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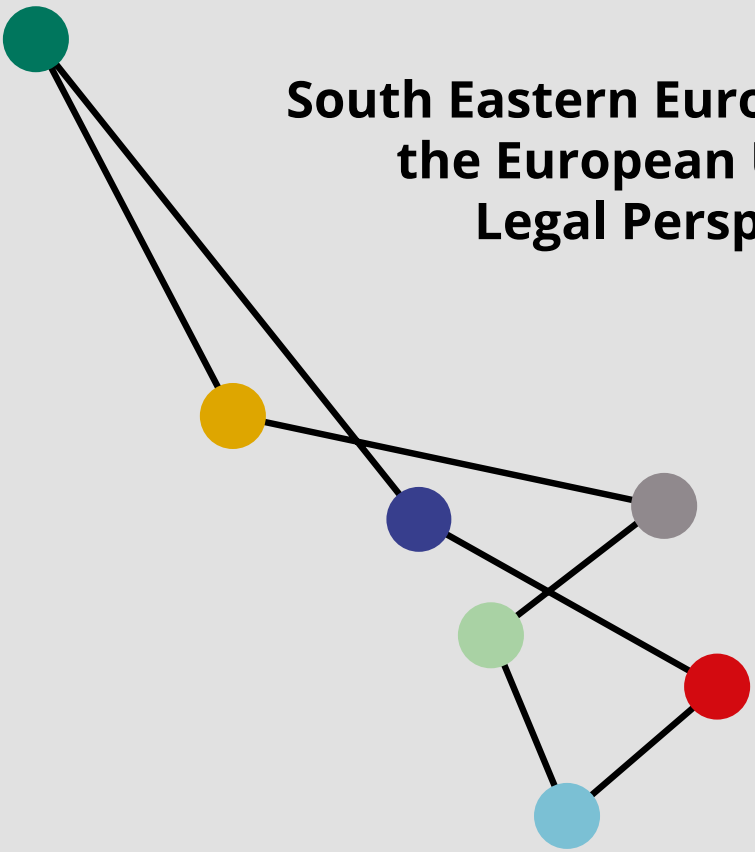
South Eastern Europe and the European Union – Legal Perspectives



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South Eastern Europe and the European Union – Legal Perspectives

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Preface

This publication is the third volume of the series of papers published within 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 sets to 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 in the development of common structures and strategies. The Cluster of Excellence seeks to explore new avenues in the transfer of knowledge, as we firmly believe that sharing expertise and experiences will strengthen the profile of each partner and the network as a whole. To this end, the Cluster implements 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 is purported to 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 are 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 2018 encompasses ten papers from academic staff and junior researchers from the law faculties in Belgrade, Niš, Osijek, Podgorica, Skopje, Tirana and Zenica. 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 and transnational trade law, to name a few. Also addressed are a series of 'hot topics', such as regulation of unmanned aircrafts (drones) and the Bitcoin.

We thank the German Academic Exchange Service (DAAD) and the German Federal Ministry for Education and Research for their financial support. We owe a special thanks to all authors for their contributions as well as to Ass. iur. Mareike Fröhlich LL.M., Regi Salataj LL.M. and Corina Vodă 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 2017

Prof. Dr. Marc Bungenberg LL.M., Director
Europa-Institut of Saarland University

Prof. Dr. Thomas Giegerich LL.M., Director
Europa-Institut of Saarland University

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Unmanned Aircrafts ('Drones') – The Need for Legal Regulation and Harmonisation of Legislation in the European Union

Biljana Činčurak Erceg, Aleksandra Vasilj and Aleksandar Erceg[*]

Abstract

Unmanned aircrafts are used for diverse applications, from military and surveillance purposes to the entertainment industry and delivery. Although they can be used for various purposes there are some serious problems with respect to their usage. Inadequate legal regulation is one of them. Unmanned aircrafts in the European Union are used under a fragmented regulatory framework since every Member State has its own regulation. Such a situation strengthens legal uncertainty and slows down the development of unmanned aircrafts usage.

The main challenges for the use of drones are safety and privacy issues. Solving barriers regarding legal regulation will enable further development of drones. Due to constant progress of unmanned aircrafts and actions at the European regulatory level, Member States will need to change their national legislation which will hopefully lead to the harmonisation of rules that regulate unmanned aircraft operations.

This paper will provide a definition of unmanned aircrafts and other relevant terms, as well as the types currently used throughout the world. The paper will review legal regulation in the EU and in the Republic of Croatia. There are still some open questions concerning the regulation of the unmanned aircrafts so the paper also discusses possible problems as well as some proposals for further action.

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A. Introduction

The idea of unmanned aircrafts (commonly known as drones) has a long history[1] and it was always a huge challenge, both from the civilian and military perspective. Most simple a drone can be defined as an "aircraft without a human pilot on board",[2] that can be categorised in several groups according to their measurement, specifications, range, build type, etc.

When speaking of drones from the European perspective, it should be stated that the terminology, which regulates this substance is not established. The current terminology for unmanned civilian or military aircraft is diverse[3]: drone, unmanned aerial vehicle (UAV), unmanned aircraft system (UAS), remotely piloted aircraft system (RPAS) or aircraft (RPA). The terms RPAS and RPA refer to the rules set by the International Civil Aviation Organization (ICAO), and the ICAO does not use the term 'drone'.[4] In accordance with the Commission communication 'A new era for aviation opening the aviation market to the civil use of remotely piloted aircraft systems in a safe and sustainable manner' "the term UAV is used to mean an unmanned, autonomously functioning aircraft. An RPAS is an aircraft controlled remotely by a third party."[5] The European Aviation Safety Agency (EASA) uses the term 'unmanned aircraft' (which means any aircraft operated or designed to be operated without a pilot on board) for

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1 *Gonzalez-Aguilera, Rodriguez-Gonzalez,* Drones – editorial, Drones, 2017, p. 1 et seqq. http://www.mdpi.com/journal/drones (8/9/2017).

2 *Estampe*, Planning the Future Supply Chain Together – New Technologies: Big data, 3d Printers, Drones, White paper, 2015, p. 15.

3 For some examples of terminology and definitions see: ICAO, Circular 328-AN/190, Unmanned Aircraft Systems (UAS), 2011; Communication from the Commission to the European Parliament and the Council, A new era for aviation Opening the aviation market to the civil use of remotely piloted aircraft systems in a safe and sustainable manner, Brussels, 8. 4. 2014, COM (2014) 207 final; Prototype' Regulation on Unmanned Aircraft Operations in 2016 that presents a 'prototype' regulation for to the operation of unmanned aircraft in the 'open' and 'specific' categories.

4 Opinion of the European Economic and Social Committee on the Communication from the Commission to the European Parliament and the Council – A new era for aviation – Opening the aviation market to the civil use of remotely piloted aircraft systems in a safe and sustainable manner COM (2014) 207 final, OJ C 12 of 15/1/2015, p. 90.

5 *Ibid*.

regulatory proposals. The term 'drone' is being used in communications addressing the general public.[6]

Remotely Piloted Aircraft (RPA) can perform tasks that manned systems would not be able to perform. They are well suited to perform long monitoring tasks or risky flights into ash clouds or in the proximity of nuclear or chemical plants after major incidents; they can efficiently complement existing infrastructure (manned aircraft or satellites) and they can also deliver profitable commercial aerial services in various areas.[7]

Today unmanned aircraft are becoming increasingly widely used and such use represents one of the most urgent issues that needs to be appropriately regulated. However, they are used in the European Union under a fragmented regulatory framework since each Member State has its own rules. Therefore, the safe management and use of unmanned aircraft require the harmonisation of such rules, at least at the European level.

The aim of the paper is to review current legislation in the EU and in the Republic of Croatia. In the end, the paper discusses possible problems as well as some proposals for further action.

B. Application of Drones – New Sector of World's Economy

The drone market worldwide is growing significantly. Production will grow from 4 billion USD/year to 14 billion USD/year[8] and total drones' application in different industrial sectors will be more than 120 billion USD,[9] of which 13 billion USD will be in the transport sector.

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6 https://www.easa.europa.eu/system/files/dfu/Introduction%20of%20a%20regulatory%20framework%20for%20the%20operation%20of%20unmanned%20aircraft.pdf (8/9/2017), pp. 4-5.

7 European Commission, Commission Staff Working Document, Towards a European strategy for the development of civil applications of Remotely Piloted Aircraft Systems (RPAS), 4/9/2012, SWD (2012) 259 final, p. 3.

8 http://tealgroup.com/index.php/teal-group-news-media/item/press-release-uav-production-will-total-93-billion (29/7/2017).

9 http://www.pwc.pl/en/publikacje/2016/clarity-from-above.html (31/3/2017).

These figures show how important the use of drones is in world's economy as a new sector and as a part of today's sectors.[10]

The use of drones can be divided in accordance to different commercial and civil market application from government and energy sectors to agriculture and communications[11] and the biggest potential for drone use is in different infrastructure, agriculture and transport applications. Although drones were not an integral part of the transport sector, today they are used because of their speed, operational costs and accessibility in relation to other transport possibilities.[12]

The key opportunities for the use of drones in transport are in continuous development (leads to lower prices), enhancement in data processing and accessibility and in finding legal and financial support. On the other side, challenges include privacy and aviation safety issues.[13] For further development of drones as part of the new transport sector in the world's economy, stakeholders are facing several noteworthy barriers.[14]

Due to the complex problems, their use is still questionable although there is a huge economic potential in their application. The biggest barrier to reaching the full potential of drones in the world

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[10] Beyond the RPAS manufacturers and system integrators the RPAS industry also includes a broad supply chain providing a large range of enabling technologies (flight control, communication, propulsion, energy, sensors, telemetry, etc.) European Commission, Commission Staff Working Document, Towards a European strategy for the development of civil applications of Remotely Piloted Aircraft Systems (RPAS), 4/9/2012, SWD (2012) 259 final, p. 4.

[11] https://ec.europa.eu/home-affairs/sites/homeaffairs/files/e-library/documents/policies/security/pdf/uav_study_element_2_en.pdf (30/7/2017).

[12] Drones can be used for the transport of spare parts, food, parcels and medical products especially for the urban first and last mile and rural deliveries. http://www.dhl.com/content/dam/downloads/g0/about_us/logistics_insights/DHL_TrendReport_UAV.pdf (12/8/2017).

[13] http://www.pwc.pl/en/publikacje/2016/clarity-from-above-transport-infrastructure.html (11/8/2017).

[14] These barriers include: lack of training and standards regarding safety of use, limitations of transport capacity and flight space restrictions, issues of non-military frequencies security, liability for civil operations, issues regarding air space regulations for UAV systems, negative consumer perception. http://www.casa.arizona.edu/data/abigail/Abigail_Rosenberg_Final_Dissertation.pdf (11/8/2017).

economy is lack of legal regulation. Thus, it is of utmost importance to solve this obstacle and some countries (e.g. Israel and China) already have their governments involved in removing these barriers.

C. Overview of Legal Regulation in the European Union

Currently, there is no adequate legal framework regulating the operations of unmanned aircrafts both on the international and EU levels.

The legal issues of drones are considered at three levels: international[15] (International Civil Aviation Organization[16] – ICAO), European (European Aviation Safety Agency – EASA), including the European Organization for the Safety of Air Navigation (EUROCONTROL), Joint Authorities for Rulemaking on Unmanned Systems (JARUS), etc. and national.

Most drone flights are in the segregated airspace to avoid danger to other aircrafts. Drones are increasingly being used in the EU, but under a fragmented regulatory framework, since every Member State has its own rules. European countries are increasingly adopting ordinances governing the legal framework for the implementation of UAS flight operations. Most of the adopted legal frameworks regulate this matter in a similar way, and differ according to the categories of unmanned aircrafts, the areas above which flight operations are performed, conditions for flying operations, etc.[17]

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[15] According to Article 8 of the Convention on International Civil Aviation (the Chicago Convention) no aircraft capable of being flown without a pilot shall be flown without a pilot over the territory of a contracting State without special authorization by that State and in accordance with the terms of such authorisation. Each contracting State undertakes to ensure that flight of such aircraft without a pilot in region open to civil aircraft shall be so controlled as to obviate danger to civil aircraft. Convention on International Civil Aviation, Official Gazette of the Republic of Croatia – International Agreements, No. 1/1996.

[16] It should be mentioned that ICAO has published Circular 328 (2011) on Unmanned Aircraft Systems (UAS) and amended Annexes 2, 7 and 13 to the Chicago Convention to accommodate Remotely Piloted Aircraft Systems (RPAS) intended to be used by international civil aviation.

[17] *Mudrić/Katulić*, Regulacija sustava bespilotnih zrakoplova u hrvatskom, europskom i međunarodnom pravnom okviru, Pravo u gospodarstvu, vol. 55, no. 2/2016, p. 126.

As already stated there is no regulation *de lege lata* in the EU which regulates all unmanned aircrafts but the EU is working on this issue. The legislation process has now lasted for years and the regulation has not yet been adopted. The reasons can be found in the fact that there are many different stakeholders involved and that unmanned aircrafts evolve every day. It is often the case with new technologies that legal frameworks are lagging behind.

In the continuation of the paper, we will briefly present the work of the EU on the adoption of the regulation of unmanned aircraft.

To solve problems caused by the absence of a clear regulatory framework at the EU level, the European Commission has proposed, under the 2015 EU Aviation Strategy, a risk-based framework for all types of drone operations, which will ensure the safe use of drones in civil airspace and create legal certainty for the industry. Items related to data and privacy protection, security, insurance, liability, and environment will also be considered.[18]

Regulation (EC) No 216/2008 of the European Parliament and of the Council of 20 February 2008[19], known as the Basic Regulation, mandates the EASA to regulate UAS and RPAS when used for civil applications and with an operating mass of 150 kg or more. Experimental or amateur-built RPAS, military and non-military governmental RPAS flights, civil RPAS below 150 kg, as well as model aircraft, are regulated by the individual Member States.

The European Commission published the Proposal for a Regulation on common rules in the field of civil aviation,[20] in 2015, which prescribes new demands based on past experiences and problems

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18 https://ec.europa.eu/transport/modes/air/uas_en (10/9/2017).

19 Regulation (EC) No 216/2008 on common rules in the field of civil aviation and establishing a European Aviation Safety Agency, and repealing Council Directive 91/670/EEC, Regulation (EC) No 1592/2002 and Directive 2004/36/EC, OJ L 79 of 19/3/2008, pp. 1-49.

20 Proposal for a Regulation of the European Parliament and of the Council on common rules in the field of civil aviation and establishing a European Union Aviation Safety Agency, and repealing Regulation (EC) No 216/2008 of the European Parliament and of the Council, COM (2015) 0613 final – 2015/0277 (COD).

encountered.[21] The European Commission correctly stated in the mentioned Proposal that the current division of competence between the Union and the Member States regarding regulation of unmanned aircraft, which is based on a threshold of 150 kg, is generally deemed to be out-dated. The rules for unmanned aircraft should develop towards an operation-centric approach, where the risk of an operation is made dependent on a range of factors.[22] In addition, EASA published a Technical Opinion[23] in 2015 which demonstrates the contents of the draft changes to the Basic Regulation and serves as guidance for the Member States to develop or modify regulations on unmanned aircraft. It includes 27 concrete proposals for a regulatory framework and for low-risk operations of all unmanned aircraft irrespective of their maximum certified take-off mass (MTOM). This regulatory framework is operation-centric,[24] proportionate,[25] risk-based[26] and

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21 It contains provisions (Article 45-47) that create the legal basis to provide for more detailed rules on unmanned aircraft. Annex IX of the Proposal contains the essential requirements concerning the design, production, operation and maintenance of unmanned aircraft that need to be complied with to ensure safe operations.

22 COM (2015) 0613 final – 2015/0277 (COD), p. 7.

23 https://www.easa.europa.eu/system/files/dfu/Introduction%20of%20a%20regulatory%20framework%20for%20the%20operation%20of%20unmanned%20aircraft.pdf (8/9/2017).

24 Operation-centric means that instead of focusing on the aircraft (aircraft centred approach), the focus shifts to the particular risk of a particular unmanned aircraft operation.

25 Proportionality is a key feature of the regulatory framework and means that the operation of unmanned aircraft should be regulated in a manner proportionate to the risk of the specific operation.

26 The risk-based principle means that the level of risk depends on a range of factors, such as the energy, the size and the complexity of the unmanned aircraft; the population density of the overflown area; the design of the airspace, the density of traffic and the services provided therein. As the proposed regulatory framework is risk-based, it applies to both commercial and non-commercial operations as identical unmanned aircraft might be used for both commercial and non-commercial activities with the same risk to uninvolved parties.

performance-based,[27] and establishes three operation categories: open, specific and certified. [28]

Furthermore, the EASA also produced a 'Prototype' Regulation on Unmanned Aircraft Operations in 2016 that presents a 'prototype' for the operation of unmanned aircraft in the 'open' and 'specific' categories.[29] After receiving a great number of comments on the 'Prototype', EASA published a Notice of proposed Amendment (NPA) 2017-05 (A) 'Unmanned aircraft system operations in the open and specific category'[30] in 2017. In this NPA EASA improved the quality of the 'Prototype' regulation. It defines the technical and operational requirements for the drones and gives complex and new solutions.[31] Since this is not the Regulation in force we will not give a detailed analysis of the mentioned provisions. After the public commenting period of this NPA is closed, EASA will review all comments and will

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27 Performance-based regulation is a regulatory approach that focuses on desired, measurable outcomes instead of focusing on the method or the technical solution.

28 According to Technical opinion, open category operations, considering the risks involved, require neither an authorisation by the competent authority nor a declaration by the UAS operator before the operation takes place. Specific category operations, considering the risks involved, do require an authorisation by the competent authority before the operation takes place and take into account the mitigation measures identified in an operational risk assessment, except for certain standard scenarios for which a declaration by the UAS operator is sufficient. Certified category operations that, considering the risks involved, require the certification of the UAS and its operator, as well as licensing of the flight crew.

29 https://www.easa.europa.eu/system/files/dfu/UAS%20Prototype%20Regulation%20final.pdf (22/9/2017). The UAS operation in the certified category will be the subject of future NPAs.

30 https://www.easa.europa.eu/system/files/dfu/NPA%202017-05%20%28A%29_0.pdf (25/9/2017).

31 E.g. it combines product legislation and aviation legislation. Design requirements for small drones will be implemented by using the legislation relative to making products available on the market (CE marking). The standard CE mark will be accompanied by the identification of the class of the drone (from C0 to C4) and by a do's and don'ts leaflet that will be found in all drone boxes. Based on the drone class an operator will know in which area he can operate and what competence is required. The proposal allows a high degree of flexibility for EASA Member States which will be able to define zones in their territory where either drones operations are prohibited or restricted, or where certain requirements are alleviated. https://www.easa.europa.eu/easa-and-you/civil-drones-rpas (25/9/2017).

develop an 'opinion' (by the end of 2017). The opinion will be submitted to the European Commission, which will use it as a technical basis to prepare an EU regulation.[32]

The main purpose of the aviation regulatory framework is to achieve and preserve the highest possible uniform level of safety. In the case of unmanned aircraft, this means ensuring the safety of any other airspace user as well as the safety of persons and property on the ground.

At present, the EU is competent for regulating unmanned aircraft that have a maximum take-off mass (MTOM) above 150 kg, while the lighter ones are subject to national rules. Several EU Member States adopted and implemented national rules but these rules are not harmonised with each other.[33] This leads to a fragmented regulatory system obstructing the development of a single EU market for unmanned aircrafts and their cross-border operations. Therefore, it was proposed to extend the competence of the EU to regulate all UAS regardless of their MTOM.

This tremendous job of adopting a new regulation is still in progress. The present work has been followed by many changes and amendments to the proposed texts. The adoption of the new regulation will take a long time and the proposed provisions will continue to change. Nevertheless, we have to emphasise the necessity of its adoption.

D. Legal Regulation in the Republic of Croatia

All civil aviation activities carried out on the territory and in the airspace of the Republic of Croatia are regulated by the Air Traffic Act.[34] Based on its provisions[35], the Ordinance on unmanned aircraft

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32 https://www.easa.europa.eu/system/files/dfu/NPA%202017-05%20%28A%29_0.pdf, p. 3, and https://www.easa.europa.eu/easa-and-you/civil-drones-rpas (25/9/2017).

33 See http://dronerules.eu/en/ (25/9/2017). The differences are also visible in the below described Croatian legislation and the proposed EU regulations.

34 Official Gazette of the Republic of Croatia, 17/6/2009, No. 69/2009; 20/7/2011, No. 84/2011; 7/5/2013, No. 54/2013; 18/10/2013, No. 127/2013; 28/7/2014, No. 92/2014.

35 Air Traffic Act prescribes in Article 93a that conditions for the safe use of unmanned aircraft, unmanned aircraft systems and model aircraft, as well as the conditions to

systems[36] was adopted in 2015. The Ordinance differentiates unmanned aircraft[37] from the term unmanned aircraft system[38] (UAS).

The provisions of the Ordinance, in accordance with Article 1 (2), shall apply to unmanned aircraft systems, with an operating mass of up to and including 150 kilograms that are used in the Republic of Croatia.[39] With regard to operating mass, unmanned aircraft, according to Article 3 of the Ordinance, are divided into three classes.[40] In Article 4, the Ordinance clearly defines the classification of flight areas in relation to buildings, population, and presence of people. In accordance with Annex 1 of the Ordinance, the flight operations category is determined by the level of risk that their performance represents for the environment.[41]

With respect to the safety of flying, Article 11 of the Ordinance prescribes general conditions for flying unmanned aircraft, and some them in practice lead to the greatest restrictions on the use of

be met by persons involved in the management of these aircraft and systems are determined by a special regulation.

36 Official Gazette of the Republic of Croatia, 6/5/2015, No. 49/2015; 15/7/2015, No. 77/2015.

37 In accordance with Article 2, point 2 of the Ordinance, an unmanned aircraft is an aircraft intended for the operation without a pilot in aircraft, which is either remote controlled or programmed and autonomous.

38 Unmanned aircraft system (UAS), according to point 13, is a system designed to perform flights with aircraft without a pilot that is remote controlled or programmed and autonomous. It consists of unmanned aircraft and other control or programming components necessary for the control of unmanned aircraft, by one or more persons.

39 The provisions of the Ordinance, pursuant to Article 2 (3), shall not apply to unmanned aircraft systems when they are used for state activities (military, police, security intelligence, customs, search and rescue, firefighting, coastal guarding and similar activities or services).

40 1. Class 5: to 5 kilograms, 2. Class 25: from 5 kilograms to 25 kilograms, 3. Class 150: from 25 kilograms to and including 150 kilograms.

41 In accordance with Annex 1 of the Ordinance, combination of operating mass and flight area defines one of the four categories of flight operations (A, B, C and D.) The operator can perform flight operations category A and B if he has submitted an Declaration to the Croatian Civil Aviation Agency (CCAA) prior to their performance, of Category C if he has prepared the Operations Manual and has submitted the Declaration to the CCAA before performing the flight operations, and of category D if he has previously obtained the authorization of the CCAA.

unmanned aircrafts.[42] One of the most problematic provisions is one on flight performance during the daylight (Article 11, paragraph 2, point a) because it disables the full exploitation of the technological capabilities of unmanned aircrafts.

As for one of the problems of UAS, we can mention the fact that Croatia doesn't have a register of UAS. The problem of missing a registry may become apparent when it is necessary to identify the unmanned aircraft and locate a responsible person (operator, pilot, owner). This register should be implemented based on comparative legal solutions. As Mudrić and Katulić[43] cited, UAS registers or registers of operators of UAS flight operations are present in legal frameworks for performing UAS flight operations in the Czech Republic, Italy, the Netherlands and Sweden.

"Although Annex 5 of the Ordinance provides the fulfilment of certain requirements relating to flight operations, relating to the age of the operator, the psychophysical ability, knowledge of the aviation regulations and ability to manage the system depending on the category of flight operations, they are not strict."[44] Therefore, we emphasise the issue and the problem concerning the safety of performing such flights as well as issues related to liability for damage in correlation with the sufficient ability of the operator of flight operations.

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[42] E. g. provisions about: flight must be during a daylight (Article 11 (2), point a), flight distances from certain objects: from humans, animals, buildings, vehicles, vessels, other aircraft, roads, railways, waterways or transmission lines (Article 11 (2), points f, g, h and j), flight takes place within the pilot's visual line of sight and at a distance of not more than 500 m from the pilot (Article 11 (2), point h), unmanned aircraft flight takes place outside the controlled airspace (Article 11 (2), point i). At the same time in Article 14 it predicts some exceptions to these provisions if the operator gets permit from the Croatian Civil Aviation Agency. This exceptions apply to some provisions from the Article 11 (namely points f), g), h), i) and k)) and to others do not (point a) – flight performance during the daylight, point j) – distance from the airport) which will further slow development and use of unmanned aircraft.

[43] *Mudrić/Katulić*, (fn. 17), p. 147.

[44] *Erceg/Činčurak Erceg/Vasilj*, Unmanned Aircraft Systems in Logistics – Legal Regulation and Worldwide Examples Toward Use in Croatia, Proceedings of the 17th International Scientific Conference 'Business Logistics in Modern Management', 2017, p. 54.

Taking into account the specificities of unmanned aviation, revision, improvement and supplementing of the present legislation will be required. Future changes to the Croatian unmanned aircraft's legislation will certainly have to take into account the problems in practice as well as the change of legislation at the EU level.

E. Conclusion

Unmanned aircraft (drones) are already being widely used but there are still some open questions concerning their regulation. There should be common rules for manufacturers and operators of unmanned aircrafts. The main challenges for the use of drones are the safety and privacy issues and safety is the principal objective of EU aviation policy.

There is no regulation *de lege lata* in the EU which regulates all unmanned aircrafts and there is no adequate regulatory framework in most Member States. Efforts of the European Commission and the EASA to regulate this area are significant. However, it is a long-lasting process subject to permanent amendments. The new regulation is expected to increase the level of safety of unmanned aircraft operations; provide an operation-centric, risk-based, performance-based and proportionate regulatory framework for all UAS operations conducted in the open and specific category; harmonise legislation among the EU Member States, as well as create an EU market that will reduce the cost of the UAS and allow cross-border operations. Solving barrier regarding legal regulation will also enable further development (production and use) of this new sector in the world's economy.

Some Member States, including the Republic of Croatia, have legally regulated unmanned aircrafts. Due to constant progress of unmanned aircrafts and actions at the European regulatory level, they will need to change their national legislation. This will ultimately, hopefully, lead to the goal – the harmonisation of rules that regulate unmanned aircraft operations. The harmonised legislation is required due to the, potentially international, use of drones.

We recommend further research which should continue with an examinination of the legal regulations in the other Member States and problems in the practice of using unmanned aircrafts. Further European Commission activities regarding adoption of the new legal

regulation and its possible influence on national economies and the European Union market should also be followed. When analysing the comparative legal framework question regarding conditions for flying unmanned aircraft, the register of unmanned aircraft as well as responsible persons for the damage should be in focus. Changes to the Croatian Ordinance on unmanned aircraft systems may be proposed on the basis of the results. Some other actions, such as workshops, presentations, symposiums, the purpose of which is to educate people concerned about the safe use of drones, will certainly be useful.

Adoption of European legislation as well as amendments to national legislation will increase legal certainty regarding unmanned aircrafts, enable their safe use and integration in the existing airspace.

The Fallacies in Evidence-Based Psychiatry and the Right to Self-Determination of Persons with Mental Health Issues*

*Rezarta Demneri***

Abstract

The scientific accuracy of evidence-based psychiatry is anything but established due to the non-physicality of its object of study, the human psyche. A mental capacity assessment gains legal relevance when evaluating the need for an involuntary treatment or placement. The UN Convention on Rights of People with Disabilities (CRPD) provides that a person with mental health issues should benefit from equal recognition before the law in all aspects of life. This includes the right to consent or deny medical treatment.

This paper aims to outline the shortcomings of the legal regulation in Italy and Albania concerning informed consent to medical treatment when persons with mental health issues are involved. A case-sensitive evaluation of the mental capacity, and consequently of the legal competence, typical of common law countries such as the UK is more attuned to the principles of medical ethics and deontology, which recognise that the person with mental health issues is entitled to autonomy.

A. Introduction

Informed consent is crucial to the legitimacy of any medical intervention. It is through consent that the person exercises his or her right to self-determination, which is ultimately linked to the principle of autonomy in biomedical ethics. Any hindrance to the realisation of the right to self-determination could entail a violation of

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the right to liberty, the right to be free from torture and other inhuman or degrading treatment as well as the right to private life, as listed in the European Convention of Human Rights (ECHR).

The Italian and Albanian jurisprudence and doctrine stand on completely different levels when it comes to medical liability and human rights. Regardless of the different backgrounds, both countries struggle to understand and effectively carry out the provisions of equality before the law and non-discrimination on grounds of mental disability provided by the UN Convention on the Rights of Persons with Disabilities (CRPD). According to the United Kingdom (UK) law and consolidated jurisprudence, it is possible for a person with mental health issues to be considered mentally capable and therefore legally competent to make decisions about his or her medical treatment.[1] Furthermore, the UK law recognises a right to be unwise without the risk of being considered unsound i.e. mentally incapable on that ground. I argue that the challenges encountered in Italy and Albania may be attributable to the rigidity of continental law, which clashes with the inductive approach – typical of the common law systems – that is necessary when dealing with medical cases.

B. The Fallacies of Evidence-Based Psychiatry

Evidence-based medicine (EBM) has standardised the medical opinion on the methodology applicable for the diagnosis, treatment and prognosis of the different pathologies, shifting the practice away from non-systematic clinical approaches.[2] EBM requires continuing education on the part of health professionals in order to ensure that the healthcare provided is in accordance with the most recent scientific knowledge. Results are therefore considered as scientific if they stand rigorous testing and integrated evaluation, which typically consists of meta-analysis.

The systematic categorisation of mental disorders is offered by the Diagnostic and Statistical Manual of Mental Disorders (DSM-V)

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1 Although approved by the Parliament of the UK, the provisions of the laws discussed in this article are applicable only to England and Wales.

