantees the right to peaceful and undisturbed enjoyment of private property which may not be taken, expropriated or diminished in any way without consent, unless provided by law and to the extent necessary to achieve the public good.[43] Furthermore, everyone in the district has the right to engage in entrepreneurial activity which again shall not be restricted unless provided by law and to the extent necessary to achieve the public good.[44] Thus, at the constitutional level of all BIH's units of internal structure as well as at the state level, certain guarantees to foreign investments against political risks are available.

Having analysed all the constitutional levels available in the complicated internal structure of Bosnia and Herzegovina, all that remains to be addressed is the statutory level. The Law on the policy of foreign direct investment in BIH[45] as well as the Law on foreign investment of RS,[46] the Law on foreign investment of FBIH[47] and the Law on promotion of commercial development in the Brčko District of BIH[48] regulate the subject matter in the same manner, each of them for the respective territory. The Law on the policy of foreign direct investment in BIH is the framework law on the basis of which the entity and district laws have been adopted and from which they do not deviate but rather provide "more detailed provisions to facilitate implementation […][of the regulatory goals and] form a coherent legal framework for FDI".[49] All four laws quite generally foresee national treatment of foreign investors[50] and go on to more specifically guarantee national

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[42] Article 1(4) Statute of Brčko District, Official Gazette of Brčko District BIH No. 02/10.

[43] Article 13(5) Statute of Brčko District.

[44] Article 13(6) Statute of Brčko District.

[45] Law on the policy of foreign direct investment in BIH, Official Gazette of BiH No. 17/98, 13/03, 48/10 and 22/15.

[46] Law on foreign investment of RS, Official Gazette of RS No. 25/02, 24/04, 52/11 and 68/13.

[47] Law on foreign investment of FBIH, Official Gazette of FBiH No. 61/01, 50/03 and 77/15.

[48] Law on promotion of commercial development in Brčko District of BIH, Official Gazette of Brčko District BIH No. 1/00, 4/00, 7/04, 20/05 and 24/05.

[49] UNCTAD, (fn. 22), p. 9.

[50] Article 8(1) Law on the policy of foreign direct investment in BIH; Article 3 Law on foreign investment of RS; Article 3 Law on foreign investment of FBIH; Article 4 Law on promotion of commercial development in Brčko District BIH.

treatment of foreign investors concerning property rights in respect of real estate,[51] with BIH and RS also setting the specific condition of reciprocity for successor states of the former Yugoslavia.[52] Furthermore, nationalisation, expropriation, requisition or measures which have similar effects are not allowed unless in the public interest in accordance with applicable laws, without discrimination and against the payment of prompt, adequate and effective compensation.[53] On top of that, BIH and RS law guarantee foreign investors the right to freely exchange national currency to any other freely convertible currency,[54] whereas all the laws in question guarantee, to freely and without delay, in freely convertible currency and upon fulfilment of all tax and other legal obligations connected to public revenues, transfer abroad any profit resulting from their investment on domestic territory.[55] Additionally, except in the district law, transitional and final provisions guarantee the continuation of foreign investment policy and protection provided by stipulating that no right or benefit granted to foreign investors may be terminated or eliminated by subsequent laws.[56] Last but not least, entity laws provide for application of the Law on the policy of foreign direct investment in BIH for issues not regulated by their provisions.[57]

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[51] Article 6 Law on foreign investment of FBIH; Article 4 Law on promotion of commercial development in Brčko District BIH.

[52] Article 12 Law on the policy of foreign direct investment in BIH, Article 7 Law on foreign investment of RS.

[53] Article 16 Law on the policy of foreign direct investment in BIH; Article 10 Law on foreign investment of RS; Article 8 Law on foreign investment of FBIH; Article 11 Law on promotion of commercial development in Brčko District BIH.

[54] Article 11(a) Law on the policy of foreign direct investment in BIH; Article 8(2) Law on foreign investment of RS; Article 9(2) Law on promotion of commercial development in Brčko District BIH.

[55] Article 11(c) and (d) Law on the policy of foreign direct investment in BIH; Article 8(3) Law on foreign investment of RS; Article 7 Law on foreign investment of FBIH; Article 9(3) Law on promotion of commercial development in Brčko District BIH.

[56] Article 20 Law on the policy of foreign direct investment in BIH; Article 16 Law on foreign investment of FBIH; Article 17 Law on foreign investment of RS.