2 *Thomas/Bracke/Timimi*, The Limits of Evidence-Based Medicine in Psychiatry, Philosophy, Psychiatry & Psychology (PPP), 2012, vol. 19, no. 4, p. 296.

issued by the American Psychiatric Association (APA) and alternatively by the International Statistical Classification of Diseases and Related Health Problems (ICD-10) issued by the World Health Organization (WHO). It is not uncommon for the definitions of the different types of mental disorders to change in newer editions of these manuals, altering as a result the whole system of knowledge. For example, pursuant to the Mental Health Act (MHA 2007) of the UK, intellectual disabilities are no longer considered as mental disorders. Compared to EBM, evidence-based psychiatry (EBP) is much more likely to suffer from the lack of psychiatric and statistical expertise of statisticians and physicians respectively involved in gathering and interpreting scientific data.[3] *Nieuwenhuis, Birte & Wagenmaker* give an example of this situation by pointing out that a common mistake researchers make is reporting "*that one effect was statistically significant, whereas the other effect was not*" instead of proving "*a statistically significant interaction"* between two effects.[4]

There has been longstanding debate in legal doctrine and jurisprudence whether there should be a threshold over which the probability of accuracy of the medical opinion can be considered sufficient as to constitute legal evidence. This is especially relevant when evaluating the existence of a causal link between two or more circumstances in a criminal trial or lawsuit for damages. Scientifically based decisions are even more challenging to achieve in psychiatry. According to *Schauer*, the evaluation of scientific evidence in a legal case should not be carried out according to scientific parameters; rather the legal criteria should instead be chosen by that particular judicial system.[5] The current Italian jurisprudence and doctrine do not recognise legal incontestability to the scientific evidence, which typically is expressed in terms of statistical probability. In the

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[3] *Nieuwenhuis/Birte/Wagenmakers*, Erroneous Analyses of Interactions in Neuroscience: A problem of Significance, Nature Neuroscience, 2011, no. 14, http://www.nature.com/neuro/journal/v14/n9/full/nn.2886.html (01/09/2017).

[4] *Ibid.*, p. 304.

[5] *Schauer* reports how medical opinions with 55 percent or even percent of probability of accuracy were admitted as evidence in court for the simple reason that it was the highest degree of precision achievable at that stage of development. As cited by *Lavazza/Sartori* (eds.), Neuroetica. Scienze del Cervello, Filosofia e Libero Arbitrio, 2011, p. 146.

Franzese sentence, the Supreme Court of Italy abandoned deductive reasoning in favour of the inductive approach by pointing out that regardless of how elevated the probability of accuracy of a scientific law, the judge must ponder all pieces of evidence admitted in order to reach a decision based on logical probability.[6] This prevents the danger of the technical expert becoming the *de facto* judge of the case.

Differential diagnosis and treatment in EBM should result from an integrated evaluation of the information gathered through clinical, laboratory and imaging examination. Unless the mental disorder is caused by brain lesions or other physiological causes i.e. influence of alcohol or drugs, psychiatric treatment is based strongly, if not exclusively, on inductions and statistical data correlating to the behaviour of different persons involved in separate studies. The need for meta-analysis derives from the fact that the various studies may have applied similar yet non identical criteria and standards. EBP can provide results, which *may* apply to a given case but it cannot explain how and why an action caused an effect. This can be interpreted as lack of scientific ground, at least based on the theory elaborated originally by Popper. The results based on inductive interpretations of the behaviour of a person have limited possibilities for empirical validation. Hence, they bear a high risk of fallacy due to the uncontrollability of the environment under study: the human psyche.

The pursuit of the aetiology of the mental disorder or that of a "*treatment algorithm*" [7] as a premise for EBP is doomed to fail from the start. *Saraceno* points out that inconsistency in psychiatric knowledge is not a crime, it is a fact.[8] Confirming this position are *Thomas, Bracken & Timimi* who deem that the so-called '*nontechnical/non-specific aspects*' i.e. the contexts, values, meanings and relationships in which the person with mental health issues engages, considered as being of secondary importance by EBP,

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6 Supreme Court of the Republic of Italy (*Corte di Cassazione*) (United Penal Sections), judgement no. 30328/02, paras. 8-10.

7 The term "treatment algorithm" is used by *Thomas/Bracke/Timimi*, (fn. 2), p. 296.

8 *Saraceno* as cited by *Rossi*, La Salute Mentale tra Frammentazione e Ricomposizione dell'Identità dei Diritti, Ragion Pratica, 2015, no. 2, p. 464.

actually play a cardinal role in the assessment of the condition of the patient.[9]

Recognising the importance of these factors would reshape the approach of psychiatry as well as the expectations from the medical practitioners operating in the psychiatry branch in terms of medical liability. This brief analysis of the (shaky) ground upon which psychiatry is erected, evidences how the (alleged) scientific character of the data and methodology applied by the medical practitioners represents everything but a reliable premise when overruling the decision concerning a medical treatment made by a patient with mental health issues. *Appelbaum* refers to a study according to which 48% of 302 medical inpatients with acute conditions were mentally incompetent to consent to medical treatment; however only a quarter of these 302 inpatients were deemed as mentally incapable by the caregivers providing for them in the mental health institution they were admitted to.[10]

C. The Validity of Consent to Treatment of a Person with Mental Health Problems

I. The Cross-Reference between Inalienable Rights and Consent to Treatment

Alongside the acknowledgement of the limitations intrinsic to EBP comes the acceptance of the fact that tailored healthcare is crucial if the person in need is affected by mental health issues. The volatility of EBP is a weakness, which cannot be ignored nor avoided at the current stage of development. However, it should not be used by those who are in a stronger position i.e. healthcare practitioners or legislator, to overrule the will of the vulnerable person because of the presence of a mental illness. This would hinder the right to self-determination of the person to which he or she is entitled in the same way as a person free from any mental disorder, granted that the person with mental health issues is comparatively more

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9 *Thomas/Bracke/Timimi*, (fn. 2), p. 296.

10 *Raymont/Bingley/Buchanan et al*. as cited by *Appelbaum*, Assessment of Patients' Competence to Consent to Treatment, The New England Journal of Medicine (NEJM), 2007; http://www.nejm.org/doi/pdf/10.1056/NEJMcp074045 (01/09/2017), p. 1835.

vulnerable. International case law has shown that the typical human rights violated because of a mental illness are the right to liberty, the right to be free from torture and other inhuman or degrading treatment[11] as well as the right to a private life. A person's right to liberty comprises a physical as well as a mental element and it can be limited only if provided by and in accordance with the law. Article 27 (1/d) of the Albanian Constitution provides that the right to liberty can be limited only if the mentally incapable person represents a danger to the society.[12] According to the DSM-V, a mental disorder is:

"[…] *a syndrome characterized by clinically significant disturbance in an individual's cognition, emotion regulation, or behaviour that reflects a dysfunction in the psychological, biological, or developmental processes underlying mental functioning. Mental disorders are usually associated with significant distress in social, occupational, or other important activities. An expectable or culturally approved response to a common stress or loss, such as the death of a loved one, is not a mental disorder. Socially deviant behaviour (e.g., political, religious, or sexual) and conflicts that are primarily between the individual and society are not mental disorders unless the deviance or conflict results from a dysfunction in the individual, as described above".*[13]

The mental dimension of the right to freedom is directly linked to the principle of self-determination, which is exercised through consent. The Italian Constitutional Court defines consent as the "*foundation and legitimacy*" to any medical treatment.[14] The current

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[11] The Albanian Criminal Code provides for the crime of "Torture" in Article 86 and 87. After much debate, Italy has finally integrated "Torture" in its Criminal Code (Article 613-ter) through Law No. 110 of 14/07/17.

[12] The criterion of danger is absent in the provision of Article 5 (1/e) of the ECHR and will be discussed briefly *infra note,* (fn. 52).

[13] Diagnostic and Statistical Manual of Mental Disorders (DSM-V) of the APA, 2013, p.20.

[14] Constitutional Court of the Republic of Italy (*Corte Costituzionale*), judgement no. 471/90, para. 3 and judgement no. 238/96, paras. 3.1-4. A brief synthesis of the national and international legal substrate as well as of the jurisprudence and doctrine relevant to informed consent to medical treatment and criminal liability is provided by *Canestrari* in Bioetica e Diritto Penale, 2014, pp. 79-93, and *Funghi/Giunta* in Medicina Bioetica e Diritto. I Problemi e la loro Dimensione Normativa, 2005, pp. 91-214.

position of the Italian Supreme Court penal jurisprudence is that neither the absence nor the invalidity of consent due to insufficient information provided to the patient can be relevant to establishing whether there was negligence in the care he or she received.[15] The Italian Supreme Court has also stated that although consent is a premise to providing healthcare, it does not entail a medical "*right to intervene*" if it is contrary to the wishes of the patient.

Doctrine has dedicated less attention to information as a crucial element for a valid consent. According to *Beauchamp & Childress*, the fulfilment of the obligation to provide 'due information' should be more of a reference point rather than an objective in itself.[16] The *Authors* discern two declensions of informed consent:

- An autonomous, therefore personal, authorisation to undergo a medical procedure or to take part in clinical trials.[17]
- The second meaning refers to the social rules that require for consent to be expressed in a specific form and institutionalised language. In some cases, even if consent is granted in autonomy, it can be invalid because it is not in compliance with the formal requirements.[18] An "*enhanced*" informed consent form for clinical trials as modelled in *Koonrungsesomboon et al.* study, would grant the patient the right to decide over new categories of circumstances such as the consequences from withdrawal of consent, the right to receive updated information, the right to know the direct and indirect risks and benefits from the clinical trial as well as the right to access the data collected from the trial[19].

Two of the most important international acts which recognise informed consent as a fundamental premise for any medical

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15 Supreme Court of the Republic of Italy, Sezione IV, judgement no. 2347/14, para. 8.

16 *Beauchamp/Childress*, Principi di Etica Biomedica, 1999, pp. 149-150.

17 *Ibid.*

18 *Ibid.*, p. 149.

19 *Koonrungsesomboon et al.,* Improved Participants' Understanding In A Healthy Volunteer Study Using The SIDCER Informed Consent Form: A Randomized-Controlled Study, European Journal of Clinical Pharmacology, 2016, p. 415.

treatment are the Oviedo Convention (CoE)[20] and the CRPD (UN)[21]. These instruments however offer different levels of protection with respect to the right to self-determination.

According to the Oviedo Convention, a physician can intervene exceptionally in emergency cases where there is absence of consent from the patient or his or her legal proxy.[22] In the Albanian and Italian criminal law, this situation can be absorbed within the legal justification of the "*state of necessity*", which however requires that the harm (in this case harm to the health of the patient) must be actual and not otherwise avoidable.[23] A part of the Italian doctrine takes a slightly more moderate stand arguing that the state of necessity can activate also in cases where the conduct of the physician is aimed at neutralising "*an eventual source of harm*" i.e. when harm is not imminent.[24] This flexibility is akin to what is provided by the Mental Health Act (MHA 2007) of the UK on what constitutes medical treatment of a mental disorder.[25]

For involuntary treatment specifically, in consideration of the jurisprudence of the ECtHR and pursuant to Articles 5 and 7 of the Oviedo Convention and Articles 12, 18 and 19 of the

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20 Pursuant to Article 7 of the Convention on Human Rights and Biomedicine (ETS no. 164) (Oviedo Convention) the possibility to order involuntary psychiatric treatment is limited only to the cases it is for the shortest amount of time necessary and only in presence of a serious mental disorder, which poses great danger for the health of the patient. Furthermore, a right to appeal the involuntary treatment on part of the patient or its guardian must be ensured.

21 Article 15 of the CRPD (UN) provides that "[…] *no one shall be subjected without his or her free consent to medical or scientific experimentation*" and that States "[…] *shall take all effective legislative, administrative, judicial or other measures to prevent persons with disabilities, on an equal basis with others, from being subjected to torture or cruel, inhuman or degrading treatment or punishment*".

22 On emergency as a justification for administering a medical intervention without prior consent on part of the patient or its legal guardian see ECtHR, no. 61827/00, *Glass v. the UK*, judgement of 09/03/2004.

23 Article 20 of the Criminal Code of the Republic of Albania and Article 54 of the Criminal Code of the Republic of Italy.

24 *Canestrari*, Genitori rifiutano il Consenso al Test per l'HIV per il Figlio appena Nato – Il Punto di Vista Giuridico in: Funghi/Giunta, Medicina Bioetica e Diritto. I Problemi e la loro Dimensione Normativa, 2005, pp. 178-179.

25 *Infra note,* (fn. 48).

Recommendation Rec (2004)10 of the Committee of Ministers (CoE), it is possible to infer that the two fundamental rights affected are the right to be free from cruel, inhuman or degrading treatment and the right to respect for private life.[26] With respect to the violation of the first right, the ECtHR has stated that "[…] a *measure which is a therapeutic necessity cannot be regarded as inhuman or degrading*. *The Court must nevertheless satisfy itself that the medical necessity has been convincingly shown to exist*".[27] In the same decision, the ECtHR continues: "*What distinguishes treatment from torture or inhumane or degrading treatment is the manner in which the treatment is administered*".[28] For example, the abusive administration of neuroleptics to inpatients was considered by the Special Rapporteur on Torture of the UN (2008) as a violation of Article 3 of the ECHR.[29]

Recalling the principle of equality and non-discrimination, the CRPD establishes that nobody affected by a mental disorder should be denied legal capacity only because of his or her condition. An assessment of the mental capacity is necessary whenever seeking to administer involuntary treatment. As pointed out by the European Union Agency for Fundamental Rights (FRA), in order to be applied correctly, Articles 15, 17 and 25 (d) of the CRPD on consent to medical treatment need to be read in conjuction.[30] However, there is still no unified standard on how to reach to such integrated interpretation.

The Italian law provides that the respect owed to the human being cannot be violated under any circumstance and that any intervention should respect the dignity of the person.[31] The same provision of the Italian law refers to Article 32 of the Constitution so to indicate the legal ground for the administration of involuntary treatment, which

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[26] A violation of Article 8 of the ECHR can be justified only if pursuant to the second paragraph of Article 8, the intervention is aimed at avoiding any harm to the person itself or to society.

[27] ECtHR, no. 10533/83, *Herczegfalvy v. Austria*, judgement of 24/09/1992.

[28] *Ibid.* On this matter, see also ECtHR, no. 27229/95, *Keenan v. the UK*, judgement of 03/04/2001.

[29] Para. 63 as cited *infra note* by FRA, (fn. 30), p. 23.

[30] European Union Agency for Fundamental Rights (FRA), Involuntary Placement and Involuntary Treatment of Persons with Mental Health Problems, 2012, p. 22.

[31] Article 33 of Law No. 833/1978 of the Republic of Italy.

states that nobody shall be forced to undergo medical treatment unless provided by the law.

II. A Medically-Assessed Mental Capacity as a Limitation for an Effective Implementation of the Shared Decision-Making Model?

In late April 2017, the lower Chamber of the Italian Parliament (*Camera dei Deputati*, it.) approved the law on consent to medical treatment and advanced directives, which provide for a new type of proxy called "*fiduciario*" (it.) who will participate exclusively in the decision-making processes of a medical nature.[32] Currently, the Italian and Albanian law apply the *substituted decision-making model,* which authorises the legal guardian to make any decision on behalf of the person under guardianship. The substituted decision-making model is considered to clash with the *shared decision-making* model promoted by the CRPD. For this reason, in 2016 Italy was advised to repeal all laws blocking the implementation of the shared decision-making model.[33]

Shared decision-making could entail in some cases the interpretation of the signs or any type of manifestation of the wishes of the person with mental health issues. Much debate has ensued as to whether this interpretation should be faithful to the essence of the person or to what is considered as logical and 'normal'. As noted by *Donnelly*: "*When interpreting signals from a person whose views and feelings are essentially alien to them, decision-makers may fall back on what they believe to be a 'normal' response to the situation. In so doing, the wishes identified may not be those of the person lacking capacity but those which the decision-maker believes she would have if she were in the*

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[32] The Italian law on informed consent and advanced directives "*Norme in materia di consenso informato e di disposizioni anticipate di trattamento*" was approved by the Senate of the Republic of Italy on December 14, 2017 (Law No. 219/17 of the Republic of Italy)**.** The Italian Civil Code provides for three different types of legal guardianship depending on the level of dependency of the person: *Curatela, Tutela* and *Amministrazione di sostegno.*

[33] Concluding Observations on the Initial Report of Italy of the Committee on the Rights of Persons with Disabilities (OHCHR) 2016, paras. 27-28. http://tbinternet.ohchr.org/_layouts/treatybodyexternal/Download.aspx?symbolno=CRPD%2fC%2fITA%2fCO%2f1&Lang=en (01/09/2017).

patient's situation."[34] The Code of Practice for the MCA 2007 (UK) recommends decision-makers to be empathetic in reconstructing the wishes of the person lacking capacity by evaluating extensively all relevant information, without limiting themselves to an appreciation of only what they i.e. the decision-maker thinks is important.[35] The Handbook on the Convention on the Rights of Persons with Disabilities goes further, recommending that the person affected by a mental disorder should be allowed to enter a "*representation agreement*" that allows for assisted decision-making without being limited by a preliminary assessment of his or her legal competence i.e. mental capacity according to medical criteria, as this would undermine the effective application of Article 12 of the CRPD.[36]

The WHO recognises the validity of consent by legal proxy, however it recommends "*to inform the patient about the nature of the treatment and any possible alternatives and to involve the patient as far as practicable in the development of the treatment plan*".[37] Congruous to legal norms, the Italian Code of Medical Deontology (CMD) provides that consent to treatment of a mentally capable minor or that of a mentally incapable adult should be granted by his or her legal guardian. However, in the case of a legally incompetent but mentally capable minor, in compliance with Article 6 (3) of the Oviedo Convention, the physician is bound to involve the minor in the decision-making process, to have consideration of his or her wishes as well as to take note of any eventual disagreement of the minor

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[34] *Donnelly,* Best Interests, Patient Participation and the Mental Capacity Act 2005, Medical Law Review, 2009, vol. 17, no. 1, 2009, pp. 1-29, https://doi.org/10.1093/medlaw/fwn021 (01/09/2017).

[35] Code of Practice for the MCA 2007 by the Department of Constitutional Affairs (DCA) 2007, Paragraph 5.7.

[36] Handbook for Parliamentarians on the Convention on the Rights of Persons with Disabilities (UN) no. 14, 2007, pp. 89-90, http://www.ipu.org/PDF/publications/disabilities-e.pdf (01/09/2017).

[37] Principle 11 (9) of the Guidelines for the Promotion of Human Rights of the Persons with Mental Disorders of the (WHO), 1996, http://apps.who.int/iris/bitstream/10665/41880/1/WHO_MNH_MND_95.4.pdf (01/09/2017). Also, Article 19 of Recommendation Rec(2004)10 (CoE) on the Protection of the Human Rights and Dignity of Persons with Mental Disorder.

regarding the treatment proposed.[38] As pointed out by *Canestrari, "The hardcore personal nature of life and health as well as the constitutional stature of the relevant legal safeguards applicable to these values, represent a public order limit which render them unavailable to either the incapable person and his or her legal guardian."*[39]

In some instances, the term 'assent' is used instead of 'consent' whenever the person receiving medical treatment is affected by mental health issues.[40] According to *Donnelly*, the shared decision-making model supported by Section 6 of the Mental Capacity Act (MCA 2005) (UK) implies that the mere lack of mental capacity due to a mental disorder, does not justify an automatic disregard of the wishes of the patient.[41] Furthermore, the involvement of the patient in the decision-making process would enable the medical staff to achieve a clearer perception of his or her condition and personality, contributing therefore to a correct application of the law.[42]

Even the so-called liberal countries such as the UK, struggle when it comes to respecting the decisions of a person affected by a mental disorder related to medical treatments. The UK law recognises a proper right of the person to make unwise decisions without the risk

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38 Article 33 (4); Article 35 (3), Article 37 of the Code of Medical Deontology (CMD) of the National Federation of the Orders of Medical Surgeons and Dentists (FNOMCeO) of the Republic of Italy.

39 *Canestrari,* (fn. 24), p. 176.

40 Guidelines on Medical Research for and with Older People in Europe by the European Forum for Good Clinical Practice (EFGCP), 2013, p. 12: "*The notion of assent is recognised in the Declaration of Helsinki: When a potential subject who is deemed legally incompetent, is able to give assent to decisions about participation in research, the physician must seek that assent in addition to the consent of the legally authorized representative. The potential subject's dissent should be respected. […]. At the same time as obtaining consent from the legal representative (if any), the assent or willing agreement of the older patient must be sought. The central role of the legal or authorised representative in the protection of the older patient should be recognised. The family or proxy or the legal representative (if any) might also wish to discuss with the older patient on their own, after having been informed about the trial, and before meeting with the investigator. If the older patient's assent is not obtained, it is recommended that this be documented with justification in the consent form, which is signed by the legal representative and the investigator."*

41 *Donnelly,* (fn. 34), pp. 7-8.

42 *Ibid.*

of being considered mentally incapable as a consequence.[43] This right is also recognised in non-binding international acts such as by Principle 4 (3) of the "Guidelines for the Promotion of Human Rights of the Persons with Mental Disorders" (WHO) as well as Article 19 of the Recommendation Rec (2004)10 on the Protection of the Human Rights and Dignity of Persons with Mental Disorder (CoE), which both reflect what was originally elaborated by Beauchamp & Childress.[44]

Prior to the consolidation of jurisprudence associating freedom of religion with the right to self-determination, a refusal to undergo a life-saving blood transfusion because it was contrary to one's religious beliefs was considered unwise from a medical perspective. The physician had the obligation to assess the mental capacity of the patient since its existence was and still is a legal presumption. This is indicative of the fact that medical practice is able to discern between unwise and unsound. As stated in the ECtHR milestone case *Winterwerp v. The Netherlands* concerning involuntary placement "[…] *Article 5.1e [of the European Convention on Human Rights] obviously cannot be taken as permitting the detention of a person simply because his views or behaviour deviate from the norms prevailing in a particular society*".[45]

Mental capacity is assessed by applying clinical standards as elaborated originally in 1988 and later updated in 2007 by Appelbaum. These clinical standards measure the ability of the person to understand the information pertinent to the medical treatment proposed, to retain and evaluate the different variables explained in lay terms and finally to come out with a decision as a result of such a process.[46] The right to self-determination is also inextricably linked to the principle of dignity. A blind and sterile execution of the wishes of the person with mental health issues by calling upon the respect of the right to liberty or of the right to private

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43 Section (4) of the (MCA 2005) of the UK provides that "*A person is not to be treated as unable to make a decision merely because he makes an unwise decision*".

44 *Beauchamp/Childress,* (fn. 16), p. 147.

45 ECtHR, no. 6301/73, *Winterwerp v. the Netherlands*, judgement of 24/10/1979. It must be noted that the Italian and Albanian law and regulations do not make any distinction between involuntary placement and involuntary treatment, with the latter absorbing the former.

46 *Appelbaum*, (fn. 10). The same standards are listed in the Italian CMD.

life would be just as detrimental as the unjustified violation of these rights on the grounds of the person's mental disorder.[47] This leads us to the need for the adoption of case-sensitive regulations on matters of consent to medical treatment i.e. rules that are flexible enough to strike a balance between the interests in play.

The Albanian and Italian law do not provide a legal definition of mental illness. The MHA 2007 (UK) offers a legal definition of the medical treatment related to mental disorder as any intervention, the purpose of which is "*to alleviate, or prevent a worsening of the disorder or one or more of its symptoms or manifestations*".[48] By this provision, an involuntary measure can therefore be ordered if it is able to prevent a worsening of the illness without necessarily being appropriate to actually treating the disorder.[49]

The introduction of new guidelines on the administration of involuntary treatment that include the criterion of danger to oneself or to others could help buffer any eventual undue interference in human rights. In several countries, involuntary treatment is ordered depending on the seriousness of the mental illness. The Norwegian regulation provides that a person is administered involuntary treatment if affected by 'serious mental disorders', which include "*psychosis or deviant states of mental deficiency where the reduction in functioning is as substantial as that seen in psychosis interpretation*".[50] *Zhang et al.* led a comparative study on involuntary psychiatric treatment and observed that as a general rule, involuntary treatment is ordered only once the physician has diagnosed a mental disorder and it is proved psychiatric treatment is needed.[51] The legal orders, which provide for the danger criterion, require additional evidence that such danger is caused by the mental disorder. Unlike what is

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47 *Buchanan/ Brock*, Deciding for Others. The ethics of surrogate decision making 1989 as cited by *Berghmans/Widdershoven*, Ethical Perspectives on Decision-Making Capacity and Consent for Treatment and Research, Medicine and Law, 2003, vol. 22, no. 3, p. 392.

48 S145 (4) of Mental Health Act (MHA 2007) of the United Kingdom.

49 ECtHR, no. 50272/99, *Hutchinson Reid v. the UK*, judgement of 20/02/2003.

50 *Zhang et al.,* Involuntary Admission and Treatment of Patients with Mental Disorder, Neuroscience Bulletin, 2015, vol. 31, no. 1, p. 101.

51 *Ibid.,* pp. 100, 103.

provided by Article 27 (1/d) of the Albanian Constitution, involuntary treatment in Italy can be administered without having to prove that the behaviour of the mentally disturbed person poses a danger to oneself or to society.[52]

D. Information as an Essential Element of a Valid Consent

Equality before the law as provided by Article 15 of the CRPD can be achieved by demanding that healthcare providers support the person with mental health issues in the decision-making process instead of leading over him or her. The final step in the decision-making process is the collection of consent (or refusal) to medical treatment from the patient or his or her legal guardian. As mentioned briefly in Section B, the decision needs to be informed in order to be valid.[53]

The right to consent to medical treatment is also a vital element of the right to integrity pursuant to Article 3 (2) of the Charter of Fundamental Rights of the European Union and Article 17 of the CRPD. The Italian Constitutional Court has stated that informed consent to medical treatment is a synthesis of two fundamental rights traceable to Article 32 of the Constitution: the right to self-determination and the right to health.[54] According to Article 32 (2), nobody shall be obligated to undergo medical treatment except when provided by the law. Similarly, Article 56 of the Albanian Constitution guarantees the right to equal access to healthcare and to benefit from health insurance. From a bioethics perspective, this formulation recalls the principle of justice rather than that of autonomy.

The jurisprudence of the Italian Constitutional Court on consent to medical treatment has recognised that the person has a proper '*right to information*' with regards to the nature and possible outcomes of

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[52] The adoption of the danger criterion in administering involuntary treatment is however recommended in the White Paper of the Steering Committee on Bioethics (CDBI) of the Council of Europe 2000, http://www.coe.int/t/dg3/healthbioethic/Activities/08_Psychiatry_and_human_rights_en/DIR-JUR(2000)2WhitePaper.pdf (01/09/2017).

[53] *Supra note,* (fn. 16-19).

[54] Constitutional Court of the Republic of Italy, Judgement no. 438 of 15/12/2008, para. 4.

the treatment as well as to the alternatives available.[55] The right to information stems from the right to liberty (provided by Article 13 of the Italian Constitution), which in compliance with Article 32 (2) of the Italian Constitution calls for autonomy in the decisions concerning medical treatments.[56] Additionally, the right to information can be violated independently from the right to health, as pointed out by the Italian Supreme Court.[57] This means that a physician can be held civilly liable for failing to provide due information prior to collecting consent even though his or her conduct did not actually cause any harm to the health of the patient.[58]

Uniform standards for providing due information are yet to be established. On this matter, Beauchamp & Childress suggest preferring the "*subjective standard*" to that of the "*reasonable person*" or that of the "*professional practice*". The subjective standard is tailored to the needs of the patient in that the physician will have to determine and provide the information the patient would want to know in order to participate effectively in the decision-making process.[59] The adoption of this standard is important for two reasons: The ECtHR case law has found a violation of the right to liberty when involuntary placement has been ordered without a physician carrying out an actual clinical assessment of the patient's condition[60]; secondly, several legal regulations including the Italian one, do not

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55 *Ibid*.

56 *Ibid*.

57 On the right to information for a valid consent to treatment, see Supreme Court of the Republic of Italy (Civil Section), judgement no. 11950/2013 and judgement no. 16543/2011.

58 Recent case law include the following judgements: Tribunale of Bari 18/07/13; Tribunale of Bari 27/05/14; Court of Appeals of Bologna 20/02/14; Tribunale of Campobasso 4/02/14; Tribunale of Firenze 22/01/14; Tribunale of Milano 19/03/14; Tribunale of Milano 27/01/15; Tribunale of Roma 4/01/16 as listed by *Fargione,* Il Danno da Lesione del Diritto all'Autodeterminazione nella Scelta dei Trattamenti Sanitari, Danno e Responsabilità, no. 5, 2016, p. 556.

59 *Beauchamp/Childress,* (fn. 16), p. 155.

60 ECtHR, no. 36673/04, *Malofeyeva v. Russia*, judgement of 30/05/2013; ECtHR, no. 11737/06, *Zagidulina v. Russia,* judgement of 02/08/2013; ECtHR, no. 28796/07, *Petukhova v. Russia*, judgement of 02/08/2013.

require for the physicians requesting the administration of involuntary treatment to be trained specialists i.e. psychiatrists.[61]

E. Conclusions

The reformation of the medical science achieved through the adoption of the EBM has reverberated through the relevant legal framework, especially that concerning human rights and medical liability. Despite relying heavily on neuroscience in an attempt to provide physical validation to its results, EBP has a higher risk of fallacy compared to EBM. In addition, EBP is based on inductive interpretations of the human behaviour and it cannot control the environment under study i.e. the human psyche. The current law and jurisprudence provide that regardless of the rate of accuracy, scientific evidence, including medical opinions, should be evaluated in conjunction with all the other pieces of evidence admitted in court. The reasoning underlying the decision of the court should be expressed in terms of logical probability instead of statistical probability.[62] This current position of the Italian jurisprudence and doctrine acknowledges the limitations of medical science with regards to the applicability of its results in a legal decision.

There is no reason not to implement the shared decision-making model also in those cases where the person involved has mental health issues. This brings up the need for uniform medical standards on how the physician should provide due information as well as collect a valid consent to medical treatment. The Albanian and Italian legal orders could attempt to harmonise their regulation with the legal safeguards on matters of equality before the law and non-discrimination provided by the CRPD by recognising a right of the person to make unwise decisions without being considered mentally incapable based on that ground. The first step to achieving this harmonisation could be adopting a legal definition of mental disorder.

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61 Article 33-35 of the Italian Law No. 833/78 provide that a motivated request for administering involuntary inpatient treatment must be presented by two physicians to the Mayor of the city where the institution is located.