[57] Article 1(2) Law on foreign investment of RS; Article 1(2) Law on foreign investment of FBIH.

Except for the aforementioned *legis specialis* on all levels of Bosnian internal organisation, certain further legal acts, again at all levels of the internal structure, regulate issues relevant for foreign investors as well as their investments. Among these laws are, on all levels of state structure, laws on proprietary rights, laws on expropriation, laws on concessions, laws on business companies and laws on foreign exchange operations. However, out of the numerous acts touching upon certain aspects relevant for foreign investment on all institutional levels, only the Laws on expropriation of the Brčko District of BIH,[58] FBIH[59] and RS[60] and the Laws on foreign exchange operations of FBIH[61] and RS[62] further touch upon the matters relevant for the field of political risks guarantees, based on the foundations set by the laws regulating foreign investments.

As is evident, Bosnian and Herzegovinian domestic legislation on foreign investment does not at any level of the internal structure provide any guarantees against risks of political violence. Nevertheless, guarantees against unlawful expropriation without compensation and proclamation of transfer and exchange rights are provided on various levels of internal organisation of the state and in legal acts of different legal force.

C. Bosnia and Herzegovina's BITs' Guarantees against Political Risks

Bosnia and Herzegovina currently has some 37 BITs in force, mainly with European countries but also with Egypt and some Middle Eastern and Asian countries.[63] It is evident from the analyses of

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58 Law on expropriation of real estate in Brčko District of BIH, Official Gazette of Brčko District of BIH No. 26/04, 19/07, 2/08, 19/10 and 15/11.

59 Law on expropriation of FBIH, Official Gazette of FBIH No. 70/07, 36/10, 25/12 and 34/16.

60 Law on expropriation of RS, Official Gazette of RS No. 112/06, 37/07, 66/08, 110/08, 106/10, 121/10, 2/15 and 79/15.

61 Law on foreign exchange operations of FBIH, Official Gazette of FBIH No. 47/10.

62 Law on foreign exchange operations of RS, Official Gazette of RS No. 96/03, 123/06, 92/09 and 20/14.

63 Information on BIH's BITs as well as the treaties themselves are available at www.investmentpolicyhub.unctad.org/IIA/CountryBits/25#iiaInnerMenu (1/12/2016). Ministry of Foreign Trade and Economic Relations of BIH provides the texts of respective treaties however only in local languages at www.mvteo.gov.ba/sporazumi/

bilateral investment treaties concluded by BIH that they all employ very similar, actually in most cases identical, treaty language.[64]

To start with, fair and equitable treatment and full protection and security, as well as national treatment and most-favoured nation treatment are standards present in almost all BIH's BITs.[65] Fair and equitable treatment, although present in almost all BITs in force worldwide, is not defined in these BITs and is mostly seen as "a flexible tool of *ex post facto* control of host States' measures based on the arbitrators' ideological inclinations or good feelings as to what might be considered fair and equitable."[66] As for the most-favoured nation treatment, it requires the contracting parties to accord investors and investments from the other contracting party treatment no less favourable than that accorded to investors from third countries.[67] The national treatment standard goes one step further to stipulate the obligation to provide investors and investments from the other contracting party treatment no less favourable than that given to own investors and investments.[68] When it comes to political risk protection and guarantees in particular, Bosnian and Herzegovinian BITs follow the common approaches to these respective terms.

Deprivations of investor's property rights, expropriation, nationalisation, requisition as well as measures having equivalent

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trgovinski/bilateralni/investicije/Archive.aspx?id=275&langTag=bs-BA (1/12/2016). The number of BIH's BITs is 37, since the BIT with Jordan does not exist in either of the sources, the second one being the official source of the Bosnian government.

64 All Bosnian and Herzegovinian BITs have been analysed during the preparation of this paper. However, due to space limitations, when the same solutions are offered among BITs, only some of them will be referred to. These BITs have not been chosen by any criteria other than the endeavour to cover different geographical areas. Particularities of certain BITs, on the other hand, have of course been specified without exception.

65 Egyptian Bosnian BIT (1998) and Malaysian Bosnian BIT (1994) omit to guarantee national treatment while providing for the other standards, whereas Indian Bosnian BIT (2006) and Qatar Bosnian BIT (1998) omit to provide for full protection and security. Furthermore, Article 2 Turkish Bosnian BIT (1998) establishes only national and most-favoured-nation treatments.