62 Supreme Court of the Republic of Italy, *supra note,* (fn. 6).

Monetary Sovereignty in Contemporary European and International Monetary Law*

Marko Dimitrijević **

Abstract

The subject of analysis in this paper is the concept of monetary sovereignty in terms of globalised economic and financial relations, which have defined contemporary international monetary law. In this context, the first part of the paper points to the notion of monetary sovereignty, its components, the principles of monetary law that determine its scope, as well as the implications for the monetary stability of the economic system, which increasingly acquires the characteristics of a pure public good. The second part of the paper points to the tendency of limiting certain components of monetary sovereignty, with which countries do not agree, when establishing membership in the monetary union. This is best seen in the case of the European Monetary Union, which provides us with a redefinition and a different understanding of monetary sovereignty.

A. Introduction

According to some authors, monetary sovereignty can be regarded as a constitutional part of political sovereignty, but another group points out that the concept of monetary sovereignty is older because it originated in the Roman period (according to some even earlier, in India and the Babylonian Empire), while the concept of political sovereignty is created much later during the Renaissance (1567) by Jean Bodin.[1] In considering monetary sovereignty, we must take into account the fact that monetary systems were initially developed beyond the states and that modern forms of money such as banknotes were created and developed for a long time in the payment system, and that the state began to regulate it from a

* This paper is a result of research conducted within the project „Harmonization of Serbian Law with EU Law (2013-2018)", carried out by Faculty of Law, University of Niš.

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1 *Mundell*, Money and the Sovereignty of the States, 1997, pp. 18-21.

monetary-legal standpoint only in their improved form.[2] It is interesting that, historically, the concept of monetary sovereignty has not enjoyed the recognition by the international community for a long time, although this is about a key category of international monetary law that has not explicitly found its justification and protection in any of the articles of Agreement on the Founding of the International Monetary Fund (IMF). In fact, the first official recognition of this concept does not have its source in jurisprudence, but in the judiciary of the former Permanent Court of International Justice, in a judgment concerning the legitimacy of a public loan in the case of France vs. Serbia (where the right of the state to independently and completely regulate all issues related to the definition and use of the local currency was explicitly recognised).

Contemporary restrictions (both legal and economic) that determine the scope of sovereign monetary authorisations of the state have been the subject of comprehensive analysis and interpretations in diverse legal, economic and political literature. In today's circumstances, the majority of authors considered that the concept of monetary sovereignty cannot be regarded as static, which means it would simply be reduced to a set of catalogue authorisations, i.e. the rights of the state and other public legal collectives in the monetary flow. On the other hand, according to the conditions of existence of monetary unions, a significant number of authors advocate the thesis of an intense "erosion of monetary sovereignty", which, according to their views, exists only in the figurative sense. Of course, in the globalised economic and financial relations there is a transformation of the concept of monetary sovereignty, but we can only speak of the tendency of the evolution of the same, not of its absolute or relative weakening, but rather of its adapting to modern economic occasions and international circumstances.

Thus, we can observe that monetary law increasingly finds its sources in some new legal and economic facts which were formed by international monetary agents when concluding certain interstate agreements in the domain of secondary legislation, which, in the conditions of the global economic and financial crisis perform the

[2] *Meichsner*, Basic of Monetary Law, 1981, pp. 5-6.

function of filling in legal gaps in the primary sources of international monetary law. Although the concept of monetary sovereignty owes its existence to the efforts of legal theoreticians that incorporate the already established and well-developed internal monetary sovereignty of the monarch into a coherent legal framework, it must be noted that the concept itself has never been identified with the untouchable privileges of the monarch. The *ratio* of its origin should be sought in the need for an *ex-post* justification of state powers in monetary flows in the period when the central government is weakened in almost all countries.[3] Legal constraints on the manifestation of monetary sovereignty come out from customary international law and concluded international agreements, the most influential of which is the IMF Agreement, while the greatest constraints on the economic nature are embodied in the consequences of globalisation and deepening integration of the financial market. In addition to the aforementioned restrictions, the actual impact in practice has limitations that are not explicitly prescribed, for example, Article VI (3) leaves the possibility (right) for Member States of the IMF to freely impose (use) certain control measures for capital movements, provided that it is a mechanism that does not jeopardise payments for any current transactions. Of course, the fact is that when the state opts for the liberalisation of capital flows, the eventual introduction of new controls in the future would prove to be a major economic expense that will act as a disincentive.[4] Beyond the conventional limitations of monetary sovereignty (legal and economic), there are also major non-standard factual constraints that imply the dominance of economic laws over legal regulations. When the monetary system finds itself at odds with economic reality (as a form of legal regulation of monetary system) it can keep its datedness, but it will be de facto modified to a greater or lesser degree.

This only confirms the thesis that the monetary system of the state is not exhausted in the laws and by-laws regulations, but that it has been supplemented and, in part with the factual and legal effect, supplemented and (or) complemented by trade preferences, bank

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3 *Zimmermann*, The Concept of Monetary Sovereignty Revisited, The European Journal of International Law, 2013, pp. 797-819.

4 *Ibid*.

customs, customs, and the behaviour of citizens under a specific monetary jurisdiction.[5] In the analysis of the concept of monetary sovereignty, a direct or indirect method can be applied.[6] The first method starts from the notion of monetary sovereignty as an element of the general sovereignty of the state, which must be inviolable and complete, while the other method proceeds from the fact that all sovereign authorisations (and so monetary) are derived from the same source, that is, the capacity of the independence of the position of each state. The direct method was more widely used in practice and obtained its justification in 1923 when the International Court of Justice decided the *SS Wimbledon case*. In the literature, the concept of monetary sovereignty is said to be "essentially competitive in nature", in the sense that it does not merely express normative standards, which makes its perception different from individuals, and this leads to misunderstanding about the optimal way of effective implementation in practice and the meaning of the concept *per se.* [7]

B. Concept and Nature of Monetary Sovereignty

The concept of monetary sovereignty in practice shows the characteristics of a dual nature, so in addition to the positive components, it includes normative components. As such, the concept of monetary sovereignty is much more than a "mere" framework of the powers and duties of the state in the field of national and international monetary and legal relations.[8] In the context of globalised economic and financial flows, this concept carries out the functions of a legal benchmark for evaluating modern ways of implementing the sovereign authorisations of the state in the field of monetary obligations, which helps us to perceive the essence of complex and heterogeneous factors that form the norms of international monetary law. The contemporary concept of monetary sovereignty undoubtedly follows the conceptual continuity of the

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5 *Meichsner*, (fn. 2), p. 7.

6 *Besson*, Sovereignty in Conflict, European Integration Online Papers 8 (15), 2004, pp. 1-3.

7 *Ibid*.

8 *Zimmermann*, (fn. 3), pp. 798-800.

doctrinal and historical origins of classical monetary sovereignty, but in its basis is today very dynamic, as its positive and normative components continuously evolve in the conditions of the international economic environment. The characteristics of modern monetary sovereignty are essential complexity (must include different dimensions of its meaning), a criterion character (but with the absence of a universal criterion of consistent application) and normativity since it expresses and includes mutually different values.[9]

The concept of monetary sovereignty cannot be characterised as a purely positive or purely normative concept because in this case, it would be a matter of simplifying the facts and components from which it was compiled. Monetary sovereignty cannot be reduced to only the positive components (in the form of a descriptive catalogue of the regulatory powers of the state in monetary flows) because it incorporates dynamic categories and values that constitute the benchmark of the legitimacy of monetary entities. This would mean that in the narrowest sense, monetary sovereignty implies the existence of a kind of "public monetary management", which does not tolerate any external actors and that can hardly be sustained today. The growing economic and commercial interdependence and the process of harmonisation of economic, financial and monetary law in the European Union (EU) do not, however, speak in favour of ending the concept of monetary sovereignty.[10] On the contrary, these tendencies merely confirm the thesis of its evolution through a new form (sui generis) of sovereignty in the form of a joint exercise, so-called "cooperative monetary sovereignty".[11] Such a change was

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9 *Besson*, (fn. 6), p. 4.

10 *Dimitrijević*, The Impact of European Integration on the Formation of New Monetary Law: The Case of Serbia, Hungarian Journal of Legal Studies (Acta Juridica Hungarica) 57/4, pp. 416-426.

11 *Besson*, (fn. 5), p. 10 et seq. The latest example of such disputes relates to the ECB's behaviour in the event of the application of measures to buy bonds on the secondary market. Namely, the measures undertaken by the ECB in the conditions of the crisis reflect the new jurisdiction in the field of controlling functions aimed at preserving monetary and maintaining financial stability. By pronouncing this judgment the Court indirectly confirmed the inviolability of the first components of monetary sovereignty, which is the best example of the lack of the thesis on the erosion of monetary sovereignty in the EMU. See: *Dimitrijević*, On the procedural Legitimacy of the European Central Bank in Monetary Disputes, Law and Economy

highly anticipated given the fact that countries have great difficulties in securing adequate legal protection of all constituent elements of monetary sovereignty, and hence the cooperative model replaces all the weaknesses of national protection.

In the case of the EMU, the majority of authors state that the unilateral transfer of monetary sovereignty is realised without the contextual transfer of legislative and regulatory powers. This fact is best illustrated by the centralisation of monetary policy at the communitarian level and the financial supervision that is still carried out by the national central banks. The controversy arising from this plan is due to the fact that the *lex monetae* has been transferred to the level of the EMU. Its structure is very broad, thus encompassing the suppression of the payment system (which should in the strictest sense be subordinated to the *lex obligationis*), which remains at the level of the Member State of the EMU, but at the same time the national manoeuvring space (at least in the segment of monetary policy and public debt management policy) is significantly reduced.[12] In considering the justifiability of this joint manifestation of monetary authorisations, it is necessary to apply a subsidiary test that justifies the community's action. The application of this principle in practice further aggravates the uncertainty of its contents, both in legal and economic terms. In economic terms, this principle is often identified with the institutional manifestation of the general principle of comparative advantage.[13] The existence of different "standards and techniques" of interpretations based on different economic positions of the Member States and political influence imply the need to establish uniformity in the application of the principle of subsidiaries. Legal science advocates the application of various mechanisms by which the implementation of the principle of subsidiaries in the field of monetary law can be improved. Rhetorical examinations regarding the distribution of competencies in the domain of monetary

(7-9), 2017, pp. 158-169, and *Dimitrijević*, Normative Regulation of Banking Union in European Monetary Law, TEME XLI (2), 2017, pp. 517-528.

12 *Vardi*, The Integration of European Financial Markets: The Regulation of International Monetary Obligations, 2011, p. 115.

13 *Schäfer*, Harmonization and Centralization Versus Subsidiarity: Which Should Apply Where?, Intereconomics 41 (5), 2006, pp. 246-249.

sovereignty may be diminished using the so-called "functional subsidiary test".[14]

The main issue in connection with the manifestation of monetary sovereignty concerns the determination of the *locus*, i.e. ownership of sovereignty. Thus, in monetary literature, one can observe the perceptions that sovereignty belongs to national governments that enjoy discretionary powers for its more precise implementation or implies the original authority of citizens delegating to governments or international organisations through a certain functional model. For this reason, representatives of the state and socio-psychological theory on the legal definition of the concept of money have different views on the structure and scope of monetary authorisations. In the analysis of monetary sovereignty, the current issues are related to the problem of its normative value, the scope of application (geographic and material) and the method of implementation, but also the very fragile issue of the rights of states that have limited their monetary sovereignty by joining monetary unions.[15] In order to protect the legal position of these countries, it is necessary to make all efforts in the segment of the right of states to independently determine the direction and course of their economic development, that is, the right to act inefficiently and be free from interference by other states, *de*

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[14] *Pelkmans*, An EU Subsidiarity Test is Indispensable, Intereconomics 41(5), 2006, pp. 249-254. The application of this test involves the successive application of four steps. The first step involves identifying the legal field in which measures and instruments did not give the satisfactory results. In the case of an area falling under the exclusive competence of the Community, the test is abandoned, but it should be noted that this step, although initial, may be required to be applied because the Maastricht Treaty is very complex. The second step is the application of external criteria, economies of scale or some other principles. If Member States cooperate voluntarily in solving a particular problem, there is no need for intervention at the supranational level of government, provided cooperation is credible. In the third step, it is necessary to check whether there are conditions for such cooperation to remain a credible *pro-futura* or not, due to exposure to different political interests and turmoil. In the fourth step, if we assume that the first and second steps are met, and the third is not, the competence belongs to the Community. If there are a sufficient number of conditions for credible interstate cooperation, the Community does not have to intervene, and therefore jurisdiction remains at the national level of government.

[15] *Hertogen*, An Usual Suspects? Monetary Sovereignty and Financial Stability, Goettingen Journal of International Law 2 (1), 2010, pp. 243-266.

iure rights to act monetarily (which is authenticated) and *de facto* freedom, which is not absolutely guaranteed and protected.[16] Practice shows that the benefits of full monetary sovereignty are particularly valuable to countries with more rigid economic systems because it is easier to mitigate and prevent economic shocks. In such circumstances, the central bank monitors the monetary policy, while the government seeks to limit all barriers to the free flow of foreign trade flows.[17] The influence of legal norms on choosing the optimal monetary policy is crucial in circumstances where the state wants to restore shaky credibility in monetary flows, because it precisely makes clear the legal commitment to the government into a balanced "behavioural trajectory" from which it will not be so easy to turn into a monetary game.[18]

The biggest changes in the way monetary sovereignty is realised are reflected in the circumstances of monetary integration when the states approach monetary unions. The first indications of monetary union were in the period of ancient Rome.[19] These early monetary structures, created in the period of ancient Rome, after time evolved into monetary policies and strategies of monetary unions, of which the European Monetary Union is the most developed and complex union in the monetary history (despite the apparent asymmetry between decentralised economic policy that remains in the competence of the Member States and the unique monetary a policy that is under the jurisdiction of the European Central Bank as a supreme monetary institution).

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16 *Schwartz*, The Uselessness of Monetary Sovereignty, Cato Journal 24 (1-2), 2004, p. 107.

17 *Ibid*.

18 *Simmons*, International Law and State Behavior: Commitment and Compliance in International Monetary Affairs, American Political Science Review 94 (4), 2000, pp. 819-835.

19 Thus in the Roman monetary system, in one period, there was evidence of the existence of a two-step monetary structure, within which two currency units (denarius and victoriatus) were simultaneously in the money circulation. The first unit was used for transactions in domestic monetary traffic, while the second unit was used for transactions in foreign monetary traffic. This kind of structure has confirmed its universality in modern monetary unions, which points to a broad understanding of the sophisticated international monetary discourse of the Roman legislators.

We can note that through history states have created numerous monetary unions, while the number of fiscal unions is far smaller, which supports the apparent opposition of fiscus to delegate the powers of establishing, introducing, controlling and collecting taxes. In that sense, we have to ask why the states agree to delegate the right to issue and determine the value of their own currency in which taxes are charged and whether the rights of taxpayers are more privileged than the rights of citizens living within the domestic monetary jurisdiction to enjoy the monetary stability in a sense of their general interests (right to solid and convertible currency) and personal interests (strong purchasing power of the domestic currency)? More precisely, at this point, we are asking why the states are ready to "sacrifice" the independence and credibility of the central bank (but not the tax administration) taking into account that the central bank is an independent institution that conducts *de lege artis*, while the tax administration remains a public administration body? In that sense, we are of the opinion that from the state monetary prerogatives it is possible to derive the monetary rights of citizens (in analogy to the taxpayer's rights), because the issue of defining domestic money is a prerequisite for fiscal and financial policy.

Monetary integration *per se* does not mean the loss of monetary sovereignty, but rather its adjustment in the circumstances of coordination of national monetary policies for the achievement of certain benefits, although practice shows that in globalised economic systems the valid rule is that the smaller the state, the smaller the intensity of monetary sovereignty.[20] Many monetarists consider that with the completion of the third phase in the formation of the EMU only led to the theoretical loss of monetary sovereignty in Member States, but not actual loss.

These understandings are confirmed by the fact that all Member States retained a certain degree of influence on the monetary policy that is best reflected in the exercise of the voting rights of the governors of the national central bank in the Board of Directors of the ECB. Also, one should bear in mind that countries that, in addition to membership in the IMF, are formed by special regional unions can, to a greater degree, relativise sovereign monetary powers and that

[20] *Angyal*, Monetary Sovereignty and the European Economic and Monetary Union, European Integration Studies, Miskolc, vol. 7 (1), 2009, pp. 109-119.

can be best seen in the EMU case.[21] However, there is a much higher degree of constraint in the Member States of the West African and Central African Monetary Union, which are integrated more consistently without the operation of national central banks.[22] The great challenge in determining the monetary sovereignty in monetary unions is measuring the level of remaining monetary sovereignty and setting the boundaries among the members because it can hardly be determined where the sovereignty of a Member State actually ends and where the monetary sovereignty of another Member State begins.

The state, as the owner of monetary sovereignty, primarily enjoys three exclusive legal powers, which include: the right to define the domestic currency (and the imposition of criminal sanctions for direct or indirect expulsion of the same from the market — *lex condenate monetae*), the right to determine and change the value of the domestic currency (as well as institutional regulation of the domestic banking system) and the right to use domestic or any other currency in monetary and legal relations within its territory.[23] The first right corresponds to the role of money as a means of payment, while another right corresponds to the function of money as the means of calculation. The right of the state to independently consider all the issues related to the definition and issuance of a domestic currency is protected by customary international law and the provisions of the Geneva Convention (1929), in which we can notice that this right is a prerequisite for the realisation of the remaining two rights and is therefore subject to strict legal protection. This right is essentially purely monopolistic (the widest scope) and belongs to the central bank as the supreme monetary institution, which implies the adoption of laws regulating the internal and external dimension of money, the credit system, the payment and clearing system.[24] The right to determine the value of a currency on a particular topic is obtained when using public debt (loan) when capitalising the budget deficit. The change in the value of the domestic currency does not

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21 *Golubović*, Fiscal Rules in European Monetary Union, 2010, p. 22.

22 *Gianviti*, Current Legal Aspecsts of Monetary Sovereignty, IMF Current Developments in Monetary and Financial Law No. 4, 2006, pp. 3-16.

23 *Proctor*, Mann on the Legal Aspects of Money, 2005, pp. 499-526.

24 *Lastra*, International Financial and Monetary Law, 2015, pp. 340-342.

constitute a violation of the norms of international monetary law and states will not be held accountable for the consequences to the creditors of the loan, and the permissibility of such changes is of particular importance in cases of devaluation and revaluation of the domestic currency. Of course, if the motive for the realisation of this right is met with deliberate damage to creditors of the loan or is discriminatory, it will result in its narrowing in a legal transaction. When it comes to the right to use the domestic currency in domestic or foreign payment transactions, we must point out that the provisions of various international agreements limit the scope of this right. Monetary conduct, (viewed in a wider context), refers to the way in which monetary sovereignty is implemented in practice (for example, establishing a fixed or fluctuating exchange rate, imposing foreign exchange controls in regulating monetary relations with other countries).[25] The mode of realisation of monetary sovereignty in practice is determined by the principles of international law which, in terms of their nature, can be *customary* or *contractual*. The contractual principles have their basis in the Vienna Convention on contractual obligations, the relevance of which in the field of monetary obligations is confirmed in the case of numerous interstate agreements. On the other hand, the usual rules of good monetary and financial management involve the use of legal standards such as "duty of fair and equal treatment", which is more a manifestation of good faith in the implementation of intergovernmental contractual obligations than the imperative rule of law. Nevertheless, the consciousness of the contracting parties with respect to the application of the principle, its repetition in a large number of concluded contracts gives it mandatory force. The rules that generate the structure of good monetary management are in practice aimed at promoting international monetary cooperation, exchange rate stability, creating a multilateral payment system, and eliminating risks and limitations in the system of foreign currency payments.[26]

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[25] *Proctor*, (fn. 23), pp. 557-558.

[26] The rules themselves are also based on the correct interpretation of the material provisions of international monetary agreements because they are often formulated under great coordination, concern cooperation and consultation with other international monetary and financial organisations or states in the sphere of international monetary payments.

Monetary disputes are a special kind of administrative dispute, which involve a central bank as the keeper of monetary sovereignty. Due to the specific nature of relationships and outcomes, monetary disputes cannot be guided by the interests of the politically influential members of the EMU and justified by reasons of pragmatism. It must primarily be motivated by the protection of supreme monetary institutions that perform their tasks in the interests of society and economy, which was, in our opinion, first confirmed in the OMT case (outright monetary transaction).[27] The European Court of Justice confirmed legitimacy and legalities to the proposed measures of the ECB, explaining it by the fact that the OMT program falls under the program of a unified monetary policy which the ECB sovereignty is conducted in accordance with the monetary strategy in order to preserve monetary stability (i.e. price stability as the primary goal that is more consistently realised by the application of these measures). We can note that in monetary disputes the requirements for the assessment of constitutionality and legality are subject to certain limitations. It is clear from the Court's decision that the conduct of monetary policy requires the possession of expert knowledge and expertise, which in European monetary law is only enjoyed by the ECB which has discretionary powers for their implementation.[28] Although for some theorists, this decision represents another confirmation of the expansion competence trend of the communitarian institutions by the provisions of secondary legislation, we consider that in this case the conduct of the ECB was not contrary to the provisions of primary law, but rather represents a new way of manifesting the competence in conditions of crisis.

D. Conclusion

The monetary sovereignty in the EU is not lost, its keeper is the European Central Bank. In conditions of crisis, the preservation of monetary and financial stability is of particular importance. Monetary

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[27] CJEU, case C-62/14, *Gauweiler and Others v Deutscher Bundestag (OMT)*, ECLI:EU:C:2015:400. This program contains monetary mesaures for buying bonds in secondary financial markets.

[28] Given that in monetary disputes, the Court cannot impose the essence of monetary measures (because there is no competence for such a thing).

stability is most often viewed as a synonym for price stability and takes a central place in the monetary strategies of the national central banks. Financial stability is, in most cases, defined in a negative way and indirectly as a contrast to financial instability, which is understood as the inability of the financial system to ensure the allocation of savings and investments in an economically efficient way without significant distortions (transaction costs). The synthetic-dialectical connection of monetary and financial stability is given a special dimension in the conditions of the economic monetary union. In that sense, we can notice that the ECB, besides securing monetary stability, must also take the role of custodians of financial stability and perform the role of the last-bank resort, especially in the circumstances of the future banking and fiscal union.

Exclusion Clauses and Notion of the "Third Party" in Motor Third Party Liability Insurance

Overview of the EU Law and Harmonisation Process in Bosnia and Herzegovina

Jasmina Đokić [*]

Abstract

The author analyses some of the measures introduced by Motor Insurance Directives for the purpose of the protection of the victims of traffic accidents. Through brief analysis of the grounds for exclusion from cover under third party liability insurance and the notion of the "third party", it will be shown how this aim has been achieved. Special attention is given to the process of harmonisation of legislation in the field of motor third party liability insurance in Bosnia and Herzegovina. Although it is a country with non-unified legal system whose territorial units have their own legislative competences in almost all civil law matters, the interstate conflict of law is inevitable. The article will include a brief overview of the existence of two legislative acts in the field of motor liability insurance and how they affect the rights of traffic accident victims.

A. Introduction

The process of communitarisation of law in the field of motor third party liability insurance was initiated in the early 1970s.[1] This process

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[1] The process of communitarisation of motor third party liability (MTPL) insurance legislation was preceded by the European Convention on Compulsory Insurance against Civil Liability in respect of Motor Vehicles (so-called – "Strasbourg Convention") enacted within the Council of Europe in 1959 (ETS No. 029 European Convention on Compulsory Insurance against Civil Liability in respect of Motor Vehicles). Although it had only a few ratifications, it set the rules for establishment of compulsory motor vehicle insurance and served as the guideline for the developement of modern national legislations in this field.

was a result of the need for clearer rules in a period of great expansion of road traffic. The European legislature has decided to harmonise insurance law through the directives[2] as general acts of secondary law of the EU that are directed more to the states, than to the citizens. The Member States have to implement the directives' provisions into their legislation, taking into consideration their particular aims.[3] The intention of the motor insurance directives was not to harmonise national tort law[4] because the consensus on such a wide terrain should not be achieved easily. The harmonisation of legislation has been achieved with the purpose of the protection of victims of road traffic accidents by means of mandatory third party liability insurance[5] that ensured the free movement of vehicles normally based on EU territory and of persons travelling in those vehicles.[6] EU motor insurance legislation has been evolving from

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2 Basically, the insurance directives could be divided into five groups: Directives related to freedom of establishment (the First generation directives on life and non-life insurance); Directives related to freedom of services (the Second generation directives); Directives related to the internal market on insurance (the Third generation directives); Directives related to particular types of insurance services and mediation (for example, Directive on insurance of legal aid, Directive on credit and guarantee insurance, Directive on insurance mediation, etc.); and Directives in field of third party liability insurance. See: *Pak*, Pravo osiguranja, 2011, p. 45 et seq.

3 *Meškić/Samardžić,* Pravo Europske Unije I, 2012, pp. 188-189.

4 It has been confirmed in the Judgement *Almeida* (C-300/10) in which CJEU took a position that it was apparent from the aim of the Directives that they do not seek to harmonize the rules of Member States governing civil liability, and that the Member States are free to determine the rules on civil liability applicable to road accidents. See: *Grubišić-Đogić,* Direktive EU-a o obveznom osiguranju od građanske odgovornosti za štete od motornih vozila u praksi suda EU-a, Zbornik radova Dani hrvatskog osiguranja, 2015, p. 77.

5 Protection of victims of the traffic accidents on EU level is not provided only by the Directives. For example, there is Regulation (EU) No 181/2011 concerning the rights of passengers in bus and coach transport and amending Regulation (EC) No 2006/2004 Text with EEA relevance**,** OJ L 55 of 28/2/2011, pp. 1-12, that regulates right on reimbursement to the passengers in public bus transportation in case of death or personal injuries, as well as loss or damage of luggage.

6 *Heiss,* Liability and Insurance in European Private Law, in: Schulze (ed.), Compensation of Private Loses – The Evolution of Torts in European Business Law*,* 2011, Part IV, pp. 215-216.

1972 through six Motor Insurance Directives (hereinafter: MIDs).[7] The main attempt of the first three Directives was to eliminate the barriers in cross-border movement of vehicles, whereas the later two Directives paid more attention to the improvement of protection of victims. The Sixth MID has been created as the codification of the previous five.[8]

This article will be present the victim protecting instruments introduced by the Second and the Third MID that are still subject to interpretation by the Court of Justice of the European Union (hereinafter: CJEU), i.e. exclusion clauses and the notion of "third party" in compulsory motor third party liability insurance. We will see how the provisions of the Directives regarding these issues were implemented in the legislation of Bosnia and Herzegovina, as one of the potential candidates for accession to the EU.

I. Exclusion Clauses in Motor Third Party Liability Insurance

The Second MID required Member States to take the appropriate measures to ensure that provisions or contractual clauses contained in the insurance policies should be deemed to be void in respect of claims by third parties who had been victims of an accident where they exclude cover for damage caused by drivers without authorisation or a driving license, or if the technical requirements

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7 Directive 72/166/EEC on the approximation of the laws of Member States relating to insurance against civil liability in respect of the use of motor vehicles, and to the enforcement of the obligation to insure against such liability, OJ L 103 of 2/5/1972, p. 1; Second Council Directive 84/5/EEC on the approximation of the laws of the Member States relating to insurance against civil liability in respect of the use of motor vehicles, OJ L 8 of 11/1/1984, pp. 17-20; Third Council Directive 90/232/EEC on the approximation of the laws of the Member States relating to insurance against civil liability in respect of the use of motor vehicles, OJ L 129 of 19/5/1990, pp. 33-35; Directive 2000/26/EC on the approximation of the laws of the Member States relating to insurance against civil liability in respect of the use of motor vehicles – Fourth motor insurance Directive, OJ L 181 of 20/7/2000, pp. 65-74; and Directive 2005/14/EC amending Council Directives 72/166/EEC, 84/5/EEC, 88/357/EEC and 90/232/EEC and Directive 2000/26/EC relating to insurance against civil liability in respect of the use of motor vehicles, OJ L 149 of 11/6/2005, pp. 14-21.

8 Directive 2009/103/EC relating to insurance against civil liability in respect of the use of motor vehicles, and the enforcement of the obligation to insure against such liability (codified version), OJ L 263 of 7/10/2009, pp. 11-31.

concerning vehicle safety have not been fulfilled.[9] With respect to passenger claims, the clauses that exclude them from cover on the basis that they knew or should have known that the driver was under the influence of alcohol or otherwise intoxicated, shall also be deemed to be void.[10] However, the exclusion clause may be invoked against persons who voluntarily entered the vehicle which caused the damage or injury, when the insurer can prove that they knew the vehicle was stolen.[11]

Interpretation of the exclusions from compulsory insurance against the third persons who suffered harm was the subject of a decision of the CJEU in the case of *Bernaldez*[12]. The request for preliminary ruling arose from the criminal procedure against the driver who caused the accident and who was under the influence of alcohol at the moment of the accident. According to the judgement of the national Spanish court, the driver was obliged to compensate the victims because Spanish law on motor third party liability (hereinafter: MTPL) insurance contained the exception clause for damages caused by intoxicated drivers. The CJEU ruled that exclusion from insurance cover should not be invoked against third persons, except if they were partially responsible for the accident. The Court again emphasised the main requirement of the directives, namely the protection of victims of traffic accidents. Any different interpretation would have the effect of allowing Member States to limit payment of compensation to victims, thus bringing about disparities in the treatment of victims depending on where the accident occurred, which is precisely what the directives are intended to avoid.[13]

There are some recent interpretations of exception clauses. In the case of *Fidelidade – companhia de seguros SA v Caisse Suisse de*

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9 Article 2 (1) of the Second MID; Article 13(1) of the Sixth MID.

10 For a more wide review of the framework of motor insurance law and its development in EU legislation see: *Merkin/Smith*, The Law of Motor Insurance, 2004, para. 1.

11 Article 2 (2) of the Second MID, Article 13 (1) of the Sixth MID.

12 CJEU, case C-129/94, *Rafael Ruiz Bernaldez*, ECLI:EU:C:1996:143.

13 *Ibid.*, para. 18.

compensation,[14] the CJEU confirmed that the third party cannot be excluded from cover under the MTPL insurance contract, although the contract between the insurer and policyholder was null and void due to the fact that it was concluded on the basis of false statements concerning ownership and the identity of the usual driver of the vehicle. In this decision it has been repeated that the Second MID provides that certain victims may be excluded from compensation, having regard to the situation they have themselves brought about, that is to say, persons who voluntarily entered the vehicle which caused the damage or injury, when the insurer can prove that they knew the vehicle had been stolen.[15]

II. Expanding of the Concept of the "Third Party"

With the objective of overcoming significant disparities between the Member States relating to the scope of cover under the motor liability insurance, the Third MID introduced the additional protecting instruments. This Directive states that insurance contracts cover civil liability for personal injuries to all passengers, other than the driver, arising out of the use of a vehicle.[16] This formulation triggered doubts about whether the MTPL insurance covers the damage suffered by the owner of vehicle, i.e. whether a passenger is insured in his or her own vehicle. In the case of *Churchill*[17] the CJEU interpreted that a passenger who voluntarily gave permission for another driver to drive his vehicle, and who suffered the injuries as a passenger in the accident that has been caused by that driver, has the right to compensation for damage. A similar interpretation was given in the

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[14] CJEU, case C-287/16, *Fidelidade – companhia de seguros SA v Caisse Suisse de compensation,* ECLI:EU:C:2017:575.

[15] *Ibid.*, para. 26.

[16] Article 1(1) of the Third MID. The protection of compulsory insurance was extended to all family members by Article 3 of the Second MID but the position of other passengers was a matter of domestic law. See*: Merkin/Smith*, (fn. 10), p. 22.

[17] CJEU, case C-442/10, *Churchill Insurance Company Ltd. v Benjamin Wilkinson and Tracy Evans v Equity Claims Ltd*, ECLI:EU:C:2011:799, para. 44. and 50. The commentary of the case see in: *Mantrov*, Clarifying the Concept of Victim in the Motor Vehicle Drivers' Liability Insurance, European Journal of Risk and Regulation, 2/2012, p. 257.

case of *Candolin,*[18] which concerned a passenger that was under the influence of alcohol being driven by another intoxicated driver, and the CJEU held that even where the passenger was blameworthy, the insurance law derogation in Article 2 (1) of the Second MID must be interpreted strictly and therefore insurance exclusions could not be utilised.[19]

The victim protection function of the MIDs received confirmation in a recent decision of the CJEU, and the notion of "third party" as well as exclusion clauses were discussed once again. The case of *Luís Mendes*[20] concerned a dispute for compensation of damage for a victim who sustained serious injuries as a pedestrian in an accident caused by his own vehicle, which was being driven by the person who stole the vehicle. The Portuguese national court refused the claim on the basis that the insurance contractor, namely the owner of the vehicle, was not a third party covered by MTPL insurance and, moreover, because the insurance did not cover the damage caused intentionally or by the vehicle that was stolen. The CJEU held that national legislation, which excluded the damage sustained by a pedestrian victim of a motor vehicle accident from MTPL insurance cover, on the sole ground that that pedestrian was the insurance policyholder and the owner of the vehicle that caused the damage, is precluded by the provisions of the MIDs. The Court observed the above mentioned decision in the *Churchill* case in which the passenger was allowed to get compensation despite being a victim in his own vehicle, and, in the name of protection of the victims of traffic accidents provided by the MIDs, by analogy this right extended to the pedestrians, even though his vehicle was stolen.

Contemporary authors[21] emphasise that the protecting role of the MIDs is sometimes too wide, and thanks to their provisions, the

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18 CJEU, case C-537/03 *Katja Candolin et al. vs. Vahinkovakuutusosakeyhtiö Pohjola*, ECLI:EU:C:2005:417, para. 35.

19 *Mantrov*, A Victim of a Road Traffic Accident not Fastened by a Seat Belt and Contributory Negligence in the EU Motor Insurance Law, European Journal for Risk and Regulation, 1/2014, p. 117.

20 CJEU, case C-503/16 *Luís Isidro Delgado Mendes v Crédito Agrícola Seguros – Companhia de Seguros de Ramos Reais SA,* ECLI:EU:C:2017:681.

21 *Bevan*, A World Turned Upside Down, Journal of Personal Injury Law, no. 3, 2014, p. 136; *Marson/Ferris/Nicholson,* Irreconcilable differences? The Road Traffic Act and the

victims sometimes have right to compensation despite voluntarily entering into a dangerous situation (for example, driving with an intoxicated driver). Furthermore, owing to the protection measures provided by the MIDs and adopted in national legislation, there are situations when the victims can be indemnified even though they sustained the injuries while committing a crime. Such an example can be found in the recent British case *Delaney v Secretary of State for Transport*[22] in which the compensation of damage was admitted to a passenger who was injured in an uninsured vehicle with both driver and passenger, who were drug dealers, carrying a significant quantity of illegal substances in the vehicle.[23]

From these examples, it could be concluded that the MIDs set the framework for compulsory insurance against civil liability with respect to the use of motor vehicles and improved the protection of road traffic accident victims. Exception clauses are minimised and the concept of "third party" is widened. There are many other protecting measures provided by the MIDs, such as the protection of victims of non-insured or unknown vehicles, an increase in the minimum sums insured, facilitated procedure of reimbursement of victims in case of accidents suffered abroad, possibility of direct action against the insurer in the home country of the victim, and many others. The process of enhancement of EU-wide victim protection is still ongoing. The European Commission adopted a roadmap (Inception Impact Assessment) named: *Adaptation of the scope of Directive 2009/103/EC on motor insurance*[24] with the purpose of reviewing the provisions of the MIDs, solving the problems in interpretation that have been identified so far, and ensuring that the high level of protection for victims of motor vehicle accidents is upheld.

European Motor Vehicle Insurance Directives. The Journal of Business Law, 1, 2017, pp. 51-70; *Channon*, Does the EU and UK Correctly Balance the Interests of the Consumer and Third Party Victim in Motor Insurance*,* Motor Insurance Working Party (AIDA Europe Prize Winning Paper, 2016, http://www.aida.org.uk/AIDAEurop/AIDA-Europe-Scientific-Committee.asp (07/10/2017)).

22 *Delaney v Secretary of State for Transport*, (2015), 1 W.L.R. 5177, para. 33.

23 Critics of the decision *Delaney* see in: *Marson/Ferris*, Delaney and the Motor Vehicle Insurance Directives: lessons for the teaching of EU law*,* The Law Teacher 2016, p. 11.

24 The Roadmap is available at: http://ec.europa.eu/smart-regulation/roadmaps/docs/2016_fisma_030_motor_insurance_en.pdf (07/10/2017).

B. Compulsory Motor Liability Insurance in Bosnia and Herzegovina

The present political divisions and the structure of governments of Bosnia and Herzegovina are the result of the General Framework Agreement for Peace in Bosnia and Herzegovina signed in Paris on 14 December 1995, also known as the Dayton Agreement.[25] The Constitution of the country, that is a constituent part of the Dayton Agreement (Annex IV), prescribes the territorial division of the state into two entities: Federation of Bosnia and Herzegovina (FB&H) and Republic of Srpska (RS).[26] The legislative competence of the entities is presumed in the main areas of civil law,[27] and the responsibilities of the institutions of Bosnia and Herzegovina are limited to the matters exclusively set in the Constitution.[28]

Upon the signing of the Stabilisation and Association Agreement (SAA)[29] with European Community and its Member States in 2008, which entered into force in 2015, Bosnia and Herzegovina expressed a willingness to ensure that its existing laws and future legislation would be gradually made compatible with the Community *acquis,* meaning that existing and future legislation would be properly implemented and enforced.[30] Divergence and lack of harmonisation between the legislatures within the entities of Bosnia and Herzegovina make the function of the internal market more complicated and produce the interstate conflict of law[31] in almost all civil law matters that are within the competence of the two entities

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25 Annex 4 of Dayton Agreement.

26 During the Dayton negotiations, consent was not reached on the territory of the city of Brčko, so that District of Brčko became an autonomous administrative unit according to the Final Arbitration Decision of 5 March 1999.

27 *Jessel-Holst*, The Reform of Private International Law Acts in South East Europe, with Particular Regard to the West Balkan Region, Anali Pravnog fakulteta u Zenici, no. 18, year 9, p. 139.

28 Article III.1 of the Constitution of Bosnia and Herzegovina.

29 Full text of SAA is available at: https://europa.ba/wp-content/uploads/2008/06/SAA-EU-BiH-eur-lex.europa1.pdf (03/10/2017).

30 Article 70 of the SAA.

31 *Alihodžić/Altumbabić*, Interlokalni sukob zakona s obzirom na zakon o finansijskom poslovanju privrednih subjekata u Bosni i Hercegovini [...], Revija za pravo i ekonomiju, year 18, no. 1, 2017, p. 84.

and Brčko District.[32] In light of further accession to the EU and with the purpose of fulfilling the obligations stipulated by the SAA, it is deemed necessary to find a possible solution for resolving this conflict.[33]

Insurance is one of the civil law matters in which there is a lack of mutual harmonisation between the legislation of the entities, as well as a different approach of the entities' legislators towards harmonisation of the existing insurance law acts with the Community law. General provisions about civil liability, types of material and non-material damage as well as the provisions on contracts on insurance are prescribed in the ex-Yugoslav Code on Obligations that was adopted into the legal system of Bosnia and Herzegovina.[34] It is the main source of civil law on obligations, and it has remained almost unchanged since 1978.[35] The MTPL Insurance Laws, as *legis specialis* for the regulation of mandatory liability insurance in traffic, were enacted in the Federation of Bosnia and Herzegovina and the Republic of Srpska in 2005.[36] These laws contained very similar

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[32] Brčko District of Bosnia and Herzegovina has been formed as an autonomous administrative unit under the sovereignty of Bosnia and Herzegovina. Its main legal act is the Statute of Brčko District of Bosnia and Herzegovina (last version published in Official Gazette of Brčko District, 14/1/2010, No. 2/2010) and it regulates the internal organisation and division of powers in the District. The Orders of International Supervisor for Brčko District override all inconsistent legal acts. By the Supervisory Order of 4 August 2006 all the entity laws were abolished in the District, except the ones stated in the Annex of that Order.

[33] *Alihodžić,* Razvoj evropskog međunarodnog privatnog prava: pravci reforme zakonodavstva u Bosni i Hercegovini, 2012, p. 229.

[34] Code on Obligations, Official Gazette of Socialist Federative Republic of Yugoslavia, 30/3/1978, No. 29/78; 3/8/1985, No. 39/85; 10/7/1989, No. 45/89; and 7/10/1989, No. 57/89. In Federation of Bosnia and Herzegovina the integral text of the Code was published in Official Gazette, 11/4/1992, No. 2/92; 7/7/1993, No. 13/93; and 1/6/1994, No. 13/94, and in Republic of Srpska in Official Gazette of RS, 308/1993, No. 7/93; and 3/3/1996, No. 3/96.

[35] There were around twenty articles that were changed. For more about the Yugoslav Code on Obligations and its versions that are in force in Bosnia and Herzegovina see: *Bevanda*, Obveznopravno uređenje u Bosni i Hercegovini, Pravni fakultet Mostar, 2013, p. 117.

[36] The Law on Liability Insurance for Motor Vehicles and Other Provisions of Mandatory Liability Insurance of Federation of B&H, Official Gazette of FB&H, 6/4/2005, No. 24/05; The Law on Liability Insurance for Motor Vehicles and Other

provisions and a notable level of harmonisation with EU legislation in the field of compulsory insurance was achieved after they entered into force. About ten years after the enactment of these laws, in light of further development of EU-integration process, the additional steps towards harmonisation of law with the *acquis* have been taken. But the dynamism of laying down new legislation is not the same in both entities of Bosnia and Herzegovina. While the Republic of Srpska enacted the new MTPL Insurance Law in 2015,[37] the legislator of the Federation of B&H still does not have the revision of the 2005 law on its schedule.

Keeping in mind the theme of this paper, the differences between the MTPL insurance acts in FB&H and RS will be shown through examples of exclusion clauses and the notion of the "third party".

I. Exclusion Clauses in MTPL Insurance Acts of FB&H and RS

Mutual disharmony in the MTPL insurance acts of FB&H and RS that are presently in force, as well as their incompatibility with EU legislation, could be noticed through the example of the exclusion clauses. In FB&H there is only one exclusion from insurance cover under the MTPL insurance, meaning that the claimant has no right to compensation unless the insurer can prove that he suffered the damage in a vehicle that was stolen.[38] Considering the fact that MTPL Insurance Laws of FB&H and RS of 2005 have been adopted in accordance with the strategy of accession into the EU, the mentioned provision is, without a doubt, completely compatible with the provision of the Second MID that precludes the states from

Provisions of Mandatory Liability Insurance of Republic of Srpska, Official Gazette of RS, 16/2/2005, No. 17/05. Bussines operations and governance of the insurance companies in Brčko District are regulated by the law of the entity of their registration. If the companies have seat in Brčko District, they are free to choose the insurance regulating agency of an entity which they wish to register. Once they are registered, they fall under the supervision of that particular entity insurance agency (Order of Supervisory for Brčko District of 17 January 2008).

37 The Law of Mandatory Insurance in Traffic, Official Gazzete of RS, 17/9/2015, No. 82/15.

38 Article 8 of the MTPL Insurance Act of FB&H.

prescribing any exclusion from cover, apart from the mentioned "stolen vehicle" clause.[39]

However, the new MTPL Insurance Law of RS of 2015 contains more exclusions. It prescribes that the insurer is not obliged to pay compensation of damage to the passenger who voluntarily entered into a vehicle which caused the damage, if the vehicle was driven by an unauthorised driver, or a driver under the influence of alcohol or drugs, presuming that the insurer can prove that the passenger should have been aware of any of these circumstances.[40] This provision is contrary to the provisions of the Second MID, as well as the jurisprudence of the CJEU from the above mentioned cases of *Bernaldez*, *Churchill* and *Candolin*. Therefore, it can be assumed that the legislator of RS moved one step backwards in the matter of protection of the passengers as the victims of traffic accidents.

II. The "Third Party" in MTPL Insurance Acts of FB&H and RS

The MTPL Insurance Law of FB&H lays down the provision that, a contract on insurance covers liability of the possessor, owner or driver of the vehicle towards third persons in accordance with the provisions of the Code on Obligations.[41] The person whose liability is covered by the insurance cannot be considered as the third party. It means that, for example, the owner of the vehicle who suffered the injuries in an accident as a passenger in his own vehicle driven by another driver, has no right to compensation of damage.[42] Moreover, the MTPL Insurance Law of FB&H excludes the responsible person in

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39 Article 2 of the Second MID, or Article 13 of the Sixth (codified) MID.

40 Article 27 (2) of MTPL Insurance Act of RS.

41 Article 8 of MTPL Insurance Act of FB&H.

42 This provision has been applied in many court decisions in FB&H, as well as in RS when the MTPL Insurance Act of 2005 has been in force and had the same provision regarding the passenger as a third party (Article 7 para. 2 of MTPL Insurance Act of RS of 2005). By judgement of Cantonal Court in Livno (FB&H) No. 68 2 P 002944 13 Gž of 23 March 2014, the court rejected the lawsuit of the claimant that suffered serious injuries as a passenger in her own vehicle. The County Court of Banja Luka (RS) No. 71 0 P 079930 13 Gž 2, the lawsuit of the claimant who suffered injuries as a passenger in his own vehicle in a collision with another vehicle, has also been rejected because the claimant was not considered as the "third party" under the provisions of MTPL insurance act.

a legal entity (for example, the director of a company) from cover if the damage has been caused by a vehicle owned by that legal entity. The new MTPL Insurance Law of RS does not contain such exclusions either for the owners of vehicles or for responsible persons in legal entities.[43]

From the above it can be seen that the entity MTPL Insurance Laws regulate differently the matter of who is entitled to compensation of damage. Obviously, in this very important question one can find unequal treatment towards the victims of traffic accidents in Bosnia and Herzegovina. There are many other no less important differences between the provisions of MTPL Insurance Laws of FB&H and RS that directly affect the rights of victims of traffic accidents. For example, minimum sums insured are not equal on the whole territory of Bosnia and Herzegovina, nor is the regulation of the period in which the insurer is obliged to settle the compensation claims. There is also a problem of the compensation in cases of damage caused by uninsured or unknown vehicles. A detailed analysis of all of the differences between provisions of MTPL Insurance Acts of FB&H and RS deserves more comprehensive research that exceeds the boundaries of this paper.

C. Interstate Conflict of Law in MTPL Insurance in B&H

As a consequence of the intensive road traffic and increased number of vehicles in the last decades, there were numerous traffic accidents occurring across the whole state territory, involving the residents of both FB&H and RS, as well as foreign citizens and vehicles. The existence of two different law acts in the field of MTPL insurance in Bosnia and Herzegovina that are applicable for settlement of the claims, produce the interstate conflict of law. The legislators of both entities stipulated the provisions for interstate conflict of law in the Insurance Acts,[44] as the substantive legislative

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[43] *Hadžimahmutović*, Treća lica u Zakonu o osiguranju od odgovornosti za motorna vozila FBiH, Anali Pravnog fakulteta u Zenici, No. 17/2016, p. 158.

[44] Article 4 of the Insurance Act of RS (Official Gazette of RS, 16/2/2005, No. 17/05; 3/1/2006, No. 01/06; and 30/6/2006, No. 64/06), in the Federation of B&H there is a new legislative act that came into force in 2017, i.e. the Insurance Act (Official

acts containing the provisions about internal organisation of the insurance companies, the insurance supervision and some features of contract on insurance. The provisions that regulate the interstate conflict of law concerning the contract on insurance in these Acts were modelled according to the provisions of so-called Second Non-Life Insurance Directive.[45] The main criterion for determination of conflict of law rules is the place where the risk is situated, and for insurance of vehicles, the mentioned Directive prescribes that the risk is situated in the country where the vehicle is registered.[46] In Community law, the provisions of this Directive were replaced by the Rome I Regulation[47] in 2008.[48]

I. The Law of Contract on Insurance in MTPL Insurance Claims

If one supposes that the law of the place where the risk is situated is applicable to MTPL insurance claims with interstate conflict of law, it would mean that the law of FB&H is always applicable if the vehicle was registered and insured in FB&H and if the insured person (tortfeasor) is a resident of FB&H, irrespective of other connecting factors (place of accident, place of residence of the third party, etc.) The same rule would be applicable in RS as well. The law of the place of registration of vehicle, i.e. the law of the territorial unit where the contract on insurance was concluded, is suitable for the regulation of

Gazette of FB&H, 29/3/2017, No. 23/17), and conflict of law rules are set in Article 215. The provisions in both Acts are the same.

45 Full term is: Second Council Directive 88/357/EEC on the coordination of laws, regulations and administrative provisions relating to direct insurance other than life assurance and laying down provisions to facilitate the effective exercise of freedom to provide services and amending Directive 73/239/EEC, OJ L 228 of 16/08/1973, pp. 3-19.

46 Article 2 of the Second Non-Life Directive OJ L 172 of 04/07/1988, pp. 1-2.

47 Article 7 and 23 of Regulation (EC) No 593/2008 on the law applicable to contractual obligations (Rome I), OJ L 177 of 4/7/2008, pp. 6-16.

48 More about conflict of law rules for insurance contract in Rome I Regulation see in: *Behr*, Rome I Regulation – a Mostly-Unified Private International Law of Contractual Relationships Within Most of the EU, Journal of Law and Commerce, vol. 29:233, p. 248, *Ferrari/Leible*, Rome I Regulation: the Law Applicable to Contractual Obligations in Europe, 2009, p. 110 et seq.; *Merrett*, Choice of Law in Insurance Contracts under the Rome I Regulation, Journal of Private International Law, 2009, pp. 49-67.; *Heiss,* Insurance Contracts in Rome I Regulation, Yearbook of PIL, Vol. 10, 2008, p. 279.

the relationship between the insurer and policyholder, and it is not the most appropriate law for regulation of legal relations between the MTPL insurer and the third party. The obligation between the third party and MTPL insurer is non-contractual in nature, because the relationship between them is established upon submitting a claim for compensation of damage suffered in a tortuous act, and therefore interstate conflict of law rules for insurance contracts are not applicable. Although no interstate conflict of law rules for the non-contractual obligations have been enacted so far, there is a legal gap that must be filled in the future.

II. Application of the Rules Contained in ex-Yugoslav Code on Obligations by Analogy

Since it is not possible to rely on the solutions provided for in the Insurance Acts of FB&H and RS, consideration might be given to whether it is appropriate to rely, by analogy, on the provisions of the interstate conflict of law of the Code on Obligations.[49] These provisions were applicable for settlement of internal conflict of law between six Socialist Republics and two Autonomous Regions of the former Socialist Federative Republic of Yugoslavia.[50] But, the territorial application of this rule is limited exclusively to the area of Brčko District because there the Code on Obligations from ex-Yugoslavia (in an unchanged version) is still in force.[51] In FB&H and RS it could be applicable only by analogy because these provisions were deleted in the versions of ex-Yugoslav Code on Obligations that are currently in force in these two entities. Comparing the provisions for interstate conflict of law regarding the non-contractual obligations[52]

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[49] *Meškić/Duraković/Alihodžić*, Bosnien und Herzegowina als ein Mehrrechtsstaat, accepted for publishing in IPRax 2018.

[50] Article 1099-1105 of the Code on Obligations.

[51] Code on Obligations of year 1978 was adopted in legislature of Federation of B&H by Regulation on takeover of the Code on Obligations (Official Gazette of Republic of Bosnia and Herzegovina, 11/4/1992, No. 2/92). In Republic of Srpska the Code on Obligations is in force according to the Article 12 of the Constitutional Law on Implementation of the Constitution of RS (Official Gazette of RS, 31/12/1992, No. 21/92). In Brčko District the version of the Code from former Yugoslavia remained unchanged.

[52] Article 1102 of the Code on Obligations of 1978.

with the ones contained in the private international law act in force,[53] one can notice that they are very similar. Both prescribe the alternative application of law of the place where the tort was committed or the law of the place where the consequences occurred. Application of *lex loci delicti commissi* in MTPL insurance cases with interstate conflict of law would surely lead to a fairer solution than the application of the law of the place of registration of the tortfeasor's vehicle, especially if there is a foreign element in the case, i.e. when the claimant is a foreign citizen or a vehicle with foreign registration plates was damaged. The deficiency of this solution is that it neglects the other connecting factors, such as the residence of the participants.

III. Rome II Regulation as a Possible Model

Since the obligation between the claimant and tortfeasor, as well as the claimant and tortfeasor's MTPL insurer is non-contractual, there is a need to introduce a special rule for the obligations that include more than one territorial unit in Bosnia and Herzegovina. In view of the duties undertaken by the SAA, and considering the fact that conflict of law rules for interstate conflict of law regarding the insurance contract were regulated following the model of EU legislation, it seems that the most appropriate solution for future regulation of the interstate conflict of law regarding non-contractual obligations between the claimant and MTPL insurer, would be the model of the Rome II Regulation.[54] The general rule of *lex loci damni* would ensure a fair balance between the parties in the case of an interstate conflict of law.[55] The exceptional rule *lex loci habitationis*

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[53] Article 28 of the Law on Settlement of Conflicts of the Law with the Laws of Other Countries in Certain Relations, Official Gazette of SFRY, 15/7/1982, No. 43/1982; Gazette of Republic of B&H 11/4/1992, No. 2/92-5; 1/6/1994, No. 13/94-189.

[54] Regulation (EC) No 864/2007 on the law applicable to non-contractual obligations (Rome II), OJ L 199 of 31/7/2007, pp. 40-49.

[55] Regarding the traffic accidents, the country in which damage occurs is almost always the place of collision. It has been stressed in the EC Proposal for a Regulation of the European Parliament and the Council on the law Applicable to Non-Contractual Obligations (Rome II), COM (2003) 427 Final, 5. The CJEU interpreted the notion of "country in which the damage occurs" in case C-350/14, *Lazar v Allianz*, ECLI:EU:C:2015:802, para. 25. , as a country of the occurrence of the road accident.

communis, meaning the law of the territorial unit of habitual residence of the parties, would reflect legitimate expectations. Finally, the escape clause that applies the law of the territorial unit that is manifestly more closely connected with the tort would also attempt to achieve justice in individual cases.[56]

D. Conclusion

Protection for the victims of traffic accidents has progressed in the EU thanks to the measures introduced by the Motor Third Party Insurance Directives. The number of exclusion clauses decreased and the notion of the "third party" has been widened. Due to the existence of two different laws on MTPL insurance in Bosnia and Herzegovina, the exception clauses and notion of "third party" are differently regulated. Discrepancies in these laws and their incompatibility with EU law produce the interstate conflict of law in the matter of mandatory vehicle insurance, and consequently, unequal treatment of the victims occurs. The complexity of the legal system in Bosnia and Herzegovina limits the process of harmonisation of legislation with EU *acquis* in the domain of private international law. However, before the completion of this process, for the purpose of equitable treatment of the victims of traffic accidents, as well as for greater legal certainty, the entity legislators should consider the provisions of the Rome II Regulation as a model for the drafting of the future regulation of interstate conflict of law in the field of MTPL insurance.

[56] Detailed analysis of the provisions of Rome II Regulation, its background and relationship with other choice-of-law instruments see in: *Papettas*, The Law Applicable to Cross Border Road Traffic Accidents, 2013, pp. 38-133. Application of Rome II Regulation in claims arising from traffic accidents see in: *von Hein*, Article 4 and Traffic Accidents, in: Binchy/Ahern (eds.), The Rome II Regulation on the Law Applicable to Noncontractual Obligations: A New International Litigation Regime, 2009, p. 155.

Indemnity for Non-Material Damage Due to Negative Environmental Impact of Industrial and Adjacent Facilities: The Serbian Case and ECtHR Case Law

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Abstract

The issue of indemnity for environmental damage is regulated in accordance with the general principles of civil law, i.e. the premise that a person who causes damage has the obligation to redress it. In the matter of indemnity for environmental damage, the general rules of civil law are insufficient for environmental protection as environmental damage is an institute of both public and private law. Therefore, it is necessary to establish a special legal regime that addresses its complex nature. Firstly, the author analyses the legal nature of environmental damage. Secondly, to answer questions such as: "can a person request the award of non-material damage which arises as a result of damage to the environment", "under which circumstances is non-material damage awarded" and "which criteria determine its level", special attention is paid to the analysis of ECtHR case law and the practice of Serbian courts, along with the implementation of the Environmental Liability Directive.

A. Introduction

New standards in environmental protection, numerous cases of environmental accidents, irresponsible disposal of hazardous waste, unfinished legislation for certain aspects of environmental protection, illegal trafficking of hazardous waste with unforeseeable consequences for the life and health of people and the state of the environment, have opened many questions regarding the liability for environmental damage. We identify the following basic questions: whose responsibility is the damage caused; is there a specific model of indemnity for damage to the environment, or do the legal protection mechanisms of civil and public law apply; who is considered to be the polluter: a person who directly violates the state

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of the environment and/or any person whose activities generate emissions and immissions into the environment that exceed the limit values; what does redressing the damage include: solely the damage, or, loss of profit, remediation costs, the costs for activities aiming to prevent environmental damage and non-material damage for mental anguish; what are the possible applications of the "polluter pays" principle: i.e. whether investing in clean technology may be considered as one of them.

The need for a special legal regime regarding indemnity for environmental damage at the EU level emerged in the late 1970s in the context of regulating waste management and liability for product quality. [1] Certain issues regarding indemnity for environmental damage are regulated by the Regulation on air carrier liability in the event of accidents. [2] These cases, however, only regulate certain aspects of damage indemnity relating either to the indemnity for the damage suffered by a person or indemnity for the actual damage. They also do not regulate general standards of indemnity for environmental damage, rather they apply only to certain situations. [3]

A few months after the environmental accident in Chernobyl, Europe suffered one of the largest environmental accidents. There was a spillage of toxic chemicals, stored by the company *Sandoz*, into the Rhine River near Basel. [4] This environmental accident, which occurred on 1 November 1986, caused water pollution to such an extent that for weeks there was a visible red toxic trail 70 km long. The river was polluted in four countries, throughout the flow. The entire fish population in the Rhine River was destroyed, as well as

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1 Directive 85/374/EEC on the approximation of the laws, regulations and administrative provisions of the Member States concerning liability for defective products, OJ L 210 of 07/08/1985, pp. 29-33.

2 Regulation (EC) No. 2027/97 on air carrier liability in respect of the carriage of passengers and their baggage by air, replaced by Regulation (EC) No. 889/2002 amending Council Regulation (EC) No. 2027/97 on air carrier liability in the event of accidents, OJ L 140 of 30/5/2002, pp. 2-5.

3 *Krämer*, EU Environmental Law, 2012, p. 173.

4 *Lucas*, "The Baia Mare and Baia Borsa Accidents: Cases of Severe Transboundary Water Pollution", Environmental Policy and Law, 2/2001, pp. 106-111. *Westra*, Environmental Justice and the Rights of Unborn and Future Generations, 2012, Chapter 7.

flora and fauna inhabiting the shores of the Rhine. As a result of this accident, a criminal procedure was initiated against the authorities of the company, which raised a question of indemnity. Indemnity claims, submitted by Switzerland, Germany, France and the Netherlands were resolved by settlement, therefore, on this occasion, jurisprudence did not formulate any standpoints that would apply in future cases of indemnity for environmental damage.

Without a general principle at the EU level regarding the indemnity for environmental damage, this case encouraged the European Commission to submit a proposal for future policy addressing this issue with the established guidelines of its regulation.[5] This proposal emphasised that the issue of indemnity for environmental damage was to be regulated in accordance with the general principles of civil law, i.e. a premise that a person who causes damage has the obligation to redress it. In the matter of the indemnity for environmental damage, the general rules of civil law are insufficient for environmental protection; therefore it is necessary to establish a special legal regime that addresses its complex nature.[6] In this regard, the issue should be addressed with respect to two ecological principles: the "polluter pays" principle and the prevention principle. The "polluter pays" principle applies for the purpose of determining the indemnity payable by the persons liable for the actions that led to the damage, but also the responsibility of public authorities. This principle is also important in the process of formulating specific rules on the operator's liability for the environmental damage. The prevention principle should apply in such a manner that, by clearly stating the obligation of taking remediation measures in the case of environmental accident and remediation indemnity, potential pollutants are informed that investing in damage prevention is more favourable than the remediation indemnity in the case of an accident.[7]

After scrutinising this proposal, the European Parliament formulated an opinion on the future legal framework. The first

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5 Green Paper on Remedying Environmental Damage, COM/1993/47/Final.