66 *Jacob/Schill*, in: Bungenberg et al., (fn. 1), p. 715, para. 32.

67 For detailed analyses see *Reinisch*, in: Bungenberg et al., (fn. 1), pp. 807-845.

68 For detailed analyses see ibid., pp. 847-869.

effect,[69] in some cases specifically referred to as indirect measures[70] or simply "other similar measures",[71] are prohibited in all Bosnian BITs in force without exception. Yet again, non-discriminatory measures for a public purpose, in the public interest, undertaken in accordance with due process of law and compensated for are considered legal and permitted.[72] Although BITs establish without exception the obligation to pay compensation for the taking of foreign-owned property, the terms for compensation employed in BITs range from "prompt, adequate and effective compensation",[73] "prompt, effective and just",[74] "effective and adequate compensation",[75] "adequate and prompt",[76] "fair and equitable",[77] "just compensation"[78] to only "compensation".[79] Still, compensation normally amounts to the (fair) market value[80] unaffected by knowledge of the expropriation.[81] Thus, Bosnian and Herzegovinian BITs consistently protect foreign investment from

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69 Article 4(1) Czech BIH BIT (2002); Article 4(1) Danish BIH BIT (2004); Article 4(1) Egyptian BIH BIT (1998); Article 5(1) Indian BIH BIT (2006).

70 Article 5(1) Finnish BIH BIT (2000); Article 3(1) Turkish BIH BIT (1998); Article 4(2) German BIH BIT (2001); Article 6(1) Kuwait BIH BIT (2001); Article 5(1) Austrian BIH BIT (2000). Article 6(4) Kuwait BIH BIT (2001) goes one step further to prescribe that interventions or regulatory measures having *de facto* confiscatory or expropriatory effect amount to an expropriation.

71 Article 4(1) Chinese BIH BIT (2002); Article 6(1) Iranian BIH BIT (1996).

72 Article 4(1) Czech BIH BIT (2002); Article 4(1) Chinese BIH BIT (2002); Article 4(1) Danish BIH BIT (2004); Article 6(1) Iranian BIH BIT (1996); Article 4(1) Serbian BIH BIT (2001).

73 Article 4(2) Czech BIH BIT (2002); Article 6(1) Kuwait BIH BIT (2001); Article 4(1) Danish BIH BIT (2004); Article 5(1) Hungarian BIH BIT (2002); Article 4 Pakistani BIH BIT (2001).

74 Article 6(1) Iranian BIH BIT (1996).

75 Article 4(1) Egyptian BIH BIT (1998); Article 4(2)(c) Belgo-Luxembourgish BIH BIT (2004).

76 Article 3(1) Qatar BIH BIT (1998).

77 Article 5(1) Indian BIH BIT (2006).

78 Article 6 Dutch BIH BIT (1998).

79 Article 4(2) Chinese BIH BIT (2002).

80 Article 4(2) Chinese BIH BIT (2002) stipulates that the value "shall be determined in accordance with generally recognized principles of valuation", whereas Article 5(1) Indian BIH BIT (2006) and Article 5(1) UK BIH BIT (2002) foresee the "genuine value of the investment" and Article 3(2) Qatar BIH BIT (1998) speaks of the "real economic value".

81 Article 4(2) Czech BIH BIT (2002); Article 4(2) Chinese BIH BIT (2002); Article 4(2) Danish BIH BIT (2004); Article 4(1) Egyptian BIH BIT (1998); Article 4(2) Ukrainian BIH BIT (2002).

unlawful and discriminatory distortion of property and stipulate monetary restitution in case any form of expropriation should occur, thereby protecting foreign investment against this political risk.

Furthermore, Bosnian and Herzegovinian BITs also address, in a way, the risk of political violence. In case of investments being damaged by political violence in the host country, for example war, revolution and insurrection and other similar events,[82] or exclusively listed forms of violence,[83] concluded BITs usually offer both national and most favoured nation treatment, whereas examples of providing only most-favoured nation treatment are noted,[84] in respect of restitution, indem-nification, compensation and any other settlement. Moreover, some BIH's BITs go even one step further to provide for compensation of damages occurred though acts of host state authorities requisitioning or destroying property which were not required by the necessity of the situation[85] or not caused in combat actions.[86]

As far as further political risks are concerned, Bosnian and Herzegovinian BITs also protect the right to transfer profits as well as some other forms of transfers in and out of the country. Most BIH's BITs contain an indicative list of covered transfers, whereas exclusive list of covered transfers are provided in certain individual BITs.[87] Moreover, the majority of BIH's BITs stipulate that the transfer should be made in a freely convertible currency,[88] while others go even further to guarantee the transfer in the currency in which the investment

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[82] Article 6(1) Greek BIH BIT (2000); Article 4(1) Hungarian BIH BIT (2002); Article 6 Indian BIH BIT (2006); Article 7 Iranian BIH BIT (1996); Article 5(1) Kuwait BIH BIT (2001). Article 5 Portuguese Bosnian BIT (2002) reads "or other events considered as such by international law".

[83] Article 5 Chinese BIH BIT (2002); Article 4(2) Egyptian BIH BIT (1998); Article 3(2) Malaysian BIH BIT (1994); Article 5 Romanian BIH BIT (2001).

[84] Article 3(2) Malaysian BIH BIT (1994).

[85] Article 5(2) Danish BIH BIT (2004); Article 6(2) Greek BIH BIT (2000); Article 6(2) Austrian BIH BIT (2000); Article 5(1) Lithuanian BIH BIT (2007); Article 6(2) Spanish BIH BIT (2002).

[86] Article 6(2) Finnish BIH BIT (2000); Article 5(2) Kuwait BIH BIT (2001); Article 6(2) San Marino BIH BIT (2011); Article 4(2) Slovak BIH BIT (2008); Article 4(2) UK BIH BIT (2002).

[87] Article 7(1) French BIH BIT (2003); Article 6(1) Italian BIH BIT (2000); Article 5(1) Malaysian BIH BIT (1994); Article 5(1) Pakistani BIH BIT (2001).

[88] Article 6(2) Czech BIH BIT (2002); Article 5(1) Egyptian BIH BIT (1998).

initially occurred.[89] The applicable exchange rate is normally the market rate on the date of transfer[90] in the host country,[91] but alternatives are offered in case a market for foreign exchange does not exist.[92] Although the majority of BIH's BITs provide for an absolute right to transfer, there are still restrictions e.g. subject to national regulations and policies,[93] in cases of balance of payments difficulties,[94] if GATT 1994 prohibits or restricts exportations or sale of exports[95] or under some other circumstances.[96]

When it comes to commitments made to each other's nationals, some bilateral investment treaties stipulate obligations of contracting states to honour these commitments.[97] In fact, by including the obligation to keep commitments contracted outside of the BIT framework in their provisions, BITs upgrade such obligations to the level of international ones. The so-called umbrella clause, despite its disputed scope and impact on the protection of foreign investors

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[89] Article 6(2) Lithuanian BIH BIT (2007); Article 5(2) Croatian BIH BIT (1996); Article 7(3) Indian BIH BIT (2006); Article 4(2) Qatar BIH BIT (1998); Article 6(2) Slovenian BIH BIT (2001).

[90] Article 6(2) Czech BIH BIT (2002); Article 6(2) Chinese BIH BIT (2002); Article 7(3) Indian BIH BIT (2006).

[91] Article 5(2) Egyptian BIH BIT (1998); Article 7(3) Kuwait BIH BIT (2001).

[92] Article 6(2) Danish BIH BIT (2004) foresees the most recent exchange rate applied to inward investments to be used in such cases; Article 7(3) Finnish BIH BIT (2000) envisages the most recent exchange rate for the conversions of currencies into Special Drawing Rights; Article 6(2) Swedish BIH BIT (2000) alternatively refers to either Danish or Finnish approach; Article 7(2) German BIH BIT refers to the "cross rate obtained from those rates which would be applied by the International Monetary Fund on the date of payment for conversions of the currencies concerned into Special Drawing Rights". See also Article 7(3) Kuwait BIH BIT (2001).

[93] Article 5(1) Malaysian BIH BIT (1994).

[94] Article 7(5) French BIH BIT (2003); Article 6(4) Slovak BIH BIT (2008).

[95] Article 7(4) Austrian BIH BIT (2000).

[96] See Article 7(5) Austrian BIH BIT (2000); Article 6(5) Lithuanian BIH BIT (2007).