6 *Ibid.,* pp. 4-5.

7 *Wilde*, Civil Liability for Environmental Damage: A Comparative Analysis of Law and Policy in Europe and the United States, 2002, p. 178.

proposal of the Directive was brought in 2002, and the Directive 2004/35/E3 of the European Council and European Parliament on the liability for environmental damage was adopted in 2004.[8]

B. Classification of Environmental Damage

The application of the "polluter pays" principle corresponds to the polluter's damage liability in both a narrow and a broad sense. The indemnity in a broad sense represents indemnity for the whole damage caused by a release of hazardous substances into the environment. Liability for damages occurs when a person's activities cause or may cause disturbance to the environment, and also when an operator in the manufacturing process uses raw materials containing substances harmful to the environment.[9] The indemnity in a narrow sense includes the obligation to only indemnify the damage caused to the environment and causing disturbance to the environment and negative effects on the state and quality of the environment, with regard to the Directive 2004/35/EC.[10] Both the indemnity in a narrow and broad sense include the costs of environmental damage assessment, assessment of the damage that may occur in the environment, alternative measures and administrative costs of their execution, the cost of data collection, the costs of monitoring and control of preventive measures and remediation measures. [11]

The following questions arise: can a person request awarding non-material damage which arose as a result of damage to the

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8 Directive 2004/35/EC on environmental liability with regard to the prevention and remedying of environmental damage, OJ L 143 of 30/4/2004, pp. 56-75.

9 Law on Environmental Protection, Official Gazette RS, No. 135/04; 36/09; 14/16, Article 9(1)6. *Knetsch*, "Environmental Valuation: Some Problems of Wrong Questions and Misleading Answers." Environmental Values 3, no. 4, (1994), pp. 351-368. *Rutherford et al.,* Assessing environmental losses: Judgments of importance and damage schedules, HELR 1998/22, pp. 51-101.

10 *Drenovak-Ivanovic*, "Odgovornost za štetu u životnoj sredini: uporedni modeli i pravci noveliranja zakonodavstva Srbije", Pravni život, 2014, pp. 450-464; *Drenovak-Ivanović et al.*, Pravni instrumenti ekološke zaštite – građanskopravna i krivičnopravna zaštita, 2015, pp. 1-59; See: Article 2(1), Directive 2004/35/EC.

11 Article 2(16), Directive 2004/35/EC.

environment and, in that case, under which circumstances is non-material damage awarded? Finally, which criteria determine its level? In order to explore the potential approaches one should review reasons presented by comparative case law.

I. Non-material Damage Due to Negative Environmental Impact and ECtHR

In comparative law, we find cases in which non-material damages were awarded for mental anguish that could be a consequence of emissions into the environment. In the practice of the ECtHR we find *Öneryýldýz v. Turkey*, which contains the views demonstrating the elements of non-material damage as a consequence of environmental pollution.[12]

The case was initiated in response to the petition in which the applicant complained about the violation of the right to life under Article 2 of the European Convention on Human Rights stating that nine members of his family were killed in an explosion at an illegal waste landfill. The landfill stored waste from four districts of Istanbul. The applicant lived near this landfill in an illegally built object. When the landfill began to be used, no one had lived in the area, and the nearest settlements were located about three and a half kilometres away. An illegal settlement gradually sprouted around the landfill and subsequently turned into a poor district, Ümraniye. The competent authorities of the local government requested that the District Court appoint a commission to determine whether the landfill met the technical requirements. The Commission drew up a report stating that the landfill did not meet the technical requirements and that "it exposes humans, animals and the environment to all kinds of risks."[13]

Before the explosion, the Inspection Service prepared a report in which it indicated that the landfill did not meet the conditions prescribed by the Environmental law, that disintegration of waste releases flammable and explosive gases which can lead to accidents, and that measures should be taken for their prevention. After the adoption of the report, the competent administrative authority in

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12 ECtHR, no. 48939/99, *Öneryýldýz v. Turkey*, judgement of 30/11/2004.

13 *Ibid.*; See: *Drenovak-Ivanovic*, Ekološko pravo EU*,* 2017, pp. 62-66.

Istanbul filed a lawsuit demanding the ban of further waste dumping. Before the procedure was completed, the explosion occurred. The applicant initiated proceedings in which he sought indemnity for the death of family members, which established a direct link between the negligence of the competent administrative authorities and the adverse event. Revisiting the case regarding the complaint, the ECtHR sought to establish whether national courts, when deciding on this case, took into account the standards of protection of fundamental human rights enshrined in the Convention. The ECtHR held that the competent authorities were aware or should have been aware that there had been a direct and real risk to life of people who live near the landfill and had an obligation to implement emergency prevention measures, which derive from the provisions of the Environmental law in Turkey.

In this case, the ECtHR held that the competent administrative authorities did not provide information for the residents near the landfill to understand the danger, which violated the right to being informed. When it comes to engaging in such hazardous activities, the availability of clear and complete information to the public is considered a basic human right.[14] It is stressed in the decision that even if the country respected the right to information, it would still be accountable. Taking into account the violations made, the ECtHR stated that the measures of redress should include material and non-material indemnity.[15]

The ECtHR in this case held that the indemnity for non-material damage ordered by the Administrative Court of Turkey was not appropriate bearing in mind that it is awarded only for mental suffering due to death of family members. The ECtHR held that in determining the amount of non-material damage, "very specific circumstances of this case" should be taken into account in order to achieve full redress for non-material damage inflicted. The specific circumstances of this case refers to concealing the danger of damage, which resulted in a harmful event.[16]

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14 ECtHR, no. 48939/99, *Öneryýldýz v. Turkey*, judgement of 30/11/2004, para. 62.

15 *Ibid.,* para. 147.

16 *Ibid.,* para. 171.

In the case of *Budayeva and others v. Russia* the ECtHR decided on an application in which the applicants argued they had had no redress, in particular they had not received adequate compensation in respect of their material and non-material damage.[17] The ECtHR was asked whether the Russian government had failed to fulfil the obligation to protect the right to life under Article 2 of the European Convention on Human Rights in the case concerning events in 2000 when a mudslide led to a catastrophe in the Russian town of Tyrnauz. The ECtHR found that the Russian government breached Article 2 as the authorities omitted to implement land-planning and emergency relief policies despite the fact that the area of Tyrnauz was particularly vulnerable to mudslides, which led to exposing the residents to risk. Reviewing the decision on non-material damage, the ECtHR stated that "considerations of urgency and efficiency may lead the authorities to give priority to other general and individual measures, such as providing emergency assistance and allotting benefits to all victims irrespective of the actual losses", which could open a door for future policy on non-material environmental damage.[18]

II. Non-Material Damage Due to Negative Environmental Impact in Serbia

The analysis of case law in Serbia regarding non-material damage caused by environmental pollution aims to point to the basic issues which, in this distinctive domain, are the subject of the court's decision on the merits, and to the basic problems which applicants of damage claims and the courts encounter in these cases.

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[17] ECtHR, nos. 15339/02, 21166/02, 20058/02, 11673/02 and 15343/02, *Budayeva and Others v. Russia*, judgment of 20/3/2008, paras. 116, 178.

[18] *Budayeva and Others v. Russia*, para. 178. In case *Tătar v. Romania*, ECtHR, no. 67021/01, the ECtHR concluded that the Romanian authorities had failed in their duty to assess, to a satisfactory degree, the risks that the company's activity might entail, and to take suitable measures in order to protect the rights of those concerned to respect for their private lives and homes, within the meaning of Article 8, and more generally their right to enjoy a healthy and protected environment. The ECtHR did not consider the special position of non-material environmental damage.

Law on Contracts and Torts in Serbia distinguishes simple loss, profit lost and non-material damage.[19] While simple loss relates to the impairment of one's property, profit lost represents the damage caused by preventing its increase. A non-material damage is a form of judicial satisfaction for physical pain, mental anguish due to reduction of life activities, disfigurement, injury to reputation, honour, freedom or rights of personality, death of a close person, as well as for fear suffered. A court may award non-material damages after finding that the circumstances of the case and particularly the intensity of pains and fear and their duration provide a corresponding ground thereof.[20] The indemnity for non-material damage is independent of indemnity for property damage, which means that it may be granted alongside the property damage or without it. In deciding on the request for redressing non-material damage, as well as on the amount of such damages, the court shall take into account "the significance of the value violated, and the purpose to be achieved by such redress, but also that it does not favour ends otherwise incompatible with its nature and social purpose."[21] Non-material damages can only be awarded when there is proof of mental anguish suffered (subjective conception of non-material damage) and not for the mere damage to personality rights.

Indemnity for damage to the environment is regulated by special acts in comparative law.[22] In Serbian law, the general provision on indemnity for damage is provided by the Law on environmental protection and the draft Law on environmental liability, transposing Environmental Liability Directive (2004/35/EC), is in the preparation stages. According to the Serbian National programme for the adoption of the EU *acquis*, the Law on environmental liability should

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19 Law on Contracts and Torts, Official Gazette SFRY, No. 29/78; No. 39/85; No. 45/89 – decision of the Constitutional Court of Yugoslavia; and No. 57/89; Official Gazette Gazette SFRY, No. 31/93; and Official Gazette, Serbia and Montenegro, No. 1/2003.

20 The Law on Contract and Torts, Article 200, para. 1.

21 *Ibid.*

22 For example, Comprehensive Environmental Response, Compensation, and Liability Act, (1980) 42 U.S.C; Directive on environmental liability with regard to the prevention and remedying of environmental damage, OJ L 143 of 30/04/2004, pp. 56-75. Drenovak-Ivanovic, *Drenovak-Ivanovic*, "Odgovornost za štetu u životnoj sredini: uporedni modeli i pravci noveliranja zakonodavstva Srbije", *op. cit*. pp. 450-464.

be adopted by the end of 2018.[23] Although several claims have been submitted, there are no cases in the legal practice of Serbia, which have resulted in the award of non-material damage caused by environmental pollution.

1. Proceedings before a Basic Court on a Claim for Non-material Damage Sustained due to Environmental Pollution in Serbia

The first action for indemnity of non-material damage sustained due to environmental pollution in Serbia was filed by the plaintiff for indemnity of non-material damage sustained due to fear for her life and lives of her children, with a submission dated 3 April 2008.[24] As a basis for the claim the plaintiff alleged that the defendant released an enormous amount of strong, unpleasant smell in the air during the night of 23 October 2005 and for three following nights. Consequently, even though the windows were closed, the plaintiff could not breathe. The incident occurred again in the evening of 5 July 2006. After this incident, the plaintiff reported to the doctor for the first time on 14 July 2006 because she experienced a headache and nausea, which occurred as a result of intense odour in her apartment. The plaintiff alleged that on that occasion, bearing in mind that the identical situation occurred months earlier, she felt anxiety and fear. She reported to the doctor on 16 November 2006 and 8 February 2007 for the same symptoms.

The first instance court found that, in the period of 24 to 27 October 2005, the plaintiff experienced "post-traumatic stress syndrome, with fear of medium intensity, which turned into anxiety as a reaction of adjustment due to possible reappearance of air pollution, because she was not informed whether there were changes in the defendants."[25]

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[23] *European Integration Office*, National programme for the adoption of the EU acquis, 2014, pp. 744-745. *Drenovak-Ivanovic*, Environmental Law in Serbia, in: Burleson/Robinson/Heng Lye (eds.), Comparative Environmental Law and Regulation, 2015, pp. 111-124.

[24] Judgment of the Basic Court in Pancevo, 1 P.591/2012 of 23/01/2013, paras. 1-6.

[25] *Ibid.*

The first instance court ordered the technical and technological expertise. It was found that a certain level of benzene and ammonia can cause symptoms alleged by the plaintiff, but that their concentration in the critical period did not exceed the odour threshold level. The value of other gases in the air is not prescribed by the Rule Book on limit values, immission measuring methods, selection of sample spots criteria and data collecting. The first instance court reached the conclusion that there was no causal link between the presence of these substances in the air and vegetative symptoms that caused fear in the plaintiff, and therefore there was no causal link between the activities of the defendants who emitted these substances into the atmosphere and the mentioned symptoms. This court stressed that the sustained fear cannot be the legal basis for the award of non-material damage due to the lack of necessary causality, and, in addition, it follows from the psychiatric expertise and established facts that the fear had no independence of property, but rather that the periodic time intervals and their duration excused compensation, taking into account all the circumstances of the case.[26]

The first instance court appreciated the merits of the plaintiff's claim from the standpoint of the right to life, the right to liberty of movement and freedom to choose one's residence, the right to a healthy environment, and the right to respect for private and family life. The first instance court found that none of these rights were violated.

2. Proceedings before the Higher Court

After the plaintiff's claim, the Higher Court upheld the judgment. This Court analysed the grounds of the right to life, the right to liberty of movement and freedom to choose one's residence, and the right to respect for private and family life under Article 2 and Article 8 of the European Convention on Human Rights and the relevant articles of the Constitution of the Republic of Serbia.[27]

The Higher Court held that the conducted procedure did not establish a deterioration of plaintiff's health to the extent that it could

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[26] *Ibid.*

[27] Constitution of the Republic of Serbia, Official Gazette, No. 98/06, Articles 24 and 39.

endanger her life, or that she was deprived of the movement and the performance of any major life activities that would suggest that there was violation of the right to freedom of movement. Regarding the right to peaceful and family life, the Higher Court held that there are no elements which indicate "disruption of a larger degree" in the plaintiff's family life before and after the subject incident, explaining that "as already disclosed and taking into account the activities of the defendants, the subject events were of short duration and lack continuity, and that is a requirement for an unlawful conduct of any person to be considered violation of described rights of persons sustaining damage."[28]

Commenting on the analysis of violations of the right to a healthy environment the Higher Court alleged that the plaintiff, like any other citizen, has the right to a healthy environment, pursuant to provision 74 of the Constitution of the Republic of Serbia. The Higher Court further addressed the issue of weighing the interests of performing industrial activities, which are of importance for the development of society, whose products, among others, are polluting emissions, and the interests of each individual to live in the environment without pollutants and harmful substances. The Higher Court held that this issue must be resolved in accordance with the Law of Contract and Torts, (Article 156 para. 3), which stipulates that if the activity was undertaken in the interest of the general public, and otherwise permitted by a competent agency, the only recovery to be demanded shall concern loss exceeding normal limits. It further states that "the damage arising from these activities that does not exceed normal limits must be tolerated". [29]

This raises further questions: what is considered to be normal limits and excessive damage? Since the concept of normal limits and excessive damage is a part of legal standards and not defined by law, "but determined in accordance with the circumstances of each individual case,"[30], the case law plays a key role in setting the criteria that will contribute to equal treatment in future cases.

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[28] Judgment of the Higher Court in Pancevo, 1-GŽ. No. 886/13 of 24/12/2013, para. 5.

[29] *Ibid.*

[30] *Ibid.*

The judgement also points out the shortcomings of the current system of measurement, which allows excessive air pollution for limited periods of time in which case the polluter is not responsible for overruns. The current system of measurement averages the results of measuring, causing the time periods in which there is no pollution, or slight pollution, to neutralise the periods in which there is a higher concentration of contamination. This also means that the court cannot raise the issue of indemnity of non-material damage caused by environmental pollution, despite the exceeded emissions in certain intervals, as long as the average value of emissions is in accordance with the prescribed standards. [31] The system of measurement averaging the results of measuring should be improved by the changes of the Law on integrated pollution prevention and control which is a part of transposition of new Industrial Emission Directive 2010/75/EU into Serbian environmental law. [32]

C. Conclusion

It is possible to grasp the foundation of claims for non-material damage as a consequence of concealing or providing false information about the quantities of lead in water, food and land filed by citizens of a mining settlement, later diagnosed with the pathological presence of lead in the tissue resulting in disease. The basis of damages in this particular case would be not only the citizens' disease, but also concealing the danger of damage or giving false information on the quantities of lead (damaging act by act or omission), which subsequently leads to the damage. For the purpose of further analysis, we address several examples of ECtHR practice

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[31] *Ibid.*; The Higher Court came to the conclusion that during the relevant period the limit values of suspended particles and soot were exceeded, but their overspending cannot be linked to the production and technological processes of the defendants, "because those substances by their nature are not characteristic of the type of technology they use, since they can also be found in traffic and domestic furnaces emissions".

[32] The methodology for full transposition of this directive and examination of legal instruments should be defined by the end of 2018. *European Integration Office*, National programme for the adoption of the EU acquis, 2014, pp. 770, 801.

and judicial practice in Serbia containing the viewpoint of non-material damage as a consequence of environmental pollution.

The analysis of the jurisprudence of Serbia shows that awarding indemnity for non-material damage for mental anguish sustained due to the negative environmental impact of industrial and adjacent facilities requires the proof of causality between pollutant's activities and the occurrence of specific damage, as well as causality between the presence of pollutants and ailments of the applicant for non-material damage, that should be of such a nature as to produce mental anguish.

In accordance with the positive law of Serbia, exercisers of activities, which are in the interest of the general public, for which they have permission from the competent authority, shall provide indemnity only in cases when the damage exceeds normal limits. Although the indemnity for non-material damages, under the general provisions of the Law on Contract and Torts, is independent of property damage, the analysed example demonstrates the Court's standpoint that the non-material damages for mental anguish sustained due to the negative environmental impact of industrial and adjacent facilities may be granted only if the determined material damage exceeds "normal limits". Moreover, emissions must be of such intensity as to cause continuous distress. According to the Court's standpoint, periodic emissions, even if they exceed the limit values at certain time intervals, provide no grounds for indemnity for non-material damage. The Law on environmental liability, transposing Environmental Liability Directive (2004/35/EC), and the new Law on integrated pollution prevention and control, transposing Industrial Emission Directive (2010/75/EU), should be adopted by the end of 2018. It would establish criteria for determination on terms such as "normal limits", and the relation between periodic and continuous emissions, and exceeded emissions in certain intervals and the average value of emissions is in accordance with the prescribed standards.

The Necessity of Reforming the UN Administrative Apparatus

Ivana Kristić and Bojan Milisavljević[*]

Abstract

The United Nations represents one of the most important international organisations of a universal character and celebrated its 72nd anniversary in the face of numerous modern-day challenges. One of these is the need to reform main bodies of the organisation. In recent years, the reform of the administrative apparatus in particular has been discussed, but this issue has been present for a long time. In this paper, the authors discuss the reform of the administrative apparatus, which is justified by new challenges and roles that demand radical changes of the rules, structure, system, and culture in order to ensure the highest level of diligence, expertise, and efficiency of international officials.

The authors argue that this reform cannot be achieved without a strong Secretary General, who has a vision and the capability to initiate and implement the reform. Therefore, the authors particularly emphasise a transparent election of the head of the UN administration, who must possess managerial capabilities and execute the position of the chief executive officer. The authors point out that the election of the Secretary General should reflect the geographical criteria, but not at the expense of quality, that election criteria should be defined more clearly, that gender equality should be observed, that the length of the mandate and cancellation of the possibility of re-election should be considered. The authors conclude that with the support of the Secretary General the administrative apparatus can be more efficient and operational.

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A. Introduction

Today's international community rests on the operations of a large number of international organisations. Their activities have a special role in the application of international law, and the officials of international organisations have an especially prominent place in this context. Since the United Nations (UN) is considered the most significant international organisation with considerable competences, the analysis of the role and position of its officials carries significant weight. The administration of this organisation has a great responsibility, starting from the very top – the Secretary-General, and extending all the way down the hierarchy to a number of various employees, officials and experts. These persons are specialised in conducting important activities on behalf of the UN and whose actions are attributed to this organisation.

There is no doubt that international organisations, especially the UN, are subject to international law, which is also reflected in decisions passed by the International Court of Justice (ICJ). In that sense, the Advisory Opinion on the interpretation of the Agreement concludes that international organisations, as subjects of the international law, are bound by rules stemming from the general rules of international law, their own constitutive instruments or international agreements to which they are parties.[1] As such, they are in the horizontally positioned order of international law, and protected in respect to other subjects through immunity. States have immunity in terms of immunity before national courts of other countries (jurisdictional immunity)[2], and official state representatives enjoy immunity in their operations.[3] For these reasons, certain authors feel that international organisations, including their employees, should enjoy absolute immunity, both *de jure* and *de*

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1 ICJ, Interpretation of the Agreement of 25 March 1951 between the WHO and Egypt, Advisory Opinion of 1980, para. 37.

2 *Milisavljevic*, State immunity in international law – a review of the work of the International Law Commission, Journal of criminalistics and law, 2014, pp. 21-33.

3 See Preliminary report on immunity of State officials from foreign criminal jurisdiction, *Kolodkin*, Special Rapporteur, International Law Commission, sixtieth session, 2008, pp. 161-192. *Cassese*, When may senior state officials be tried for international crimes? Some comments on the Congo v. Belgium Case, European Journal of International Law (EJIL), vol. 13, no. 4, 2002, pp. 853-875.

facto.[4] On the other hand, it has become customary in practice to accept a functional scope of privileges and immunity, meaning the immunity for officials covering only actions or deeds performed or carried out in the official capacity.

This paper analyses the concept of officials of the UN, their legal position, types, and it also offers specific solutions for the organisational reform of the administrative apparatus of the UN. Reform of the administration is especially important because a new Secretary-General has recently been elected (October 2016) and this election of António Guterres was marked with the request for a more transparent election process, in order to select someone capable of significantly reforming the administration of the organisation and improving its efficiency, professionalism and overall quality. Since this organisation is relied upon to preserve the entire system of international law, its administration must be constantly adjusted and perfected in the organisational sense, in order to be able to respond to new challenges. Therefore, this paper discusses the need to strengthen the administrative apparatus, and does not examine the need to reform the Security Council and other UN organs, despite the major role of this principle organ in electing the Secretary-General.[5]

B. The Concept of the UN Officials

It could be said that the concept of international officials is similar to the concept of citizens in terms of their rights, except that organisations do not have their own citizens. Also, the officials owe loyalty to the UN, which can be compared to obligations stemming from citizenship. In that sense, the possibility of the UN giving diplomatic protection to its officials has been considered (the same as the right of a country to offer the same protection to its citizens), such

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[4] For more on absolute immunity see *Reinisch*, International Courts before National Courts, 2000, p. 249; *Ryngaert*, The Immunity of International Organizations Before National Courts: Recent Trends, International Organizations Law Review, 7, 2010, p. 129.

[5] For the Security Council Reform see Global Policy Forum, Background on Security Council Reform, https://www.globalpolicy.org/security-council/security-council-reform/49885.html?itemid=1321 (15/09/2017).

as in the case of Advisory opinion of 1949 on reparation for injuries suffered in the service of the UN.[6]

It was established early on that officials must be loyal to an international organisation and perform their duties objectively without anyone's influence, including the influence of the country of their citizenship. This is especially important when, at times, an agent has to act against the interests of the country of his/her own citizenship. On the other hand, Member States undertake not to exert influence over the UN officials in the performance of their duties. Due to the specific legal position, each definition of an agent of international organisation insists on their loyalty to the organisation. An international agent is therefore defined as: "A person entrusted by several countries, or a body acting on their behalf, based on international agreement under their supervision, to continuously and exclusively performs functions to the mutual benefit of these countries, in accordance with specific legal rules."[7] In addition to orthodox definitions of international agent, is the one given by the ICJ in its Advisory opinion of 1949: "The Court understands the word 'agent' in the most liberal sense, that is to say, any person who, whether a paid official or not, and whether permanently employed or not, has been charged by an organ of the Organization with carrying out, or helping to carry out, one of its functions-in short, any person through whom it acts."[8] It seems proper that the concept of administration of international organisations implies only persons acting in the name and on behalf of international organisations. Under the old doctrine, administration of organisations also included state representatives.[9] Despite being clear that state representatives in international organisations cannot be considered representatives

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6 Reparation for Injuries Suffered in the Service of the United Nations, ICJ Reports, Advisory Opinion of 11 April 1949, pp. 174-190.

7 *Basdevant*, Les fonctionnaieres internationaux, in: Akehurst (ed.), The Law Governing Employment in International Organizations, 1967, p. 53.

8 ICJ, Reparation for Injuries Suffered in the Service of the United Nations, Advisory Opinion of 1949, p. 177.

9 Gersic states: "International administration implies actions performed by members of the international community within the boundaries of international law, and for the purpose of a comprehensive fulfillment of own needs and duties." See *Gersic*, Current diplomatic and consular law, 1898, pp. 14-15.

of international organisations, the Convention on the Privileges and Immunities of the UN of 1946 causes a bit of confusion.[10] This was done to ensure their efficient protection, but it remains clear that state representatives cannot be considered as persons representing the UN. On the other hand, there is a clear influence of diplomatic privileges and immunities which refer and apply to international officials, with certain modifications and adjustments.

Further, since international officials act in the name and on behalf of organisations, then all acts are attributed to the organisation.[11] All cases are subject to general rules on attribution of acts to the states, but with certain modifications necessary for the international organisations.[12] These modifications are presented in the 2011 Draft Rules on the Liability of International Organizations, which deals with, inter alia, specificities related to international organisations and their relationship with the Member States in terms of potential liability both on the international and internal level. Also, attribution is applied when state bodies act in the name of an international organisation or under its control.[13]

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[10] Article 4 of the Convention on Privileges and Immunities of the United Nations.

[11] For a detailed analysis see *Fry*, Attribution of Responsibility, SHARES Research Paper, 2014, pp. 98-133.

[12] For a detailed analysis see *Boyle*, State Responsibility and International Liability for Injurious Consequences of Acts not Prohibited by International Law: A Necessary Distinction?, International and Comparative Law Quarterly, vol. 39, 1/1990, pp. 1-26; *Crawford*, The International Law Commission's Articles on State Responsibility 2002, pp. 963-991. *Dupuy*, The International Law of States Responsibility: Revolution or Evolution, Michigan Journal of International Law 1989-1990, pp. 105-128; *Garcia-Amador*, State Responsibility in the Light of the New Trends of International Law, American Journal of International Law, vol. 49, 3/1955339-346. *Hessbruegge*, The Historical Development of the Doctrines of Attribution and Due Diligence in International Law, New York University Journal of International Law and Politics 2003-2004, pp. 265-306. *Milisavljevic*, Attribution as a condition of the state responsibility in international law, Journal of the Faculty of Law, Belgrade University, no. 2/2012, pp. 185-207.

[13] Article 7 of the Draft provides: "Acts by a state body or a representative body of international organization placed at the disposal of another international organization shall be considered, in terms of international law, as an act of the organization to whose disposal these are placed, provided that this organization carries out effective control over such acts."

Over time, international administrative law emerged as a separate discipline, covering the area dealing with rules that govern the work and legal position of administration. Even Lorenz von Stein noticed the development of this discipline and concluded that "it is a group of legal rules partially based on international sources and partially on national sources, engaged in administrative activity in international law as a whole."[14]

There is a cumbersome administrative apparatus within the UN, which follows the activities of this organisation and serves all bodies of the organisation in their respective operations. The number of staff in the UN Secretariat started to increase rapidly, from 350 to 3,000 between April and September 1945 only.[15] Today, this number is even higher, with over 40,000 employees who perform various duties for the organisation.[16] The UN staff is quite heterogeneous due to various entrusted functions, but certain commonalities can be drawn in terms of their legal position and hierarchy.

C. Organisation of the Secretariat of the UN

The UN Charter does not contain many provisions dealing with administration, except Article 7, which establishes the Secretariat as one of the principle bodies of the organisation, and Article 97, which states that the Secretariat comprises the Secretary-General, as a chief administrative officer, and such staff as the organisation may require. Officials of the UN are divided into two groups.[17] At the top of the hierarchy of the Secretariat of the UN is the Secretary-General, deputies and assistants. In terms of the legal status, they are all equal in privileges and immunities as diplomats. The first group also comprises judges of the ICJ and commanders of the UN Peacekeeping Forces. The second group is lower staff, whose number is much higher. In terms of lower staff, they are limited to functional privileges

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14 *Vogel,* Administrative Law: International Aspects, in: Bernhardt (ed.), Encyclopedia of Public International Law, 1992, p. 23.

15 *Lengyel*, Some trends in international civil service, International Organization, vol. 13, no. 4, 1959, p. 521.

16 See https://careers.un.org/lbw/home.aspx?viewtype=VD (15/09/2017).

17 *Michaels*, International Privileges and Immunities, 1971, p. 160.

and immunities, and are often hired from among citizens of the host country. A special category of the UN staff are experts who perform specific type of work for the UN, which comprises members of the International Law Commission, members of advisory bodies, military observers and peacekeeping mission staff.[18] All staff members, both high- and low-ranking, enjoy privileges and immunities on the territory of all countries, including the country of their respective citizenship.[19]

The Secretariat is divided into offices and departments. For the purpose of elections of persons to the Secretariat, in addition to undisputable expertise, equal geographical representation is also a requirement.[20] The concept of having different nationalities in the Secretariat stems from the universal character of the organisation and the need to ensure participation of a wide circle of nations.[21] According to the data, only fifteen nations are not represented in the Secretariat, most of them being micro-nations.[22]

Over time, the Secretariat established new departments, and in the time of Boutros Boutros-Ghali, departments of political affairs, peacekeeping and humanitarian operations were established.[23] Today, the Secretariat comprises the following offices: Executive Office of the Secretary-General, Office of Internal Oversight Services, Office of Legal Affairs, Office for Disarmament Affairs, Office for the Coordination of Humanitarian Affairs, Office of the UN High Commissioner for Human Rights, High Commissioner for Refugees, Office on Drugs and Crime, UN Office of the High Representative for the Least Developed Countries, Landlocked Developing Countries and Small Island Developing States, Office for Outer Space Affairs.

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18 General Assembly Resolution, A/Res/54/695, 24 December 1999.

19 ICJ, Applicability of Article VI, Section 22, of the Convention on the Privileges and Immunities of the United Nations, Advisory Opinion, of 1989, paras. 40-52.

20 Article 4 of the Staff Rules and Regulations of the United States.

21 *Meron*, Staff of the United Nations Secretariat: Problems and Directions, American Journal of International Law, vol. 70, no. 4, 1976, p. 661.