[97] Article 3(2) Chinese BIH BIT (2002); Article 2(3) Danish BIH BIT (2004); Article 9 Austrian BIH BIT (2000); Article 8(2) Belgo-Luxembourgish BIH BIT (2004); Article 10 Iranian BIH BIT (1996); Article 6(2) Qatar BIH BIT (1998); Article 2(2) Swedish BIH BIT (2000).

against political risks, does seem relevant for the risk of breach of contract by the host state.[98]

Notwithstanding the importance of the regulatory framework for protection of foreign investments against political risks in Bosnia and Herzegovina, the case law must still be addressed. (Un)fortunately, only two sets of arbitral proceedings have been initiated against BIH as a host state for the violation of its bilateral investment treaties and obligations. However, one of the cases, where the claimant alleged breaches with regards to fair and equitable treatment, the umbrella clause and indirect expropriation, was settled without arbitral award on the issue[99] and the other one is still pending and lacks any publicly accessible information.[100] Thus, analysing case law concerning political risk protection in BITs and its violations in the case of BIH currently proves impossible.

To sum up, Bosnian and Herzegovinian BITs offer foreign investors and investments guarantees against all traditional political risks, following and employing the internationally established legal practice. Having elaborated on political risk protection offered in Bosnia and Herzegovina for the incoming foreign investment, we shall now proceed to address the neighbouring Montenegro, following the same approach.

D. Guarantees against Political Risks Stipulated in National Legislation of Montenegro

With respect to the guarantees against political risks provided in domestic legislation of Montenegro, the constitutional level of protection will be analysed first, followed by protection at the statutory level.

With respect to the constitutional guarantees for foreign investments, the Constitution of Montenegro, like Constitutions of BIH and FBIH and unlike the one of Republic Srpska, does not directly address foreign investment. It provides for certain general rights, resembling

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[98] For further explanations see *Sinclair*, in: Bungenberg et al., (fn. 1), pp. 887-958; *Stanivuković*, "Kišobran klauzula" u bilateralnim investicionim sporazumima (BIT), in: Kostić-Mandić, (fn 11), pp. 32-56.

[99] ICSID, no. ARB/07/11, *ALAS International Baustoffproduktions AG v. Bosnia and Herzegovina.*

[100] ICSID, no. ARB/14/13, *Elektrogospodarstvo Slovenije – razvoj in inzeniring d.o.o. v. Bosnia and Herzegovina.*

for the most part the Statute of Brčko District of BIH when compared to the Bosnian solutions. Namely, property rights in general are guaranteed.[101] Furthermore, no deprivations of or restrictions in property rights are allowed, unless in the public interest and with fair compensation.[102] Constitutional protection also encompasses the guarantees to freedom of entrepreneurship, which may not be restricted unless it is necessary for the public health, environment, natural resources, cultural heritage or security or defence of the country.[103] On top of that, the Montenegrin Constitution stipulates that foreign nationals may be holders of property rights in accordance with national law.[104]

Speaking of law, at the statutory level, Montenegrin provisions relevant for foreign investments are provided both in the Foreign Investment Law and in a whole range of other laws, which touch upon certain aspects relevant for this area. The Foreign Investment Law of Montenegro regulates among other issues, the rights and protection of foreign investors.[105] Quite generally, it establishes the national treatment of foreign investors in Article 6 and continues to address the protection of foreign investors more specifically in Chapter IV. Thus, guarantees against political risks are addressed. Namely, expropriating foreign investors' assets is forbidden unless public interest has been determined by, or on the basis of, law.[106] Still, the obligation for compensation is prescribed.[107] Furthermore, damages due to war or emergency entitle a foreign investor to

[101] Article 58(1) Constitution of Montenegro, Official Gazette of Montenegro No. 1/07 and 38/13.

[102] Article 58(2) Constitution of Montenegro. Expropriation and issues related thereto are regulated in the Law on expropriation, Official Gazette of Montenegro No. 55/00, 12/02, 28/06 and 21/08.

[103] Article 59 Constitution of Montenegro.

[104] Article 61 Constitution of Montenegro. Yet again, Article 415 Law on ownership rights, Official Gazette of Montenegro No. 19/09 limits this right and prohibits foreign persons to have ownership rights on certain property, e.g. natural resources.

[105] Article 1 Foreign Investment Law, Official Gazette of Montenegro No. 18/11 and 45/14.

[106] Article 11 Foreign Investment Law.

[107] Ibid.

national treatment with respect to compensation.[108] On top of that, compensation for damage caused by illegal or unlawful work of a public official or public authority is guaranteed to foreign investors.[109] As is evident, Montenegrin law guarantees protection against expropriation and political violence, but omits to guarantee the right to freely exchange national currency in other currencies or to transfer the profits resulting from their investment abroad.

Statutory provisions of other laws which touch upon various issues relevant for foreign investment include the Law on expropriation, Law on ownership rights, Law on concessions, Law on foreign capital current and capital transactions, Law on companies and Banking Law. Although all the aforementioned legal acts address issues relevant for foreign investments, only the Law on expropriation[110] actually deals with a political risk this paper focuses on, however differs in that it regulates procedural aspects of expropriation and does not grant further guarantees as to the protection of foreign investors.

E. Montenegro's BITs' Guarantees against Political Risks

Montenegro currently has some 25 BITs in force, mainly with European countries but also with some Middle Eastern and Asian countries.[111] Since Montenegro declared its independence on 3 June 2006, the BITs signed prior to that date were signed either within the Federal People's Republic of Yugoslavia and Socialist Federal Republic of Yugoslavia,[112] Federal Republic of Yugoslavia[113] or the State Union

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[108] Article 12(1) Foreign Investment Law.

[109] Article 12(2) Foreign Investment Law.

[110] Law on expropriation, Official Gazette of Montenegro No. 55/00, 12/02, 28/06 and 21/08.

[111] Data on Montenegro's BITs as well as the treaties themselves are available at www.investmentpolicyhub.unctad.org/IIA/CountryBits/140#iiaInnerMenu (1/12/2016). The number of Montenegro's BITs in force is 25, since the BITs with Belgian-Luxembourgish Union, India and Turkey are not yet in force and as well as the first Polish Montenegrin BIT from 1979.

[112] Existing from 1945 until 1992 and consisting of Socialist Republic of Bosnia and Herzegovina, Socialist Republic of Croatia, Socialist Republic of Macedonia, Socialist Republic of Montenegro, Socialist Republic of Serbia and Socialist Republic of Slovenia.

[113] Existing from 1992 until 2003 and consisting of Republic of Serbia and Republic of Montenegro.

of Serbia and Montenegro.[114] It is evident from the analyses of all Montenegrin BITs concluded before 2006 which are still in force and their comparison to the Serbian BITs with the respective countries, that both Montenegro and Serbia have taken over the same BITs from the previous countries they jointly formed part of.[115]

Montenegro does not substantially deviate from the commonly established practice, which is evident from the respective analysis of Bosnian and Herzegovinian. To start with, deprivations of investor's property rights, expropriation, nationalisation, requisition and measures having equivalent effect as well as some treaties specifically referring to indirect measures,[116] are prohibited in all Montenegrin BITs in force without exception. Yet again, as in Bosnia and Herzegovina, non-discriminatory[117] measures for public purpose, in the public interest, undertaken in accordance with due process of law and compensated are considered legal and allowed in all country's BITs. The terms for compensation due employed in countries BITs vary in the same way as those from BIH. Still, compensation in all Montenegrin BITs amounts to market (sometimes also fair or real market) value unaffected by knowledge of the expropriation. Thus, protection against unlawful and discriminatory distortion of property as well as monetary restitution in case any form of expropriation occurs is guaranteed without exception.

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[114] Successor of the Federal Republic of Yugoslavia from 2003 until the Montenegrin independence in 2006.

[115] The only exception is the Czech Republic, as Montenegro amended the BIT of 13/10/1997, which is still in force in Serbia. However, Montenegro's BITs with Austria (2001), Croatia (1998), Cyprus (2005), France (1974), Germany (1989), Greece (1997), Israel (2004), Lithuania (2005), Netherlands (2002), Poland (1996), Romania (1995), Russian Federation (1995), Slovakia (1996), Spain (2002) and Switzerland (2005) and Serbian BITs in force with these countries are the same treaties, taken over from previous joint countries.

[116] 5(1) Croatian Montenegrin BIT (1998); Article 5(1) Finnish Montenegrin BIT (2008); Article 5(1) Maltese Montenegrin BIT (2010); Article 4(1) Moldovan Montenegrin BIT (2014); Article 5(1) Qatar Montenegrin BIT (2009); Article 4(1) Romanian Montenegrin BIT (1995); Article 7(1)(a) UAE Montenegrin BIT (2012).