22 Report of Secretary-General, Composition of the Secretariat: Staff demographics, A/68/356-47/137.

23 UN Doc., A/46/882, 21 February 1992.

I. Secretary-General of the UN

The Secretary-General is the chief executive of the UN with a prominent role and significance. On the one hand, his role is representative because he represents the entire international organisation of the UN, and on the other, he holds prominent diplomatic functions and administrative competences. His significance is also supported by the fact that he elects the entire staff of the UN, but in accordance with the rules laid down by the General Assembly.[24] Also, the Secretary-General decides on the privileges and immunities of the UN officials in terms of transgressions in their operations.[25] The Security Council decides in cases of disputes related to the privileges and immunity of the Secretary-General.[26] One of the prominent functions of the Secretary-General is that of a depository.[27] Administrative functions of the Secretary-General are manifested in the position of the highest officer of the Secretariat in terms of hierarchy, while political functions are mostly determined by the UN Charter, and in part by individual practice exercised by each Secretary-General.[28] Administrative functions also include the competence to convene special session of the General Assembly, prepare meetings and sessions of other bodies, prepare a draft budget of the organisation, record and publish contracts, the public presentation of the UN, as well as acceptance of credentials of representatives of Member States. As one of the special political functions that have evolved through the practice of the UN is the preventive diplomacy of the Secretary-General.[29] In that sense, the

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24 Article 101 of the UN Charter.

25 *Munch*, Wrongdoing of International Civil Servants – Referral of Cases of National Authorities for Criminal Prosecution, Max Planck Yearbook of United Nation Law, vol. 10, 2006, p. 82.

26 Article 20 of the Convention on the Privileges and Immunities of the United Nations.

27 *Milisavljevic*, Depositor of multilateral agreements, Pravni život, no. 12/2012, p. 306.

28 Article 98 of the UN Charter provides: "The Secretary-General shall act in that capacity in all meetings of the General Assembly, of the Security Council, of the Economic and Social Council, and of the Trusteeship Council, and shall perform such other functions as are entrusted to him by these organs. The Secretary-General shall make an annual report to the General Assembly on the work of the Organization."

29 *Milisavljevic*, Preventive diplomacy and prevention of conflicts within the UN system, Pravni život, no. 12 of 2004, pp. 441-455.

number of special representative appointed by the Secretary-General has increased, and in 2007, this number was 96.[30]

Activities and competences of the Secretary-General are so vast that it would not be reasonable to expect for one person to execute them properly.[31] For that reason exactly, all competences entrusted to the Secretary-General are carried out through an entire civil service apparatus. However, certain Secretary-Generals leave a strong personal mark in particular areas, and the functioning of the entire UN administrative apparatus is dependent upon their skills and motivation.[32]

1. The Election and Role of the Secretary-General

The procedure for the election of the Secretary-General involves two main bodies of the UN: the General Assembly and the Security Council.[33] The Charter itself contains but a few provisions, which refer to the Secretary-General, such as Article 97, which stipulates that he/she is elected by the General Assembly by proposal of the Security Council. Even though this may be interpreted as the General Assembly playing a major role in the election of the Secretary-General, in practice its role entails only formal appointment. The largest influence in the election of the Secretary-General is with the Security Council i.e. the five permanent members of this body. This is evident in the fact that the permanent members of the Security Council have a special place in the voting procedure for the Secretary-General, particularly in the fact that no person can be elected with an expressed opposition from one of those members.

However, at the time of the establishment of the UN, the role of the General Assembly was not limited in this way. This was especially

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30 *Frolich/Lemanski*, Mapping UN Presence: A follow-up to the Human Security Report, 2006, p. 20.

31 *Chesterman,* The Secretary General We Deserve?, Global Governance: A review of Multilateralism and International Organizations, vol. 21, no. 4, 2015, p. 505.

32 Ban Ki-Moon was particularly engaged in remedying the consequences of climate change; See *Pazstor,* The Role of United Nations Secretary-General in the Climate Change Process, Global Policy, vol. 7, no. 3, 2016, p. 450.

33 According to Article 97 of the Charter, the General Assembly elects the Secretary-General at the proposal of the Security Council.

evident in 1950 when, due to very specific circumstances caused by the attack of North Korea on South Korea, the General Assembly extended the term of office to the Secretary-General Trygve Lie, without the recommendation from the Security Council because the USSR was opposed.[34] His term of office was extended by three years with 46 votes in favour, 5 against and 8 abstentions. Still, after these events, up until 1996, the General Assembly has had a very passive role in the election of the Secretary General.

a) Election Procedure

Article 101 of the Charter provides that the Secretary-General appoints the staff in accordance with the rules adopted by the General Assembly, ensuring the highest level of efficiency, competence and integrity and on as wide a geographical basis as possible. The Charter does not regulate the length of the mandate nor the circumstances, which may lead to his or her removal from office. As early as 1946, the General Assembly laid down the basic rules of the election procedure of the Secretary-General, and these rules are still the basis for election.[35] To avoid any unnecessary debate and divisions in the General Assembly, the Resolution 11 (I) recommends that the Security Council only propose one candidate for this position. The Resolution also stipulates that the election and appointment will be carried in a closed session, as well as by secret ballot.[36] Still, in its long practice, the General Assembly has been appointing the Secretary-General in open sessions.[37] On the other hand, the Security Council prepares draft resolutions through informal consultations, after which it holds a formal meeting behind

[34] See 1 for 7 Billion for the best UN Secretary, The First Sec-Gen was elected, not appointed, 1 February 2016, http://www.1for7billion.org/news/2016/2/1/appointment-of-first-sec-gen-set-a-precedent-for-a-more-inclusive-process (15/09/2017).

[35] Resolution 11 (I) (A/RES/1/11), Terms of Appointment of the Secretary-General, 24 January 1946.

[36] The secret ballot was introduced in the Rules of Procedure of the Security Council (Rule 141), as well as in Provisional Rules of Procedure of the Security Council (Rule 48).

[37] Security Council Report, Appointing the UN Secretary-General, Research Report, no. 2, 16 October 2015, p. 2.

closed doors to adopt the resolution by acclamation.[38] For that reason, in 1996 the General Assembly Working Group on the Strengthening of the UN System pointed out the need for a greater transparency in the election for the highest positions in specialised UN agencies, demanding greater transparency in the election of the Secretary-General.[39] In 2006, the General Assembly recognised that it is necessary to ensure a greater transparency in the election of the Secretary-General,[40] and in 2015, it resolved to take active steps towards remedying this situation.[41]

In 1996, the Working Group pointed out that it is necessary to ensure a more active role of the General Assembly in the election of the Secretary-General, by having the General Assembly draft a short list of potential candidates to be passed to the Security Council for deliberation, along with the establishment of rules on regional rotation, which is one of the main conditions for the election of other bodies of the organisation. It was also proposed to further discuss the possibility of establishing a joint committee of the General Assembly and the Security Council, to seek adequate candidates for this position, which would enable an active approach to identify potentially viable candidates with necessary qualities for the execution of this function.[42] For that reason, in 2006 the General Assembly envisaged a more significant role for the President of the General Assembly in the process of electing the first administration executive. Consultations with Member States were also proposed, for the purpose of identifying adequate candidates, of which all State members would be informed, and only after that the list would be sent to the Security Council, leaving adequate time and room for the

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38 *Ibid.,* p. 3.

39 Report of the Open-ended High-level Working Group on the Strengthening of the United Nation System, General Assembly, Supplement no. 24 (A/50/24), 1996, p. 19. The need for greater transparency was later adopted in the General Assembly Resolution, A/Res/51/241, 22 August 1997, para. 56.

40 General Assembly Resolution, A/Res/60/286, Revitalization of the General Assembly 9 October 2006, para. 18.

41 General Assembly Resolution, A/Res/69/321, 22 September 2015, paras. 29, 34, 42.

42 Report of the Open-ended High-level Working Group on the Strengthening of the United Nation System, General Assembly, Supplement no. 24 (A/50/24), 1996, p. 19.

formal presentation to state members.[43] However, it is clear from the UN Charter that the General Assembly can neither appoint the Secretary-General without the recommendation from the Security Council (except in crisis situations) nor elect a candidate who was not listed in the said recommendation.[44] But in 1945, it was recommended that the Security Council should propose only one candidate to the General Assembly, which means that the discussion and selection is carried out in the main body of the UN, with leading roles for the permanent members of the Security Council.[45] The reasons probably relate to the intention to prevent electing a Secretary-General by a narrow majority, which would weaken his/her mandate.

b) Election Criteria

One of the main issues pertains to the qualifications that a Secretary-General should hold in order to be elected to this position. Article 97 of the UN Charter regulates this issue, so in practice the

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43 General Assembly Resolution, A/Res/60/286, Revitalization of the General Assembly, 9 October 2006, paras. 19, 20. This conclusion was also stipulated in the General Assembly Resolution, A/Res/65/71, Joint Investigation Evaluation Unit, Selection and conditions of service of Executive Heads in the United Nations system organizations, 8 April 2010, pp. 11-13.

44 Security Council Report, Appointing the UN Secretary-General, Research Report, no. 2, 16 October 2015, p. 2.

45 United Nations Preparatory Commission, PC/20, section B, paras. 12, 15-6, 19, 23 December 1945, http://repository.un.org/handle/11176/248329 (15/09/2017). See, for example, Security Council Resolution, S/RES/1090 on the recommendation for the appointment of the Secretary-General of the United Nations, 13 December 1996. It would be interesting to mention that in 1976 in the case of the second term of office of the Secretary-General Kurt Waldheim, China issued a veto and then withdrew it. But in 1981, when he wanted to run for the third term, China vetoed his re-election 15 times, after which Havier Pérez de Cuéllar appeared as a new candidate, who was re-elected for the second term in 1986 without a veto. Still, the most famous case of a negative vote of a permanent member of the Security Council was during the re-election of Boutros Boutros-Ghali in 1996, when Kofi Annan was elected because the USA vetoed his re-election, after which all other members vetoed the election of other candidates. For more information, see Security Council Report, Appointing UN Secretary-General, Research report, October 2015, pp. 3-4.

conditions are clear, and they refer to both the qualitative conditions and the issue of whether geographical conditions should affect the election of the Secretary-General.

In terms of election criteria, these were already identified in 1945 and refer to the following qualifications: administrative and executive qualities necessary for integrating the activities of all UN bodies; leadership capacity; a skill to select and create a team spirit with staff coming from all over the globe; moral qualities that enable independence in the work of the bodies; mediation capabilities; political judgement of the highest degree possible and ability to point to each situation that may be a threat to peace and security; communication and representation skills that enable a person to represent the UN and all peoples; qualities that show that the candidate "embodies the principles and ideals of the Charter to which the Organization seeks to give effect", as well as the capacity to act as an informal or confidential advisor to world governments.[46] In 2006, the General Assembly emphasised that the candidate must possess certain qualities, inter alia, "commitment to the purposes and principles of the Charter of the UN, extensive leadership, and administrative and diplomatic experience".[47] It is evident that requirements are broadly set and leave room for a wide discretionary assessment, insisting upon leadership and political capabilities.

In the beginning, regional rotation was a factor in the election of the Secretary-General. It was invoked in 1981 during the election of Havier Pérez de Cuéllar, when delegates from Latin America insisted that it was their candidate's turn to be elected.[48] This principle was clearly articulated for the first time in 1997, when the General Assembly concluded that in addition to identifying the best possible candidate for this position, the principle of geographic rotation should also be considered, as well as the principle of gender

46 United Nations Preparatory Commission, PC/20.

47 General Assembly Resolution, A/Res/60/286, Revitalization of the General Assembly, 9 October 2006, para. 22.

48 Security Council Report, Appointing UN Secretary-General, Research report, October 2015, p. 5. So far, most of the Secretaries-General came from Western Europe (6 terms), Asia (4 terms), Africa (3 terms) and Latin America (2 terms).

equality,[49] which was later confirmed by the Resolution of the General Assembly in 2006.[50]

2. Length of Term of Office

One of the issues not regulated by the UN Charter is the length of term of office of the Secretary-General. Despite the fact that a 3-year term was proposed in San Francisco, it was considered that a 5-year term was optimal to enable proper and independent functioning of the organisation's administrative apparatus.[51] For that reason, in Resolution 11(I) the General Assembly passed a decision that the term lasts for 5 years, with a possibility of re-election. Still, the Resolution left the possibility to the General Assembly and the Security Council to re-evaluate the length of term of office and the possibility of future re-election, based on the exhibited experience. In practice, this rule was subject to change with Secretary-General Trygve Lie being re-elected in 1950 for a period of 3 years,[52] and U Thant being elected in 1962 for a period of 4 years.[53] In practice, the length of term of office was mostly determined by resolutions of the Security Council, starting from 1976, but the General Assembly was always able to reconsider the length of term.[54] Several decades following the 1946 resolution, the Working Group for strengthening of the UN General Assembly proposed a review of this rule, as well as

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49 General Assembly Resolution, A/Res/51/241, 22 August 1997, para. 59.

50 General Assembly Resolution, A/Res/60/286, Revitalization of the General Assembly, 9 October 2006, para. 18.

51 *Taubenfeld*, The Secretary General of the United Nations, Jag Journal, vol. 17, 1963, p. 61.

52 General Assembly Resolution, A/RES/492 (V), Continuation in Office of the Secretary-General of the United Nations, 1 November 1950.

53 *Coleman*, U Thant's Appointment as Secretary General of the United Nations, Research History in Peace, http://historyinpieces.com/research/u-thant-confirmation-as-secretary-general-of-the-united-nations#fn-10749-fn3 (15/09/2017).

54 Security Council Report, Appointing UN Secretary-General, Research report, October 2015, p. 4.

the setting up a mechanism for a mid-term review of the success of work of the Secretary-General.[55]

3. Termination of Office

As far as the termination of office, it seems that there are two possible scenarios – voluntary dismissal and death, but in the practice, a total boycott by one of the permanent members of the Security Council or refusal of the General Assembly to cooperate with the Secretary-General may result in the termination of office.[56] In practice, there was only one instance of the termination of office due to plane crash and untimely death of the second Secretary-General Dag Hammarskjöld.

II. Officers of the UN

In the narrow sense, officers are permanent employees of the Secretariat, officers of the Economic and Social Council, UN Trusteeship Council, assistants to the Secretary-General, specialised staff serving as consultants to the Secretariat, Technical assistance experts, but also persons appointed by the General Assembly. In the wider sense, officers of the UN include experts, officers of specialised agencies, experts in specialised agencies, military observers, and officers in the UN Missions, judges and tribunal staff members.

Regardless of the category of officers, it is necessary to emphasise that all of them owe exclusive loyalty to the international organisation. This is evident in the Staff Regulations for the Registry of the ICJ, which states: "Officers of the court are international officers. Their responsibility as court officers is not national but solely international."[57] To ensure loyalty of the officers, there are regulations that complete the requests for loyalty. For example, the Secretary-General's Bulletin stipulates that an officer whose personal interests are in conflict with his or her obligations and responsibilities,

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55 Report of the Open-ended High-level Working Group on the Strengthening of the United Nation System, General Assembly, Supplement no. 24 (A/50/24), 1996, p. 19.

56 *Ibid.*

57 Annex II, Section A, of the Staff Regulations of the ICJ, for the Registry Regulation.

integrity, independence and neutrality, must inform his or her superior, even in case of a potential conflict of interest.[58] It further states that: "They shall conduct themselves at all times in a manner befitting their status as international civil servants and shall not engage in any activity that is incompatible with the proper discharge of their duties with the UN. They shall avoid any action and, in particular, any kind of public pronouncement that may adversely reflect on their status, or on the integrity, independence and impartiality that are required by that status."[59]

In terms of the legal status of the UN officers, it should be said that this is a private – legal relationship between employee and employer. In 2008, the UN adopted a new system of service contracts, which include fixed-term contracts, contracts for an indefinite time, and temporary service contracts.[60] To facilitate the resolution of disputes between employees and the organisation, there is a mechanism known as the UN Dispute Tribunal, formerly the Administrative Court.[61] The Dispute Tribunal became active in 2009 and continued to resolve disputes initiated before the Administrative court. The Dispute Tribunal is the first instance, while the Appellate Tribunal is the second-instance body.

D. The Need for Reform of the UN Administration

The idea of reform of the UN management is not recent. Departments were reorganised and restructured with each new Secretary-General. After the Millennium + 5 Summit held in 2005,[62] when it was emphasised that it is necessary to ensure an efficient, effective and responsible Secretariat, advocates for the reform were

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58 United Nations Staff Rules and Staff Regulations of the UN Secretary-General's Bulletin, ST/SGB/2014/1, 2014, p. 1.

59 *Ibid.*, p. 9.

60 General Assembly Resolution on the report of the Fifth Committee A/Res/63/639, 24 December 2008.

61 The UN Dispute Tribunal was established by General Assembly Resolution, A/RES/62/228, 6 February 2008.

62 Millennium+5 Summit Outcome Document, Secretariat and Management Reform, 15 September 2005, available at https://www.globalpolicy.org/component/content/article/228/32450.html (15/09/2017).

particularly heard.[63] After the Summit, the first result of the underlined need for reform was the establishment of the Ethics Office in 2006, aimed at ensuring the highest standard of integrity of the UN officers, in accordance with Article 101, para. 3 of the Charter, which calls for the highest standards of diligence, expertise and integrity of the international staff. The Ethics Office was formed in order to promote ethical organisational culture, based on common values of integrity, responsibility, transparency and respect. It helps the Secretary-General in a way that enables all staff members to perform their duties in accordance with the highest standards of integrity and receive answers to various questions related to ethics, as well as to seek protection from retribution for reporting prohibited behaviour.[64]

Although significant, this reform of the UN Secretariat was not sufficient. The USA especially advocated that the Secretary-General should also be the Chief Executive Officer, who should lead the organisation in accordance with the rules of business.[65] In March of 2006, the then Secretary-General Kofi Anan published a report on the subject "Investing in the United Nations".[66] The report states that today the UN is significantly different from what it was at the time of its establishment, and that new challenges and new roles demand radical changes in the administrative apparatus – its rules, structure, system, and culture.[67] It especially points to the significance of the selection of officers because the system does not always reflect the selection of the best candidates, while at the same time due to the lack of financial means, even when the best candidates are selected, there isn't much room for career development.[68] For those reasons, proactive, targeted, and fast employment practice was proposed,

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63 See, for example, *Lederer,* Annan to Improve UN Accountability, Associated Press, 31 January 2005, https://www.globalpolicy.org/component/content/article/228/32513.html (15/09/2017).

64 More about the Ethics Office at http://www.un.org/en/ethics/ (6/11/2016).

65 *Müller*, Reforming the United Nations: The Struggle for Legitimacy and Effectiveness, 2006, p. 68.

66 See UN General Assembly, Report of the Secretary General, Investigating in the United Nations: for a stronger Organization worldwide, A/60/692, 7/03/2006.

67 *Ibid*., p. 1.

68 *Ibid*., p. 2.

allowing staff mobility, which should be set as the basis for career promotion, as well as support staff training to allow better planning and career development.

The report contained proposals for far-reaching reforms, related primarily to the development of information and communication technologies, financing of the Secretariat, as well as the role of the Secretary-General in budget planning without consultations with the General Assembly. However, there was a concern that the motivation behind such a proposal was not based on the need to improve the efficiency of the organisation, but to increase American control and weaken the organisation.[69] The USA has often been accused of exerting influence on the work of the administrative apparatus. This was a resounding argument when Cherif Bassiouni, famous professor of international law, acting as an independent expert of the Commission on Human Rights published a report in which he accused American armed forces of torture of prisoners in Afghanistan, after which he was informed that his mandate had expired.[70] The need for reform of the UN administration is necessary because the organisation must meet numerous modern-day challenges. Still, this reform cannot be implemented without electing the right person with true vision as the head of the UN administration. For that reason, for a long time now, the focus is on the election of the UN Secretary-General, and in 2016 during elections of the new UN Secretary-General the focus was placed on the need for greater transparency and consultations with candidates.

E. The Last Election of the Secretary-General

Bearing in mind all previous discussions and the emphasis on the need to start the election process on time, the General Assembly and the Security Council began the election process of the new Secretary-

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69 *Hoge*, Secret Meeting, Clear Mission, 'Rescue' UN, New York Times, 2 January 2005, https://www.globalpolicy.org/component/content/article/150/32631.html (1/09/2017).

70 UN General Assembly, Note by the Secretary General, Report of the independent expert of the Commission on Human, Rights on the situation of human rights in Afghanistan, A/59/370, 21 September 2004; *Hoge*, Lawyer who Told of US Human Rights Abuses, New York Times, 30 April 2005, https://www.globalpolicy.org/component/content/article/228/32514.html (15/09/2017).

General in 2015, since Ban Ki Moon's term of office expired on 31 December 2016. Unlike previous elections, numerous organisations asked for greater transparency of the process and the assessment of particular skills, bearing in mind that the organisation is facing many challenges, such as spreading conflicts, increased threats to security, and humanitarian crisis.[71] In September 2015, the General Assembly passed a resolution requesting the Assembly President and the Security Council to initiate the election process by sending a joint letter to all Member States with a description of the election process, and provide regular updates on the names of the candidates being considered, as well as their biographies and other supporting documents.[72]

The President of the General Assembly was asked to support this process, so the President of the 70th Session of the UN General Assembly asked for transparency of this process,[73] and invited Member States to present their candidates who possess the following qualities: proven leadership and managerial abilities, extensive experience in international relations, as well as strong diplomatic, communication and multilingual skills.[74] Transparency was especially demanded in ensuring informal consultations and meetings with candidates, to allow them to present their visions for the future of the organisation and the role of the Secretary-General.[75] It was pointed out that a candidate from Eastern Europe had never been elected as

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[71] See Security Council Report, Special Search Report, Appointment of a new Secretary-General, 16 February 2016, http://www.securitycouncilreport.org/atf/cf/%7B65BFCF9B-6D27-4E9C-8CD3-CF6E4FF96FF9%7D/Research%20Report_SG%20Appointment%2016%20Feb%2006.pdf (15/09/2017); Security Council Report, Appointing UN Secretary-General, Research report, October 2015, p. 1.

[72] General Assembly Resolution, A/Res/69/321, Revitalization of the Work of the General Assembly, 22 September 2015, paras. 35-36.

[73] The issue of transparency was repeated on 7539 meeting of the Security Council SC/12088, 20 October 2015. Discussion summary, http://www.un.org/press/en/2015/sc12088.doc.htm (15/09/2017).

[74] *Rowlands*, President of UN General Assembly Continues Push for Openness, Transparency, Inter Press Service, 29 July 2016, http://www.ipsnews.net/2016/07/president-of-un-general-assembly-continues-push-for-openness-transparency/ (15/09/2017).

[75] General Assembly Resolution, A/Res/69/321, Revitalization of the Work of the General Assembly, 22 September 2015, para. 42.

the chief of the UN administration, which is why a consensus was reached that a candidate should be from that region. Still, it was insisted that regional rotation should not be at the expense of fulfillment of conditions sought in the candidate, which are "the highest standards of efficiency, competence and integrity and [...] a firm commitment to the purposes and principles of the United Nations", as well as "proven leadership and managerial abilities, extensive experience in international relations and strong diplomatic, communication and multilingual skills."[76]

Countries were particularly encouraged to present female candidates for the purpose of establishing gender equality in the organisation.[77] Before the last elections, only three female candidates were nominated to the position of the Secretary-General, and with significant time-gaps - 1953, 1991 and 2006.[78] However, in 2016, 6 out of 12 candidates were women, and especially prominent candidates were Irina Bokova, Bulgarian politician and Director-General of UNESCO, Susana Malcorra, Minister of Foreign Affairs of Argentina, as well as Helen Clark, former Prime Minister of New Zealand.[79]

The election process started on time and in April 2016, the first informal consultations were carried out.[80] The list of candidates was shortened through the practice of "straw polls", established in 1991, whereby red votes are reserved for the permanent members of the Security Council, and white for all other members, as well as the practice established in 2006 whereby members of the Security Council are given three options: "encouragement", "discouragement" and "no opinion".[81] By application of this electoral process, there were

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76 *Ibid*., para. 39.

77 *Ibid*., para. 38.

78 For more information, see Security Council Report, Appointing UN Secretary-General, Research report, October 2015, p. 6.

79 Female candidates were Susana Malcorra, Irina Bokova, Helen Clark, Natalia Gherman, Christiana Figueres, Vesna Pusić. Male candidates were: António Guterres, Vuk Jeremić, Miroslav Lajčák, Danilo Türk, Srgjan Kerim and Igor Lukšić.

80 First informal dialogue was held 12-14 April 2016, when candidates were invited to present their 10-minute statements.

81 Security Council Report, Appointing UN Secretary-General, Research report, October 2015, p. 3.

six straw polls.[82] The last, sixth straw poll, was held on 5 October 2016 when António Guterres, former Prime Minister of Portugal and UN Refugee Commissioner received 13 'encourage' votes, 2 abstentions and no 'discourage' votes. On the following day, the Security Council recommended his election to the General Assembly, and on 13 October 2016, the General Assembly elected him by acclamation.[83]

F. Concluding Remarks

One of the main criticisms of the reform proposed in 2005 was the lack of vision of the Secretary-General. A question was raised as to whether this role should be that of a secretary to the Security Council, especially of its permanent members, or whether his or her competences should be strengthened so as to resemble the president of the World Bank or European Commission.[84] The latter attitude prevailed, which imposes the need for a stricter, but also a more transparent process of election of the chief of the UN administration. Whether the vision of creating an efficient UN administrative apparatus, capable of responding to today's challenges, will be realised, rests on the choice of the Secretary-General and his or her deputy.

It was already mentioned that various bodies of the UN, civil society, and experts have pointed to the need of a more transparent election of the Secretary-General, which especially came to the fore in the 2016 elections. The proposal to begin the electoral process on time was also honoured, which meant it was already clear on 6 October 2016 that António Guterres would be at the helm of the UN administrative apparatus, which provides him with enough time to adequately prepare for this function. Despite the fact that in

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[82] First Straw Poll – 21 July 2016, second Straw Poll – 5 August 2016, third Straw Poll – 29 August 2016, fourth Straw Poll – 9 September 2016, fifth Straw Poll – 26 September 2016.

[83] UN News Centre, António Guterres appointed next UN Secretary-General by acclamation, http://www.un.org/apps/news/story.asp?NewsID=55285#.WDsDzX2NzIV (15/09/2017).

[84] Financial Express, Time to Look beyond Mere Administrative Reforms, 26 April 2005, https://www.globalpolicy.org/component/content/article/226/32294.html (15/09/2017).

numerous cases the election process was completed in December, the last few elections were carried out at an earlier time, especially in cases of re-election,[85] and as such the beginning of October is considered good timing for the election of a new Secretary-General. This is also important because it allows time to properly introduce the Secretary-General to his new duties and to maintain the continuity in the work of this body.

Despite this success, certain issues have not been clarified and it will be necessary in the coming years to focus attention on their proper clarification. Firstly, the issue of regional rotation was not fully honoured. Even though this is not, nor should it be, the main criterion for the selection of the Secretary-General, geographical criteria represents one of the main principles of election to UN bodies and emphasises the need for adequate representation of all legal systems and nations in the organisation. It can be rightly said that Guterres is not a true representative of the Eastern European nations, which have never had a chief of administration, in addition to the fact that there were other quality candidates who better represent this region. Also, after 70 years of the existence of the organisation, the advantage should have been given to a female candidate, especially keeping in mind the qualifications of the six female candidates in these elections.

Despite the fact that over time the General Assembly has attained a more active role in the selection of candidates, it seems that this role should be strengthened further in the future. To that end, in order to identify quality candidates, the Working Group should carry out the main part of the work and actively participate in the search for candidates who have the capacity, knowledge, and skills to be at the helm of the organisation. The selection criteria should be more clearly defined so as to reflect the need for development of skills that are necessary to lead the organisation through modern-day challenges. In addition to adequate leadership and negotiation skills and capacities, the Secretary-General should have the knowledge pertaining to various areas, such as human rights, terrorism, climate change, etc. The role of the General Assembly in the election of the

[85] For example, in 2001, Kofi Annan was re-elected on 27 June, and Ban Ki-Moon was re-elected on 17 June 2011. Security Council Report, Appointing UN Secretary-General, Research report, October 2015, p. 5.

Secretary-General should also be improved. The election process, through the use of the "straw poll" procedure, has its significant advantages in that it allows a permanent member in the Security Council to change its mind – from veto to acceptance under the influence of the majority – giving elections a more democratic note.

However, what still remains completely unclear is the length of the term of office of the Secretary-General. The fundamental question that arises in relation to the length of term of office is the possibility of re-election. In 1996, the Working Group proposed that the mandate should last seven years, without the possibility of re-election, or for the initial mandate to last four years, with the possibility to extend it for another three years. The General Assembly had accepted to deliberate on this issue before the election of the next Secretary-General, however this issue has not been officially opened.[86] The first option seems better, and this practice was adopted in the European Court of Human Rights, where the mandate of judges was extended to 9 years, without the possibility of re-election.[87] The other option may leave room for doubt in the independence of work of the organisation, bearing in mind the privileges and reputation embedded in the function of the Secretary-General, so this issue is also one deserving attention in the years to come.

[86] General Assembly Resolution A/Res/51/241, 22 August 1997, para. 58.

[87] See Article 23 of the Protocol No. 14 to the European Convention on Human Rights, Council of Europe Treaty Series no. 194, 13/05/2004.

European and International Influence in Shaping Veil-Piercing in Albanian Company Law

Jonida Rystemaj[*]

Abstract

The path towards the European Union has nurtured almost all legislative reforms undertaken in Albania in the last 15 years. The Stabilisation and Association Agreement concluded between Albania and European Communities and its Member States led to a new era of multi-dimensional cooperation between these parties. This cooperation was extended towards building sound law foundations in Albania. Hence, the latter agreed to approximate its domestic legislation with the acquis. This process has not been easy. It has faced many challenges ranging from the correct understanding of the current European legislation to an accurate transplantation into the domestic legal order. The thrust of this article is to shed light on a very specific regulation, veil-piercing, observing its shortcomings and deviation from the relevant European Union piece of legislation. Hence, it will provide a thorough analysis on how this provision was drafted, which were the main influences and will pinpoint its drawbacks.