[117] Article 5 French Montenegrin BIT (1974) does not put the non-discrimination as a condition. Furthermore, this very old treaty practice also addresses the protection unilaterally and grants it only to French investors, guaranteeing them protection from expropriation of previous Yugoslav authorities. When the time of renegotiation of the BIT between the two countries comes, the expectations that they will revise such a provision and also employ widespread international standard are high.

Furthermore, Montenegrin BITs, again with the exception of the French Montenegrin BIT of 1974, in cases of investments being damaged by political violence in the host country – that being war, revolution and insurrection and other similar events, or exclusively listed forms of violence – offer both national and most favoured nation treatment in respect of restitution, indemnification, compensation and any other settlement. Moreover, country's BITs, with several exceptions,[118] also provide for compensation of damages incurred though acts of host state authorities requisitioning or destroying property, which were not required by the necessity of the situation[119] or not caused in combat actions.[120] As is evident, in this respect as well, the two South Eastern European countries have employed the same approach.

Be that as it may, Montenegrin and Bosnian BITs also guarantee the right to transfer payments connected to investments,[121] normally listing some transfers by way of example. Moreover, country's BITs stipulate that the transfer should be made in a freely convertible currency, while others go even further and guarantee the transfer in the currency in which the investment initially occurred.[122] The applicable exchange rate is normally the market rate on the date of transfer in the host country, but alternatives are offered in case a

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[118] German Montenegrin BIT (1989); Maltese Montenegrin BIT (2010); Qatari Montenegrin BIT (2009); Romanian Montenegrin BIT (1995); Russian Montenegrin BIT (1995) and Macedonian Montenegrin BIT (2010).

[119] Article 5(7) Azerbaijani Montenegrin BIT (2011); Article 6(2) Danish Montenegrin BIT (2009); Article 6(2) Finnish Montenegrin BIT (2008); Article 7(2) Dutch Montenegrin BIT (2002); Article 6(2) Spanish Montenegrin BIT (2002).

[120] Article 5(2) Austrian Montenegrin BIT (2001); Article 6(2) Croatian Montenegrin BIT (1998); Article 4(2) Cyprian Montenegrin BIT (2005); Article 5(2) Greek Montenegrin BIT (1997); Article 4(2) Israeli Montenegrin BIT (2004); Article 4(2) Lithuanian Montenegrin BIT (2005); Article 5(2) Moldovan Montenegrin BIT (2014); Article 4(2) Polish Montenegrin BIT (1996); Article 4(2) Serbian Montenegrin BIT (2009); Article 4(2) Slovak Montenegrin BIT (1996); Article 7(2) Swiss Montenegrin BIT (2005); Article 6(2) UAE Montenegrin BIT (2012).

[121] Even Article 6 French Montenegrin BIT of 1974 does the same, however, without any further additions apart from the transfer being free and without delay.

[122] Article 6(1)(a) Israeli Montenegrin BIT (2004); Article 6(2) Serbian Montenegrin BIT (2009); Article 6(2) Qatari Montenegrin BIT (2009).

market rate is unavailable[123] or the market for foreign exchange absent.[124] Although the majority of Montenegrin BITs provides for an absolute right to transfer, restrictions are again envisaged e.g. to ensure investor's compliance with host states national legislation in certain areas,[125] or measures adopted by the EU[126] or in cases of (serious) balance of payments difficulties.[127] With respect to this political risk, Montenegrin provisions prove generally similar when compared to the Bosnian and Herzegovinian ones. There does seem to be a difference in some of the justifiable grounds for restricting the right to transfer: BIH having national regulations and policies, GATT 1994 prohibiting or restricting exportations or sale of exports and Montenegro having the goal of ensuring investor's compliance with host states national legislation in certain areas and/or measures adopted by the EU. The balance of payment difficulties are foreseen as situations enabling the restriction of the right in question by both countries.

With respect to commitments made to each other's nationals, some BITs stipulate obligations of contracting states to keep these,[128]

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[123] Article 6(2) Azerbaijani Montenegrin BIT (2011) suggests that "the applicable rate of exchange shall be the most recent rate of exchange for conversion of currencies into Special Drawing Rights".

[124] Article 7(4) Finnish Montenegrin BIT (2008) foresees the rate to be used to be "the most recent exchange rate for the conversion of currencies into Special Drawing Rights". Article 7(3) Danish Montenegrin BIT (2009) stipulates that "the rate to be used will be the most recent exchange rate applied to inward investments". Article 8(3) UAE Montenegrin BIT foresees the rate to be applied to be "the most recent rate applied to inward investments or the exchange rate determined in accordance with the regulations of the International Monetary Fund or the exchange rate for conversion of currencies into special drawing rights or United States dollars, whichever is the most favourable to the investor".

[125] Article 6(3) Azerbaijani Montenegrin BIT (2011); Article 7(3) Finnish Montenegrin BIT (2008).

[126] Article 7(4) Danish Montenegrin BIT (2009); Article 6(2) Lithuanian Montenegrin BIT (2005); Article 6 Maltese Montenegrin BIT (2010).

[127] Article 7(5) Finnish Montenegrin BIT (2008); Article 6(2)(a) Israeli Montenegrin BIT (2004); Article 5(3) Dutch Montenegrin BIT (2002).

[128] Article 8(2) Austrian Montenegrin BIT (2001); Article 3 Croatian Montenegrin BIT (1998); Article 2(3) Danish Montenegrin BIT (2009); Article 12(2) Finnish Montenegrin BIT (2008); Article 7(2) German Montenegrin BIT (1989); Article 2(4) Greek Montenegrin BIT (1997); Article 2(2) Maltese Montenegrin BIT (2010); Article 2(5) Moldovan Montenegrin

whereas the rest of Montenegrin BITs in force do not address this issue, which is relevant for the political risk of breach of contract.

Last but not least, the case law remains to be addressed. (Un)fortunately once again, only two proceedings for the violation of its bilateral investment treaties and obligations have been initiated against Montenegro as a host state. However, in one of these cases, where the claimant alleged breaches with regards to fair and equitable treatment, full protection and security, national treatment, most-favoured nation treatment, indirect expropriation and transfer of funds, the tribunal rendered its arbitral award concluding that it lacked jurisdiction to hear the case and therefore did not consider the merits.[129] With respect to the other case in which Montenegro appeared as respondent, the claimant alleged violation of fair and equitable treatment, full protection and security, arbitrary, unreasonable and/or discriminatory measures, most-favoured nation treatment, transfer of funds and indirect expropriation whereas the arbitral tribunal found only breaches of full protection and security.[130] Yet again, the claimant filed a request for a supplementary decision, which was issued by the tribunal later on. Unfortunately, none of the documents are publicly accessible. Thus, analysing case law concerning political risk protection in BITs and its violations in the case of Montenegro cannot go any further than stating that in one of the two arbitral proceeding the tribunal found a breach of the standard of full protection and security, without having taken into account the supplementary decision of the tribunal.

F. Concluding Remarks

The conducted analyses of Bosnian and Herzegovinian and Montenegrin guarantees against political risks for incoming foreign investments, both in their internal acts as well as in their bilateral investment treaties, as well as the comparison of the guarantees

BIT (2014); Article 3(4) Dutch Montenegrin BIT (2002); Article 12(1)(3) Qatar Montenegrin BIT (2009); Article 3(3) Spanish Montenegrin BIT (2002); Article 9 Swiss Montenegrin BIT (2005).

129 ICSID, no. ARB/14/8, *CEAC Holdings Limited v. Montenegro*, award of 26/7/2016.

130 ICSID, no. ARB(AF)/12/8, *MNSS B.V. and Recupero Credito Acciaio N.V. v. Montenegro*, award of 4/5/2016, supplementary decision of 24/10/2016.

provided by the two countries, to a great extent show similar provisions. Furthermore, with regards to provisions in bilateral investment treaties both countries' approaches do not substantially deviate from international standards of guaranteeing protection against political violence, deprivations of private property in any form and freedom to transfer profits out of the host country. Thus, on an international level the two South Eastern European countries implemented relatively high guarantees against traditional political risks to foreign investors. However, when it comes to the guarantees against political risks provided in national legislation, the protection offered shows some faults. As previously indicated, Bosnian and Herzegovinian domestic legislation on foreign investment does not provide any guarantee whatsoever against risks of political violence or breach of contractual obligations, whereas Montenegrin internal legislation on foreign investment omits the guarantee of the right to freely exchange national currency for other currencies or to transfer the profits resulting from foreign investment abroad. It is the author's opinion that, when it comes to guarantees against political risks offered in national legislation, there is considerable room and necessity for improvement in both Bosnia and Herzegovina and Montenegro.

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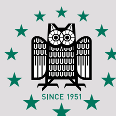

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