A. Introductory Remarks

The path towards the European Union (EU) has nurtured almost all legislative reforms undertaken in Albania in the last 15 years. The Stabilisation and Association Agreement (SAA) concluded between the Republic of Albania and European Communities and its Member States[1] led to a new era of multi-dimensional cooperation between these parties. This cooperation was extended towards building sound law foundations in Albania. Hence, the latter agreed to approximate its domestic legislation with the *acquis*. To meet this obligation,

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[1] Published in the Official Journal of the EU, OJ L107/166 of 28/4/2009, and ratified by the Albanian Parliament by Law No. 9590 of 27/7/2006, "On the ratification of the Stabilization and Association Agreement with the European Communities and their Member State", published in the Official Gazette No. 87 of 14/8/2006.

Albania has continuously required EU assistance in its efforts to bring its domestic legislation in line with the *acquis*. Unquestionably, company law is no exception.

In 2008, within the ambit of Article 70[2] of the SAA, the first law that regulated business organisations [3] was repealed by the newly promulgated law "On Entrepreneurs and Companies"[4]. The latter represented the European standards of company law, which were embodied by an international team of experts [5] bringing new concepts and institutions to the emerging Albanian company law[6] (ACL).

The drafters of the ACL maintain that the provision regulating veil-piercing[7], amongst others, was one of the novelties of the ACL back in 2008 when it was first adopted. Such regulation was absent in the law of 1992[8], and obviously, no such tradition had ever existed.

This paper aims to give an insight into the concept of veil-piercing as enshrined in the ACL, the jurisprudence of Albanian courts related

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2 Article 70 (1): "1. *The Parties recognise the importance of the approximation of Albania's existing legislation to that of the Community and of its effective implementation. Albania shall endeavour to ensure that its existing laws and future legislation shall be gradually made compatible with the Community acquis. Albania shall ensure that existing and future legislation shall be properly implemented and enforced*."

3 Law No. 7638 of 19/11/1992, "On Companies", as amended, Official Gazette, 14/12/1992, No. 8, p. 409 (Repealed).

4 Law No. 9901 of 14/04/2008, "On Entrepreneurs and Companies", as amended, Official Gazette, 6/5/2008, No. 60.

5 *Dine*, Jurisdictional Arbitrage by Multinational Companies: A National Law Solution?, Journal of Human Rights and the Environment 2012, p. 62. The international team of experts included Janet Dine and Michael Blecher who were aided by local experts as well.

6 The communist regime eradicated almost every form of private property and free economic initiative. Therefore, after almost 50 years with no regulation of business forms, the first law was introduced in 1992. Actually, the very first regulation of business organisations was made in 1929 which the enactment of the Code of King Zog, but this act had very limited lifespan. See also, *Rystemaj*, A Historic and Comparative Approach of Corporate Governance in Albania, Journal of Legal and Social Studies in South East Europe 2015, pp. 210-224.

7 Veil-piercing and veil-lifting are interchangeably used in this paper.

8 Law No. 7638 of 19/11/1992, "On Companies", as amended, Official Gazette, 14/12/1992, No. 8, p. 409 (Repealed).

to the concept of veil-piercing, albeit trivial, and the influence that has informed veil-piercing. The paper begins with an introduction of the influence that mostly EU directives have had in shaping company law in Albania. Then, the special focus of this paper, veil-piercing, is elaborated in the two following sub-sections. In the first section emphasis is put on the statutory provisions regarding veil-piercing toward individual shareholders, highlighting the shortcomings therein. These shortcomings are considered from a comparative perspective, using the jurisprudence of several jurisdictions. The second section sheds light on the veil-piercing rule in a specific setting: when companies formed by two or more shareholders become single member companies. In this section the analysis aims to identify whether the provision of Albanian law fully complies with the respective directive. Given the significant absence of Albanian experience and case law dealing with veil-piercing, the observation of the jurisprudence of the courts of EU Member States and the United States (U.S.) is continuously cited, aiming at providing a clear view of the meaning of veil-piercing embedded in the ACL. Thus, continuous reference is made to seminal court decisions, which provide a thorough comprehension of the notion itself.

Due to length limitations, veil-piercing in corporate groups, a relevant topic intrinsically related to veil-piercing, is not covered in this paper.[9] Hence, the focus of the paper remains exclusively on personal liability incurred by individual shareholders under Albanian company law.

[9] Given the notable German influence on ACL, it was reasonable for the drafters not to extend the American version of veil-piercing to corporate groups, but to follow the German model. Under the American approach, there is no distinction between individual shareholders and entity or corporate shareholders. The doctrine produced so far by the courts and scholars is to be applied mutatis mutandis to corporate groups as well. Hence, in case the conditions for the *alter ego* or *instrumentality* doctrine are met, the courts will lift the veil and reach the corporate shareholders in order to impose personal liability for corporate debts. Meanwhile, the Albanian law follows a completely different approach. Corporate groups are governed by a specific set of Articles[9] of the ACL. Therefore, the rules laid down in Article 16 are not applicable to corporate shareholders.

B. Albanian Company Law and Veil-Piercing

As highlighted above, in 2008 the new ACL was enacted amid continuous efforts for compliance with the *acquis*. In this fashion, it broadly reflected the principles of European company law (deriving from the pertinent directive) and institutions imported from EU Member States.[10] In order to align with the development in the EU, the new ACL offered simple and more modern forms of business organisations, by reflecting European standards on corporate governance and corporate social responsibility. [11] This reform intended to create a friendlier environment for all stakeholders involved in corporate activity and definitely did improve the rules regarding internal organisation of companies. Despite these efforts, the level of approximation of company law is repeatedly considered to be moderate by several progress reports.[12]

Clearly, limited liability is firmly established as a fundamental principal[13] of Albanian company law. The separate identity of the company and limited liability are articulated, *inter alia*, by Articles 3[14],

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[10] *Dine/Blecher*, "The Law on Entrepreneurs and Companies", Text with Commentary, revised version, 2016, pp. 5-8.

[11] *Ibid*., pp. 6-7. As an example I may mention the total reformation of joint stock companies which can be organised under the one or two-tier structure, the integration of the recent corporate governance debates with regard to remuneration (Article 160) and the role of the managing director and more specifically rules regarding the liability of managing directors and members of the board of directors (more specifically fiduciary duties enshrined in Article 163). Also, the law sets forth the obligation of the manager director to consider while running the company, the effects of his/her decision-making in the environmental sustainability (Article 163), etc.

[12] For example the Albania Progress Report 2016, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions 2016 Communication on EU Enlargement Policy, COM(2016)715 final; Commission staff working document, Albania 2015 Report, COM(2015)611 final; Commission Staff Working Document Albania 2014 Progress Report Accompanying the document, COM(2014)700 final.

[13] *Easterbrook/Fischel*, "Limited Liability and the Corporation", 52 University of Chicago Law Review 89 (1985), p. 89 et seqq.

[14] Article 3, Companies: *"(1) Companies are incorporated by two or more persons, who agree on achieving joint economic objectives through contributions defined by the statute. Limited liability companies and joint stock companies may also be formed by one person only (single member company).*

68(1)[15] and 105(1)[16] of the ACL. Undeniably, as per the wording of these provisions, the ACL recognises the company as an independent entity and limited liability as the rule, not as the exception. However, limited liability, in certain circumstances, is subject to restrictions.

The exceptions are defined by virtue of Articles 16, 71(1) and 114(2). The first Article deals exclusively with cases where the veil of the company no longer protects fraudulent shareholders from creditors' claims. The following Articles regulate a singular case of ignoring limited liability for the shareholder who come to hold the whole shares in a company.

One can assume that the inspiration to introduce a statutory provision for veil-piercing had its roots in the lack of uniformity of tests produced by other courts when delineating veil-piercing.[17] A huge array of tests exist, which vary from country to country and make it difficult for investors and creditors to predict whether the court will put aside the veil or not. In this setting, one can reasonably argue that the introduction of a statutory provision shows the intent

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(2) Companies must apply for registration in accordance with Article 22 and subsequent Articles of Law No. 9723, on the National Registration Center as relevant to the form of the company in question.
(3) Companies acquire legal personality on the date of their registration in the National registration Center. They are liable with all their assets for the obligations deriving from their activities." (Law No. 9901 of 14/04/2008 "On Entrepreneurs and Companies", as amended, Official Gazette, 6/5/2008, No. 60).

[15] Article 68(1), "*A limited liability company is a company founded by natural or juridical persons who are not liable for the company's commitments and which personally bear losses only to the extent of any unpaid parts of stipulated contributions. Members' contributions constitute the company's basic capital.*" (Law No. 9901 of 14/04/2008 "On Entrepreneurs and Companies", as amended, Official Gazette, 6/5/2008, No. 60).

[16] Article 105 (1) "*A joint stock company is a company the basic capital of which is divided into shares and subscribed by founders. Founders are natural or juridical persons which are not liable for the company's commitments and which personally bear losses only to the extent of any unpaid portion of the shares in the basic capital they subscribed.*" (Law No. 9901 of 14/04/2008 "On Entrepreneurs and Companies", as amended, Official Gazette, 6/5/2008, No. 60).

[17] For example test produced by U.S. or German courts. For more, see *Oh*, Veil-Piercing Unbound, Boston University Law Review, vol 93:89, p. 90. The lack of uniformity of tests applied is often seen as a failure of the concept as of its conception. For German tests see *Reich-Graefe*, Changing paradigms: The Liability of Corporate Groups in Germany, 37 Connecticut Law Review 785, 2005, pp. 807-808.

of the Albanian legislator to define clear boundaries for cases in which a court could disregard the separate entity of the company in order to protect, on the one hand investors from ungrounded and uncontrolled personal liability for company's debt and on the other hand, creditors by granting them the mechanism to request veil-lifting. There was no statutory example to follow and, consequently, the content of the provision was a result of the influence from the jurisprudence developed in Europe and in the United States.[18] Essentially, the jurisprudence of these countries left their imprint in shaping the new rule on veil-piercing in Albanian corporate law.

I. Unfolding Article 16 of Albanian Company Law (Veil-Piercing)

The statutory provision on veil-piercing, embedded in Article 16[19], revolutionised [20] the concept of 'absolute' limited liability of

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[18] *Dine/Blecher*, (fn. 10), Article 16, p. 69.

[19] The amended version of Article 16: *"(1)The individual who is a company member, shareholder, or a representative of a member or shareholder, a managing director or a member of the board of directors, that through actions or omissions secure unjust profits for him/herself, or willfully causes to third parties a loss of property, is personally responsible towards third parties, including public bodies, to pay with his/her property for company's obligations, when he/she:*
a) Abused of the legal form and/or limited liability privilege offered by the company; or
b) Treated one or more company's assets as if they were his/her own assets; or
c) At a time when he/she knew or must have known that the company did not have sufficient capital to meet its commitments as against third parties, did not take the necessary actions within his/her powers pursuant to the law to impede, depending on the circumstances, the company to continue its business and/or to assume new commitments towards third parties, including public authorities.
(2) In cases envisaged in paragraph 1 of this Article, the personal liability for commitments of the company is limited up to the following values: a) in the case under letter a) of paragraph 1 of this Article, up to the value equal to the total amount of outstanding company's obligations; or
b) in the case under letter b) of paragraph 1 of this Article, for outstanding company's obligations up to the current market value of the company's assets treated as if they were his/her own assets;
c) in the case under letter c) of paragraph 1 of this Article, up to a value equal to the total amount of outstanding company's obligations incurred after the moment he/she know or have known of the situation described in letter c) of paragraph 1 of this Article […]" (Law No. 9901 of 14/04/2008 "On Entrepreneurs and Companies", as amended, Official Gazette, 6/5/2008, No. 60)

shareholders inherited by the predecessor law. However, this Article in its first version had few definitional ambiguities and often led to confusion. There were cases where tax authorities without a decision issued from the court held the manager of the company liable for breach of Article 16 of ACL.[21] In 2014, to avoid future misunderstandings and misinterpretation of this provision,[22] the Article was amended aiming to establish clearer circumstances for imposing unlimited liability for shareholders. The amendments set clearer rules as regards the amount of the money shareholders were obliged to the company and a timeframe for bringing these actions before the court. Actually, this provision was meant to provide guidance for courts in order to make clear where they could "*draw aside the veil and [...] see what really lies behind*"[23]. This was not an easy task given the absence of any existing statutory example to follow. In any case, the drafters created the first framework for veil-piercing that provides few illustrating examples, but leaves the list open and gives full discretion to Albanian courts to disregard the legal personality and limited liability in case they observe abuse by shareholders.

It is quite obvious that the underlying rationale of the Article is based on the conclusion drawn mainly by U.S. courts that "*the courts will not permit themselves to be blinded or deceived by mere forms of law but will deal with the substance of the transaction involved as if the corporate agency did not exist and as the justice of the case may require*"[24]. According to this line of reasoning, the aforementioned

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[20] Actually, the first law regulating companies after the fall of the communist regime, enacted in 1992, had no specific regulation regarding veil-piercing. The law provided for unlimited liability only for founders of the company, if the foundation was invalid.

[21] Decision of the Court of Appeal, Tirana, No. 47/93 of 17/01/2012.

[22] By Law No. 129/2014 "On some additions and amendments to the Law No. 9901 of 14/04/2008 "On Entrepreneurs and Companies", published in the Official Gazette, 23/10/2014, No. 163).

[23] [1969] 1 W.L.R. at 1254, cited in *Cheng*, The Corporate Veil Doctrine Revisited: A Comparative Study of the English and the U.S. Corporate veil Doctrines, 34 Boston College International & Comparative Law Review 329 (2011), p. 338.

[24] 321 U.S. 349, 363 (1943) (quoting *Chi*, Milwaukee & St.Paul Ry. Co. v. Minneapolis Civic & Commerce Ass'n, 247 U.S. 490, 501 (1918)), cited in *Cheng*, The Corporate Veil Doctrine Revisited: A Comparative Study of the English and the U.S. Corporate veil

Article sets forth that the shareholder who "*[…] secures unjust profits for him/herself, or willfully causes to third parties a loss of property, is personally responsible towards third parties, including public bodies, to pay with his/her property for company's obligations […]*".[25] In such circumstances, the preservation of limited liability would be unreasonable and would harm the interest of third parties and furthermore, it would, as American courts have articulated, "*[…] sanction a fraud or promote injustice*".[26] Hence, the aforementioned Article primarily tries to balance the interest of creditors of the company with the interests of shareholders. The rule set by Article 16 provides a mechanism to stop fraudulent behaviours from controlling shareholders who may exploit the corporate form as an instrument to defraud creditors by causing them losses from appropriating the company's funds. The following sections will provide a detailed analysis of the main form of abuses as stipulated by the pertinent Article.

1. Abuse of Form and/or Limited Liability

Under the aforementioned Article, abuse of form and/or limited liability[27] is considered a form of behavior that leads to veil-lifting. As the wording suggests this is a catch-all provision that would encompass any form of abuse from shareholders. Obviously, this is far from providing a clear-cut list of justification for veil-piercing. Instead it leaves room for application of different tests as generated by other courts such as the United Kingdom (U.K.), U.S. and Germany

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Doctrines, 34 Boston College International & Comparative Law Review 329, 2011, p. 353.

[25] Article 16 (1), Law No. 9901 of 14/04/2008 "On Entrepreneurs and Companies", as amended, Official Gazette, 6/5/2008, No. 60.

[26] *Klein et al*., Business Association: Cases and Materials on Agency, Partnerships and Corporations, 2012, p. 183.

[27] "The *individual who is a company member, shareholder, or a representative of a member or shareholder, a managing director or a member of the board of directors, that through actions or omissions secure unjust profits for him/herself, or willfully causes to third parties a loss of property, is personally responsible towards third parties, including public bodies, to pay with his/her property for company's obligations, when he/she:*
a) Abused of the legal form and/or limited liability privilege offered by the company; or […]"

as countries where the drafter of the ACL imported the notion of veil-piercing.

The language of the aforementioned Article reflects the so-called *instrumentality* and *alter ego* doctrine as articulated mainly by courts in the U.S. These two doctrines constitute a benchmark when coping with veil-piercing.[28] Under the tests spawned by U.S. courts, the instrumentality doctrine is based on three main pillars:

(1) Control [...] complete domination, not only of finances, but of policy and business [...]; and

(2) [...] control must have been used by the defendant to commit fraud or wrong, to perpetrate the violation of statutory or other positive legal duty [...]; and

(3) the aforesaid control and breach of duty must proximately cause the injury or unjust loss complained of.[29]

On the other hand, the *alter ego* doctrine sees no distinguishable borders between the shareholder and the company; instead it is the shareholder who blurs this "independence". Basically, the shareholder(s) and the company are one single person having no independent existence. U.S. courts have delineated a unity of interest between the company and its shareholders.[30]

Domestic courts should closely observe the reasoning and consider the elements identified by their American counterparts to fully understand and justly resolve cases dealing with shareholders who use the company as mere instrumentality or alter ego. Thus,

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[28] See *Bainbridge*, Abolishing Veil Piercing, https://ssrn.com/abstract=236967 or http://dx.doi.org/10.2139/ssrn.236967 (10/10/2017), p. 38, and 247 A.D. at 156 (N.Y. App. Divf. 1936), aff'd, 6 N.E. 2d 56 (N.Y. 1936), cited by *Cheng*, (fn. 23), pp. 379-380. In Germany a similar test was provided by the BGH (Bundesgerichthof) in *Gervais* case, BGH, 1980 NJW 231 (1979) cited in *Schiessl*, The Liability of Corporations and Shareholders for the Capitalization and Obligations of Subsidiaries under German Law, 7 Northwestern Journal of International Law & Business 480 (1985-1986), p. 480-505. For instrumentality doctrine see also *Zaistv/Olson* 227 A.2d 552 (Conn. 1967), cited in *Bainbridge*, Abolishing Veil Piercing, https://ssrn.com/abstract=236967 or http://dx.doi.org/10.2139/ssrn.236967 (10/10/2017), p. 38.

[29] *Bainbridge*, Abolishing Veil Piercing, https://ssrn.com/abstract=236967 or http://dx.doi.org/10.2139/ssrn.236967 (10/10/2017), p. 8.

[30] *Ibid*., p. 8.

when claims arise that shareholders have abused the form and/or limited liability, courts should closely examine whether these criteria are met by the conflict at bar.

English judicial attitude has not been consistent while assessing veil-piercing.[31] There were periods when English courts have shown willingness to put aside the corporate veil as well as other periods of reluctance.[32]

In any case, when designing the original version of Article 16, the drafter had in mind the prominent case of Jones v. Lipman[33] and make specific reference to this case when illustrating abuse of form and/or limited liability. In this case the defendant had contracted to sell a property to the plaintiff, but was not willing to honour this contract any longer.[34] What he did next was incorporation of a company to which he sold the property. The contract with the plaintiff could now not be honoured because the property was not available.[35] In this case, the court allowed veil-lifting and held the mastermind of this abuse liable as it considered the company "*[…] a device and a sham, a mask which he holds before his face in an attempt to avoid recognition by the eye of equity*".[36]Furthermore the court observed that "*the company did not issue share capital or possess any real physical premise. Nor was any director appointed. It was obvious that this company had no genuine economic substance and was used solely to evade the defendant's contractual obligation.*"[37]

Basically, abuse of form in the context of Article 16 of the ACL also means the use of a company as a sham, or a mask to defraud or escape liability. Such companies, which are solely used to evade responsibility and that do not have a genuine existence should not

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31 *Ibid*., p. 331.

32 *Ibid.*, pp. 331-332.

33 The drafters when illustrating the first form of abuse make specific reference to the *Jones v. Lipman* case (High Court, [1962] 1 WLR 832). *Dine/Blecher*, (fn. 10), Article 16, p. 63 et seqq.

34 Cheng, (fn. 23), p. 384.

35 *Ibid*.

36 *Ibid*.

37 *Ibid*.

grant the privilege of limited liability to their shareholders. Instead, they should face personal liability towards third parties.

Courts in Germany have constructed the doctrine of veil-piercing given the absence of a statutory regulation. On several occasions courts have held that the separate entity should be used to ensure consistency with the goals of the legal system and have disregarded it in exceptional cases if required by serious reasons of equity and good faith.[38]

Whereas Albanian courts, in an infinitesimal number of cases, have not been reluctant to disregard corporate entity. In a case where the sole shareholder of a limited liability company, at the same time the sole manager of the company, deliberately disposed of all the assets of the company and right after dissolved the company, the court did not hesitate to look beyond the veil.[39] The sole shareholder had full knowledge of the company's obligation towards its ex-employee. Notwithstanding his knowledge, the remaining assets, through which the company had to fulfill its obligation, were nowhere to be found.[40] It was clear for the court that it was purposefully concealed to the detriment of the creditor. The court ruled that the sole shareholder (and manager at the same time) had to be personally liable because he used the benefits of limited liability and the form of the corporation to avoid the fulfillment of obligation. [41] The court did not investigate much on corporate formalities, but it only considered the intentional lack of assets and the emergency of dissolving the company as factors to hold the shareholder liable. Consequently, the court held that the company was not created as an independent entity; rather it served as an instrument to reach the sole shareholder's goal. Thus, the court imposed unlimited liability on the sole shareholder, thus depriving him from the privilege of limited liability. It seems that the court was inspired by the test spawned by U.S. courts as it made specific reference to two seminal court

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38 *Alting*, Piercing the Corporate Veil in American and German Law – Liability of Individuals and Entities: A Comparative View, 2 Tulsa Journal of Comparative and International Law 187 (1994), p. 199.

39 Decision of the Court of Appeal of Tirana, No. 2546 of 09/12/2016.

40 Decision of the Court of Appeal of Tirana, No. 2546 of 09/12/2016 at 17.1.

41 Decision of the Court of Appeal of Tirana, No. 2546 of 09/12/2016 at 17.2.

rulings.[42] This case demonstrates the broad range of abusive conduct covered by Article 16 and the discretion of the court to apply it on a case by case basis.

To conclude, it looks like the efforts of the Albanian lawmaker to unify the test of veil-piercing were futile as the domestic courts still make direct reference to the variety of tests originally generated by foreign courts. Actually, despite the efforts, which propelled the amendments in 2014, the aftermath leaves Albanian courts uncertain within the imprecise and vague list of justifications for veil-piercing.

2. Other Forms of Abuse

Two other forms of abuse foreseen by Article 16 of the ACL are: a) treating a company's assets as his/her own and b) not taking the relevant measures when detecting undercapitalisation. As the drafters of the ACL have held, the first form is imported from several German cases[43], but there is also ample case law from U.S. courts, which distinguished similar cases when the veil is lifted. It should be admitted that it is difficult to delineate each case when shareholders should be deprived from the privilege of limited liability. However, U.S. courts have identified four factors such as: "*1) the failure to maintain adequate corporate records or to comply with corporate formalities, 2) the commingling of funds or assets, 3) undercapitalisation, and 4) one corporation treating the assets of another corporation as its own*".[44]

Certainly, the element of abuse should be present in this behaviour as well because an isolated case of mere use of company assets with no consequence to the company and its creditors shall not bring personal liability for shareholders. The underlying rationale is the fact that these assets belong exclusively to the company and should primarily serve to honour the obligations towards the creditors of the company. If shareholders embezzle these assets and

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[42] Decision of the Court of Appeal of Tirana, No. 2546 of 09/12/2016 at 18 (Van Dorn Co. v. Future Chemical and Oil Corp., 753 F.2d 565 (7th Cir. 1985) and Sea-Land Services, Inc. v. Pepper Source, 941 F.2d 519 (7th 1991).

[43] BGHZ 151 (2002), 181, cited in *Dine/Blecher*, (fn. 10), Article 16, pp. 72-73.

[44] *Klein et al*. (fn. 26), p. 183.

use them as if they were theirs to the detriment of creditors of the company, then they should face the consequences of veil-piercing. A limited case of using company funds as own funds should not activate veil-piercing, but where this appropriation results in unjust enrichment and the inability of the company to pay its debt, then veil-piercing should serve as a remedy to protect creditors.

The last case, not taking the necessary measures when noticing undercapitalisation, remains complex and requires attention from Albanian courts. Undercapitalisation is a traditional cause for applying veil-piercing in Germany.[45] Therefore, these set of circumstances are imported therein. However, the notion of adequate capital in order to figure out whether the company had enough capital and whether the shareholders should be held personally liable or not remains unclear. Perhaps the test of the German court articulated in the case of Bremer Vulkan II and KBV [46] may apply in such circumstances. Basically, the court acknowledged personal liability for the shareholder (even though it was a corporate shareholder, but by analogy it may perfectly fit for individual shareholders in the Albanian legal reality), which destroys the continuous, autonomous existence of the company.[47] If the shareholders' conduct causes the immediate insolvency or the result is a collapsing situation for the company, then veil-piercing should be inevitable.

Although this jurisprudence is not obligatory in any form for Albania, in light of the influence that it had in shaping veil-piercing regulation in the ACL, it is important for Albanian judges to have a thorough understanding of tests produced by these courts.

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45 *Alting*, (fn. 33), p. 207.

46 Cited by *Reich-Graefe*, (fn. 17), p. 801 citing BGH (Feb. 25, 2002-II ZR 196/00) Neue Juristische Wochenschrift [NJW], 55 (2002), 1803 (1805) (Bremer Vulkan II), BGH (June, 24, 2002-II, 2001-II ZR178/99), Neue Juristische Wochenschrift [NJW], 55 (2002), 3024 (3025) (KBV).

47 *Ibid.,* p. 801 citing BGH (Feb. 25, 2002-II ZR 196/00) Neue Juristische Wochenschrift [NJW], 55 (2002), 1803 (1805) (Bremer Vulkan II), BGH (June, 24, 2002-II, 2001-II ZR178/99), Neue Juristische Wochenschrift [NJW], 55 (2002), 3024 (3025) (KBV); Similarly, GBH (Sept. 17, 2001-II ZR 178/99) Neue Juristische Wochenschrift [NJW] 54 (2001), 3622 (3623) Bremer Vulkan; BGH, (Mar. 29, 1993-II ZR 265/91, Neue Juristische Wochenschrift [NJW], 46 (1993), 1200 (1203) (TBB), BGH (June, 24, 2002-II ZR 300/00), Neue Juristische Wochenschrift [NJW], 55 (2002), 3024 (3025)(KBV).

II. Peculiar Veil-Piercing Case under Albanian Company Law

This section will pay heed to the regulation provided by Albanian Company law with regard to a special case of veil-piercing. The regulation provided by Article 16 of the ACL provides for disregard of limited liability in another specific situation. Articles 71(1)[48] and 114(2)[49], respectively, for limited liability companies and joint-stock companies impose personal liability for a sole shareholder who fails to enter in the registry that they are the sole owner of shares of the company after it was originally created by two or more shareholders. The drafters of the ACL argue[50], that these provisions are in compliance with Article 3 of Directive 2009/102/EC .[51] But a closer look at both solutions offered by these two legal instruments reveals a major difference between the two. The ACL intends to enforce the obligation of filing in the register of the fact that the company has one single member through veil-piercing. The directive on the other hand leaves no discretion to Member States to provide any penalty for non-disclosure of this fact as Article 2 (2) foresees other cases for which Member States may provide sanctions.[52]

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[48] Article 71 (1): "*When the number of members decreases to one, the single member shall register the decrease and his name in accordance with Article 43 of the law on the National Registration Center. If the single member fails to do so, he shall be personally liable for the commitments the company assumes, from the day the registration should have been made, until the day the registration if effectively made.*" (Law No. 9901 14/04/2008 "On Entrepreneurs and Companies", as amended, Official Gazette, 6/5/2008, No. 60).

[49] Article 114(2): "*When the number of shareholders decreases to one, the single shareholder shall register the decrease and his name in accordance with Article 43 of the law on the National Registration Center. If the single shareholder fails to do so, he shall be personally liable for the commitments the company assumes, from the day the registration should have been made, until the registration is effectively made.*" (Law No. 9901 of 14/04/2008 "On Entrepreneurs and Companies", as amended, Official Gazette, 6/5/2008, No. 60).

[50] *Dine/Blecher*, (fn. 10), Article 71, p. 109.

[51] Directive 2009/102/EC in the area of company law on single-member private limited liability companies, OJ L 258 of 1/10/2009, pp. 20-25. The extension of this rule to joint stock companies is an independent decision from the ACL, as the directive provides no regulation.

[52] Article 2(2), Directive 2009/102/EC in the area of company law on single-member private limited liability companies, OJ L 258 of 1/10/2009, pp. 20-25. "[…] a) a natural

From the Albanian lawmaker perspective, this penalty may be provided to force shareholders to register the fact that they are the sole shareholder of the company. By virtue of the aforementioned Articles, she/he will be held liable for any debt incurred from the moment of concentrating all the shares in her/his hand until she/he discloses this fact to the National Business Center (NBC). Nonetheless, this constitutes a deviation from the privilege of limited liability as the law itself allows incorporation of single member companies (either as a limited liability company or joint stock company). The mere domination of the company by the sole shareholders should not advance personal liability for him/her, unless he/she does not fall into the net abusive conducts. Here the law does not require any form of abuse, therefore the mere fact of not submitting a registration to the register should not render the sole shareholder personally liable.

Its rationale certainly departs from the underlying rationale of veil-piercing that is the protection of creditors' rights from abusing, controlling or managing shareholders. In this case, creditors are not exposed to any added risk, just because the shares are now owned by a single shareholder. Therefore, there is no room for extreme measures, if no abuse is proven. There may be a case for imposing an administrative sanction, but not an extension to personal liability. Consequently, the advice would be to align the aforementioned provision with the Directive.[53]

C. Concluding Remarks

As highlighted in this paper, Albania is constantly facing the need to approximate its domestic legislation with that of the EU. Undoubtedly, the reforms undertaken so far and European standards incorporated in the domestic legislation have ameliorated the business climate. However, as the analysis of veil-piercing demonstrates, full compatibility with the *acquis* is not yet achieved. This unsatisfactory advancement is due to partial transposition or

person is the sole member of several companies; or a single member company or any other legal person is the sole member of a company."

[53] Regardless this non-compliance, the amendments of 2014 did not pay attention to this discrepancy.

incorrect understanding of the relevant EU law. The Albanian lawmaker should therefore be mindful when approximating legislation. It should correctly assess, thoroughly apprehend, and cautiously transplant every piece of legislation that is being transposed in the domestic legal order.

With regard to the focal point of this Article, further compliance with the Directive 2009/102/EC (the so called twelfth company law directive) is needed. This means, abrogation of the penalty of personal liability for the shareholder who fails to register the fact of being the sole shareholder in the company. Furthermore, when transplanting provisions or judge-made rules from other jurisdictions the wording should be accurate and exact. The provision on veil-piercing introduced by the Albanian Company Law should be read and interpreted in light of the case law that inspired it. Despite the efforts of the lawmaker to delineate clear and certain cases of veil-piercing, the provision did not introduce a bright-line standard. Instead, Albanian courts will have to consider a myriad of tests and a laundry list of factors and criteria when determining whether or not to lift the corporate veil.

Montenegrin Road from a Federal Unit to the Next EU Member State: A Case Study of Chapter 6 of Accession Negotiations between Montenegro and European Union

Vladimir Savković and Nikola Dožic[*]

Abstract

This paper provides a retrospection of key events and dates of the process of Montenegrin transition from a federal unit of the Federative Republic of Yugoslavia and of the State Union of Serbia and Montenegro to a prominent European Union candidate country and the next Member State of the EU. In view of this broader aim, the paper focuses further on Montenegrin accession negotiations with the European Union as the most important process in the context of general foreign policy direction that Montenegro has followed steadily since regaining its independence. Finally, in order to show the value of this strategic direction, i.e. decisions for Montenegro, the authors singled out one particular part of Montenegrin accession negotiations – Chapter 6: Company Law. Namely, negotiations in this chapter represent a very convenient subject of study, since their analysis clearly displays the type of benefits that accession negotiations with European Union are bringing to future Member States, such as Montenegro. To that end, particular attention was paid to new regulatory solutions and general concepts of modern company law that are already implemented in the Montenegrin legal system or that will be implemented within a short period.

A. Introduction

Up until 2006, Montenegro has been in various forms of joint state with Serbia, which is far larger than Montenegro both in terms of territory and population. Therefore, it was only natural that the joint state was dominated by the larger constituent, especially in terms of strategic priorities of the joint foreign policy. Hence, not surprisingly, as a result of non-functionality of this rare example of two-fold

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federation, on 21 May 2006, Montenegrin citizens decided through the referendum held under the supervision and with the facilitation (i.e. "good services") of international community that it was time for Montenegro to regain its full statehood in terms of international law.[1] This historic decision has "forced" the Montenegrin political elite to take full responsibility for the future of the country.

As Montenegro sits at the millenniums-old crossroad of civilisations, and given its burdensome history and polyvalent cultural heritage, determining strategic priorities of its foreign policy is a problem far more complicated than in most other countries. Therefore, explicitly underlying European and Euro-Atlantic integration as one of its key priorities in the preamble of its Constitution, for which a two-thirds majority was required,[2] can be considered as a major success of the contemporary political elite in setting the main course of Montenegrin foreign policy in the crucial period ahead.

Only ten years after the adoption of the mentioned preamble of the Montenegrin Constitution, in addition to being a member of United Nations, OSCE and Council of Europe, Montenegro became the 29th member of North Atlantic Treaty Organization – NATO. Moreover, Montenegro is a candidate country for European Union (EU) membership and has made more progress in accession negotiations with the EU than any other state currently negotiating terms of accession, which arguably makes Montenegro the next Member State. Reaching this achievement only a decade after regaining statehood, bearing in mind all the atrocities of the 1990s in

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1 The Declaration of Independence was adopted by the Parliament of Montenegro shortly afterwards, on 3 June 2006. Although it was agreed that Serbia will be the successor of the joint state (State Union of Serbia and Montenegro), in its Declaration of Independence, Montenegro has unilaterally accepted both rights and duties from ongoing arrangements of the dissolved federation with United Nations, European union, OSCE and Council of Europe.

2 The Constitution was adopted almost one and a half year after the referendum on independence, in October 2007, after extensive negotiations between the opposition and the ruling parties. Out of the major opposition parties only one of them has voted for the final text, but this was sufficient for securing the two-thirds majority support.

the region of ex-Yugoslavia, can be considered a success by any standard.

In view of the above explained events and tendencies, this paper focuses on Montenegrin accession negotiations with the EU as the most important process in the context of the foreign policy direction that Montenegro has followed steadily since regaining its independence. In order to show the value of this strategic direction, i.e. decisions for Montenegro, one particular part of Montenegrin accession negotiations – Chapter 6: Company Law – is singled out and used as a case study. This method was chosen because negotiations in this chapter represent a convenient subject of examination, the analysis of which clearly illustrates the types of benefits that accession negotiations are bringing not only to Montenegro but to future Member States in general. Finally, after comparing the dynamics of reforms and of the progress achieved in terms of the ongoing institutional and legislative reforms in the field of company law before and after the opening of accession negotiations, this paper offers the following conclusion. The decision to apply for EU membership and undertake a set of very extensive and delicate reform projects, such as the one in the field of company law presented in this paper, was not only beneficial for Montenegrin society but it was also evidently the best alternative out of courses of action available after regaining independence in 2006.

B. Montenegrin Road to European Union – Where Have We Been and Where We Are?

Although the negotiations on concluding the Stabilisation and Association Agreement (SAA) between the EU and State Union of Serbia and Montenegro commenced in October 2005,[3] they were called off in May 2006 because of insufficient collaboration with the

[3] The Stabilisation and Association Process is the term officially used by the EU to denote its general policy towards the Western Balkans and it rests on the idea that the Western Balkan states have common political and economic goals towards EU membership and towards adhering to standards and values that the EU stands for. It was launched in June 1999 and, since then, it has been embodied in Stabilisation and Association Agreements signed individually with each of the Western Balkan countries (https://ec.europa.eu/neighbourhood-enlargement/policy/glossary/terms/sap_en (01/04/2017).

International Criminal Tribunal for the former Yugoslavia, even before the Montenegrin referendum on independence took place.[4] Therefore, after the success of the referendum, Montenegro practically started its road towards full EU membership from point zero.[5]

As the result of making European integration one of its priorities, Montenegro has succeeded in securing the official signing of the SAA on 15 October 2007, a little more than a year after regaining independence and establishing formal, i.e. diplomatic relations with "key players" in the international community.[6] This was possible because of the fact that negotiations on reaching the final text of this agreement took just over two months, from 26 September to 1 December 2006. However, this agreement did not enter into force until 1 May 2010, after being ratified by a total of 27 Member States.[7] During the largest part of this transitional period an Interim Agreement was applied in order to regulate relations between Montenegro and the EU mostly in the area of trade and trade-related issues, as well as in the areas of issuance of visas for Montenegrin citizens.[8]

2008 was particularly important for Montenegro in terms of its efforts in becoming an EU Member State. Namely, on 15 December 2008, Montenegro submitted a formal application for EU membership. From that moment Montenegro was scrutinised by the EU and its experts much more stringently, since it was on its way to becoming a candidate country. Subsequently on 23 April 2009, in response to the membership application, the European Council invited the European Commission to provide its opinion on Montenegro's application, based on which the Commission forwarded a specific questionnaire to the Government of Montenegro in order to gather the information needed to form this opinion. Following the analyses of the two sets of answers provided by the

4 http://www.seio.gov.rs/srl/srbija-i-eu/istorijat-odnosa-srbije-i-eu (01/04/2017).

5 *Orlić*, Srbija i evropske integracije – dug proces stabilizacije i prilagođavanja, Sociološki pregled 2010, vol. 44, br. 4, pp. 647-650.

6 http://www.eu.me (01/04/2017).

7 Croatia was not a Member State at the time.

8 http://www.eu.me (01/04/2017).

Montenegrin Government, on 9 November 2010, the European Commission presented a positive Opinion on Montenegro's membership application. Shortly after, on 17 December 2010, four and a half years after the referendum on independence, the European Council granted Montenegro the status of a candidate country. Finally, based on another positive opinion of the European Commission and subsequent recommendation of the European General Affairs Council, the accession negotiations between Montenegro and the EU officially commenced with the first meeting of the Accession Conference at ministerial level, on 29 June 2012.[9]

At the time of finalisation of this paper, April 2017, Montenegro is approaching its five-year anniversary since the opening of the accession negotiations. Since then, Montenegro has managed to open 26 out of 35 negotiation chapters and it has provisionally closed negotiations in 2 of those 26 chapters.[10] Keeping in mind the turbulent period that the EU has been going through for the last five or so years, which included the migrant crisis, strengthening of the right wing nationalistic movement in a number of Member States, Brexit and other troubling events and tendencies, it seems that this must also be considered a good result for Montenegro. Moreover, this period was far from smooth and calm on the national level for Montenegro. Institutional systems required in order to secure the adequate functioning of an independent state such as Montenegro need further strengthening, the country's economy has showed signs of serious weaknesses after the initial boost supported by large foreign investments and society still does not have a unified approach to many major issues and challenges it faces or needs to address in the immediate future. Nevertheless, Montenegro is steadily progressing towards the EU by bringing itself an inch closer each day to fulfilling the famous Copenhagen criteria.[11]

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9 *Ibid*.

10 Out of the non-opened chapters, two of them, Chapter 34 – Institutions and Chapter 35 – Other Issues, will not be negotiated at all, since there is no *acquis* to adopt or any other standards or reform to implement under these chapters in the case of Montenegro.

11 The set of political, economic and legislative criteria that a country must meet in order to be admitted as an EU Member State. These criteria were formulated by the

Be the above as it may, providing an answer to this apparent paradox is not the key issue of this paper, although it is undoubtedly a very important one. On the other hand, the purpose of this paper is to demonstrate, to the extent possible, the justifiability of Montenegro's firm course and persistent efforts towards meeting the Copenhagen criteria and becoming a full EU Member State. To this end, a relatively simple case study of Chapter 6: Company Law of accession negotiations between Montenegro and EU is utilised. As already underlined, this case study conveniently displays the difference in dynamic of both legislative and institutional reforms before and after the opening of accessions negotiations in this particular field, which is indeed an important one for the Montenegrin economy in particular and its society in general.

C. Case Study – Negotiations in Chapter 6: Company Law

I. In General: Overview and Timelines

The accession negotiations in Chapter 6: Company Law were amongst the first that were opened, in December 2013. The screening process with respect to this Chapter was conducted in October and November 2012, which showed that Montenegro was sufficiently prepared for the opening of negotiations, meaning that no opening benchmarks were needed. [12] In its common position for negotiations in Chapter 6: Company Law, the EU has set four closing benchmarks, meaning that this chapter of negotiations with Montenegro can be

European Council in Copenhagen, in June 1993. For more details on various aspects and controversies regarding this key set of accession criteria, for instance, see *Marktler*, The Power of the Copenhagen Criteria, Croatian Yearbook of European Law and Policy 2006 (2), pp. 343-363.

[12] Opening benchmarks are case-specific conditions that are sometimes set by the European Commission in the early stage of negotiations. These need to be fulfilled in order for the "green light" to be given for the opening of the negotiations. They usually mean that the candidate country is far behind EU standards in a particular chapter. As already stressed, this was not the case with Montenegro and Chapter 6 of its accession negotiations. This is evident from the European Commission Screening Report of Montenegrin Company Law, which is also a public document made available by the European Commission: http://ec.europa.eu/enlargement/pdf/montenegro/screening_reports/screening_report_montenegro_ch06.pdf (01/04/2017).

provisionally closed only once it is established by the EU that the following benchmarks, i.e. conditions are met:[13]

1. Montenegro adopts the new Law on Business Organisations and relevant implementing legislation, aligning it with Company Law *acquis*, in particular by introducing provisions on cross-border mergers;
2. Montenegro adopts the Law on Capital Markets and relevant implementing legislation, aligning in particular with the Transparency Directive.
3. Montenegro fully aligns its accounting and statutory audit legislation, including implementing legislation, with the *acquis*. Montenegro establishes an independent and adequately funded public oversight body and a quality assurance system so as to comply with the rules on statutory audit.
4. Montenegro completes alignment with the Directive on Takeover Bids (2004/25/EC);

It is obvious from the above presented list of closing benchmarks that the European Commission, which is the *de facto* drafter of the EU's negotiating position containing these benchmarks, in addition to requiring the formation of functional public oversight body of corporate (statutory) audit, has primarily focused on the legislative reform of Montenegrin company law. In light of certain specific facts, this approach seems well justified. Namely, the existing Montenegrin Law on Business Organisations (LBO) has been amended no less than six times since it was adopted in 2002.[14] These changes largely

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[13] Common positions are EU's negotiation positions regarding negotiations in any chapter with a candidate country. This particular document – Common position of European Union for negotiation in Chapter 6: Company Law with Montenegro is not publically available. However, the author of this paper, as a member of the Government of Montenegro Group for Negotiation in charge of overseeing and coordinating negotiations in Chapter 6: Company Law, has access to this document. In any case, the information regarding the four closing benchmarks is a part of this document that has been communicated on numerous occasions to the Montenegrin public.

[14] Law on Business Organisations, Official Gazette of the Republic of Montenegro, 8/2/2002, No. 06/02; and 31/12/2007, No. 17/07, and Official Gazette of Montenegro, 26/12/2008, No. 80/08; 22/7/2010, No. 40/10; 10/12/2010, No. 73/10; 27/7/2011, No. 36/11; and 8/8/2011, No. 40/11.

rendered its structure inadequate, as well as a considerable number of its provisions difficult to interpret and implement well before the end of 2013 and the opening of accession negotiations in Chapter 6. This tendency was strengthened by the fact that the original text was largely based on the Anglo-American corporate laws and followed a regulatory style[15] and tradition,[16] whereas the amendments mostly did not,[17] since the motive for introducing them was the need to gradually align with EU company law and to implement new regulatory standards, i.e. best regulatory practices originating mostly from the surrounding civil law countries. Hence, a mix of regulatory concepts was created with this law. Although there were numerous public voices calling for the introduction of the new law,[18] such an endeavor did not become part of the Montenegrin Government's agenda until the opening of the accession negotiations in Chapter 6: Company Law, when the adoption of the new law and its full alignment with EU had been recognised and accepted by the Montenegrin Government as one of its duties under the general framework of accession negotiations. Today, due to the importance of Law on Business Organisations for the entire Montenegrin economy, the new law is still not adopted, but this is expected to happen by the end of 2017 at the latest.

A similar story exists for the benchmark regarding the forthcoming Montenegrin Law on Capital Markets, which is set to

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15 See *Radonjić*, Komentar Zakona o privrednim društvima, 2003, p. 21.

16 For instance, Court of Chancery "Foss v. Harbottle Rule" was transposed from English into Montenegrin law regarding introduction of shareholder derivative suits (Article 30 LBO). Also, the single type of corporate governance system made available to companies registered in Montenegro was – and still is – a one-tier system (Article 34 and seq. LBO), which is omnipresent in the Anglo-American legal circle but rather rare in national systems fostering a continental legal tradition.

17 Generally, these amendments were adopted in order to bring Montenegrin company law closer to standards established by the European regulator with the so called "company law directives" and to prepare Montenegro for forthcoming accession negotiations with the EU.

18 See *Jocović*, Nužnost reforme kompanijskog zakonodavstva kao pretpostavka unapređenja konkurentnosti privrede Crne Gore, Pravni život – časopis za pravnu teoriju i praksu, br. 11/2012, pp. 99-111.

repeal the existing Law on Securities.[19] The Law on Securities has been amended seven times since its enactment in Montenegrin Parliament and, the issue of conflicting regulatory concepts aside, this means the Law on Securities almost has the same deficiencies as the existing Law on Business Organisations. As for the forthcoming Law on Capital Markets, it should be stressed that this regulatory instrument was already drafted in 2015. However, due to the long time it took for the European Commission to scrutinise the Draft Law on Capital Markets and to establish its full alignment with the *acquis*, this law has not yet been enacted by the Montenegrin Parliament. But considering that it has finally been "green-lit" by the European Commission, as well as the fact that the Proposal of the Law on Capital Markets was adopted by the Government of Montenegro, chances are that this is going to happen even before this paper is published, but in any case before the end of 2017.[20]

As for the closing benchmark on the alignment of corporate accounting and audit, particularly statutory audit with stringent standards established under the EU law, both of these important aspects of corporate governance were regulated with the single legislative act since 2005, the Law on Accounting and Audit.[21] One has to admit that this legislative instrument has provided a regulatory framework considerably more in line with best contemporary practices in the field of corporate accounting and statutory audit than was the case with current Law on Business Organisations or Law on Securities in their own domains, especially after the 2008 amendments. Nevertheless, this legislative act was also not in full alignment with EU law, particularly with regard to consolidated financial accounts, independent public oversight of statutory audit, professional ethics, as well as impartiality and objectivity standards.

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19 Law on Securities, Official Gazette of the Republic of Montenegro, 27/12/2000, No. 59/00; 28/02/2001, No. 10/01; 21/7/2005, No. 43/05; and 3/5/2006, No. 28/06; Official Gazette of Montenegro, 7/8/2009, No. 53/09; 10/12/2010, No. 73/10; 8/8/2011, No. 40/11; and 31/1/2013, No. 06/13.

20 www.gov.me/ResourceManager/FileDownload.aspx?rId=263671&rType=2 (1/4/2017).

21 Law of Accounting and Audit, Official Gazette of the Republic of Montenegro, 8/11/2005, No. 69/05, and Official Gazette of Montenegro, 26/12/2008, No. 80/08; 1/7/2011, No. 32/11.

Based on the standpoint that accounting and auditing are two different professions regulated by two related but distinct set of rules, the Montenegrin Government had decided to divide these two sets of rules into different legislative instruments. Hence, in July 2016, after a complex procedure that needs to be followed in the case of adoption of the new laws having among their purposes the alignment of Montenegrin law with the *acquis*, the Law on Accounting was adopted in the Parliament.[22] With it, Montenegro has reached full alignment with EU law in the field of corporate accounting.

As for the statutory audit, the Government of Montenegro already adopted the Proposal for the Law on audit in 2015, however, due to extreme sensitivity of numerous stakeholders with regard to this legislative instrument and the strong involvement of the European Commission in its additional scrutiny, the Law on Audit was only enacted in January 2017.[23] The key distinctive feature of this law is that it provides a legislative framework for the establishment of an independent public oversight body, the Audit Council, as a separate public body in charge of implementing and preserving a quality assurance system in the field of statutory audit. It is also significant to reiterate here that the establishment of this crucial body for securing impartiality and a high level of professionalism in the conducting of statutory audits was set as a prerequisite for the provisional closing of negotiations in Chapter 6: Company Law, within the closing benchmark dealing with corporate accounting and audits.

Finally, alignment with the Directive on Takeover Bids,[24] another condition set by the EU as a closing benchmark for Chapter 6: Company Law, was fulfilled in 2016 when the 2011 Law on Takeover of Joint Stock Companies[25] was amended.[26] This was actually the easiest of the four closing benchmarks to meet, since the existing Law on Takeover of Joint Stock Companies was pretty much already

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22 Law on Accounting, Official Gazette of Montenegro, 9/8/2016, No. 52/16.

23 Law on Audit, Official Gazette of Montenegro, 9/1/2017, No. 1/2017.

24 Directive 2004/25/EC on takeover bids, OJ L 142 of 30/04/2004, p. 12.

25 Law on Takeover of Joint Stock Companies, Official Gazette of Montenegro, 1/4/2011, No. 018/11.

26 Law on amendments of the Law on Takeover of Joint Stock Companies, Official Gazette of Montenegro, 9/8/2016, No. 52/16.

aligned with EU company law before the beginning of accession negotiations. However, the issue of takeover has been "benchmarked" due to the fact that the European Commission traditionally assigns highest importance to regulating takeover bids on capital markets.

II. Degree of Accomplished or soon to be Accomplished Harmonisation and Major (Forthcoming) Novelties in Montenegrin Company Law

A high level of harmonisation in the field of company law was achieved through several laws that were recently adopted, and through preparation of several legal texts that are in the legislative procedure and which are awaiting adoption until the end of 2017. The intention of the authors is to give an overview of the legal novelties in Montenegrin Company laws, which were the result of the harmonisation process.

1. Law on Takeover

Since the Montenegrin Law on takeover was amongst the first to be almost completely harmonised we will present its novelties first. First we must point out some of the non-harmonised rules. The first non-compliance is the result of the decision of the Montenegrin legislator not to transpose Article 5 paragraph 4 of the Directive on takeover bids containing the rule on equitable price and highest price paid. Also, we must emphasise that Montenegro didn't use the option to authorise its supervisory authority "to adjust the price referred to in the first subparagraph in circumstances and in accordance with criteria that are clearly determined." The final harmonisation in this regard is expected in the IV quarter of 2018. Also, since the amendments were made before the completion of the draft of the new Company law, a provision of article 9 paragraph 6 dealing with the meaning of "board" in a two-tier board structure was not transposed. Regardless of these cases of non-compliance, the amendments of the Law on takeover brought many novelties into the Montenegrin legal order, such as: definitions of compulsory and voluntary takeover bids; defining of the new criteria for determining a fairer price for the takeover bids; introduction of the offeror's

obligation to compile the study on fair value of shares; defining the obligations for persons that are exempt from the takeover procedure; defining the rules for the offeror to exercise his right to squeeze-out minority shareholders by voluntary takeover bid and introduction of the right of the minority shareholder to exercise "sell out".

2. Law on Accounting

The new Law on Accounting was enacted in 2016. The major novelties brought by this law were: clear definitions of the institutes and technical terms used in the text; introduction of the obligation to classify legal entities into micro, small, medium and large, depending on the average number of employees, of total income on annual level and total assets; introduction of the obligation of the parent company to compile, submit and publish consolidated financial statements, in accordance with the law, International Accounting Standards and International Financial Reporting Standards, as well as detailed rules regarding exemptions from the consolidation of financial statements; introduction of the obligation of the legal entities to prepare financial statements and consolidated statements on the day of registration of status changes (merger, acquisition, division) as well as on the day of issuing a decision on voluntary liquidation of a legal entity, in addition to the existing obligation of the legal entities to prepare annual financial statements and consolidated statements with the status as at 31 December of the business year; introduction of the obligation to compile an annual and consolidated management report for large legal entities, a central legal entity and legal entities that issue securities and other financial instruments traded on a regulated market; introduction of the institute of "public interest entities" as legal entities that issue securities and other financial instruments traded on a regulated market; banks and other financial institutions; insurance companies; legal entities classified in the category of large legal entities in accordance with the Law on Accounting, that are obliged to include a statement on the application of the corporate governance code with the annual financial report, data on significant direct and indirect owners of shares of a legal entity, as well as data on the composition and work of executive, management and supervisory bodies and their committees; introduction of the collective responsibility of the members of the administrative and

supervisory bodies for the preparation and publication of financial reports and management reports; introduction of special rules for bookkeeping and certification of accountants; detailed regulation of a number of legal issues that have so far caused problems in practice – licensing an appraiser, obtaining an accredited appraiser's title, issuing a license, recognising the acquired issue abroad, etc.

3. Law on Audit

In 2017 the Law on Audit was enacted, not only aligning national legislation in this area with the *acquis*, but also aiming for work improvement of the auditing profession. The major novelties brought by this law were: clear definitions of the institutes and technical terms used in the text; introduction of the provisions stating that the audit is carried out in accordance with the International Standards on Auditing (ISA), which have been proclaimed by the International Standards on Auditing and Assurance Services (IAASB), and the International Federation of Accountants (IFAC) bodies; regulation of necessary conditions for auditing such as 1) the status of a certified auditor; 2) professional ethics, independence and objectivity; 3) conflict of interests of the auditor; 4) issues of issuance, recognition and revocation of licenses for the performance of auditor activities; 5) continuous professional education; 6) legal status of the company for auditing, obtaining and revoking the license for carrying out the activity and 7) insurance against liability of the auditor. In the course of the public debate, particular attention was paid to the issues of the legal status of the auditing company and the status of certified auditor; introduction to the rules by which the auditing company or the certified auditor shall, by 31 March of the current year for the previous year, submit a transparency report to the Audit Council for publication on the website of the Audit Council; significant expansion of the circle of legal entities subject to mandatory audit with special consideration of medium and parent legal entities (the obligation for which is postponed until the accession of Montenegro to the EU); supervision of the implementation of this law and regulations adopted pursuant to this law is entrusted to the competent ministry of the Montenegrin Government with special regulations on object and procedure of the controls, content of the control report, taking measures and eliminating irregularities; introduction of the Audit

Council - the body for monitoring the improvement of audit practice; introduction of the obligation for the legal entities subject to mandatory audit to have an Audit Committee (with special rules on its structure, number of members, their appointment and the responsibilities of the Audit Committee).

4. Draft Law on Business Organisations

In July 2017, somewhat later than foreseen by the Action plans of the Montenegrin Government, the Draft Law on Business Organisations was opened for public debate. Undoubtedly, it is one of the most important, if not the key, legal instruments in the field of company legislation.

One of the first novelties that meets the eye is the provision providing for the corresponding application of the provisions of the new Law on Business Organizations to relations arising from the establishment, operation and termination of the European company (*Societas Europaea*) and the European Economic Interest Association-special types of companies that are established pursuant to according European regulations. Another novelty in Montenegrin law will be public interest entities which are defined as joint-stock companies or a limited liability companies established under the law whose securities are listed on the organised securities market in Montenegro or abroad. One other novelty is that the Draft Law explicitly foresees the possibility of the formation of subsidiaries, which are de facto parts of the domestic company.

The Draft Law offers an integrated concept of company representatives. The existing law did not regulate this issue in a specific and detailed manner, but rather only sporadically in certain types of companies. The Draft Law separates the notion of legal from the other types of representatives, and also regulates the scope of the powers and responsibilities of the company's representatives.

An interesting novelty is the introduction of a procurator as a special power of attorney conducting company affairs, whereby the company authorises one or more natural persons to conclude legal affairs on its behalf and to undertake other legal actions. All facets of this are fairly well regulated by the Draft Law.

Special attention is given to the concept of special duties of key personnel towards the company, with a majority or significant equity participation in the company, and also to the members of the managing bodies of the company, the agents, the procurators and liquidation managers. Hence, in comparison to the existing legislative solution, the Draft Law offers a significantly more elaborated concept of the "Business Judgment Rule", which is a well-known regulatory approach to directors' liability imported from the United States in European legal systems.[27]

A concept of duty to report a personal interest or to avoid the conflict of interest is also introduced for the first time in the Montenegrin legal system by this Draft Law. The Draft Law also regulates the question of confidentiality of business secrets for the first time.

It also regulates the obligation to respect the prohibition of competition, by all members of the partnership and limited partnership, members of a limited liability company and shareholders with majority but not significant equity participation, as well as members of the managing bodies of the company, the company representatives and the procurator.

The concept of direct lawsuits was significantly improved by the Draft Law, not so much with regard to the number of persons with active legitimisation, but by precisely elaborating forms of harmful actions to prospective prosecutors, which will contribute to better understanding and protection of their own rights in accordance with some of the highest standards of corporate governance. Considering that the concept of shareholder derivative suits in the Draft Law is based on the same factual basis, and particularly having in mind general failure of the concept of derivative suits from the present law,[28] it may be concluded that the regulatory framework in the area of the protection of rights and legitimate interests of shareholders,

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[27] See, for instance, *Vasiljević*, Korporativno upravljanje – pravni aspekti, 2007, pp. 163-170.

[28] See *Savković,* From great expectations to an even greater failure-the case of Montenegrin regulatory framework on shareholder derivative suits as an incentive for rethinking the concept itself, Juridical Tribune Journal 2016, vol. 6, no. 2, pp. 7-21.

especially minority shareholders, has been significantly improved in the Draft Law.

The concepts of partnerships and limited partnership have been changed so that these two forms of companies now have full legal personality. As a consequence, the registration of a Partnership Company is now mandatory unlike the currently optional one.

A significant difference is notable in the institute of minority representatives (expert), which is much more elaborated in the provisions of the Draft Law.

One of the most controversial issues of the new law is the return to the bicameral system of corporate governance, as an equal alternative to the current unicameral system, which was the only form of organisation of the company's management in the current legal text.

For the first time in the Draft Law, the concept of independent directors should be introduced into Montenegrin company law. More precisely, independent directors are to become indispensable members of the supervisory boards in companies implementing two-tier system orboard of directors in companies implementing one-tier corporate governance system. To that end, it is envisaged that at least one third of the members of the board of directors of joint stock companies are independent directors, and that this number should not be less than two fifths in the case of the board of directors of public interest companies.

New rules were also introduced on the use of modern electronic means of communication during the scheduling and conducting of the Assembly of joint stock companies. The Draft Law also introduces the distinctions between absolute and relatively null and void decisions of the shareholders' assembly.

Limited liability companies that have the status of public interest companies must have the same structure of the governing bodies, and members of the managing bodies, as do the joint stock companies that have the status of public interest companies. The Draft Law specifically regulates the issue of the exclusion of a member from a limited liability company.

Cross-border mergers of companies are also introduced in accordance with relevant European Directives, but implementation of

these rules is postponed until the day of accession of Montenegro to the European Union.

5. Proposal of the Law on Capital Market

In the end, we must mention the long-awaited Law on Capital Markets, which was supposed to be adopted until the second quarter of 2015. The first Draft of this law was published and public debates were held in 2014. This text of the Draft Law on Capital Market, in line with the requirements of the European Commission, has undergone significant changes and as a result the Montenegrin Securities Commission has prepared a new Second draft Law on Capital Market and the public debate was re-opened in mid-2015. After the conclusion of the public debate the Government of Montenegro didn't adopt the official version that was supposed to be sent to the parliament. The new Draft Law on the Capital Market had a deadline for execution in the second quarter of 2016, as stated in the Work Programme of the Ministry of Finance of Montenegro for 2016. Not only did the Ministry not meet the deadline, but it set the same goal for the second quarter of 2017, with the same description of the need for harmonisation with the same sources of European law. By the beginning of the fourth quarter of 2017 there was no new draft of the law on Capital Market. Hence, given the current dynamics in the preparation of this law, future developments are hard to predict.

Bearing in mind that the third Draft of the Law on the Capital Market is still not available to the public, it is still uncertain whether Montenegrin legislators will opt to harmonise Montenegrin legislation with all currently relevant sources of European law, or whether the implementation of certain sources will be left to future amendments to the basic text of the law that is still in preparation. This is especially noteworthy since the proponent of this Law in the 2015 text emphasised that an attempt was made to harmonise the Draft Law on the Capital Market with international principles and standards to the extent possible by the achieved level of development of the financial market in Montenegro in order to provide more adequate regulation of this area and to create the conditions for faster development of the domestic capital market, which may also mean that harmonisation in some areas has been deliberately left for some of the future amendments to the law.

Keeping this in mind we can only say that we have great expectations for a long-awaited Draft Law on Capital Market, but cannot be certain of the level of harmonisation and number of novelties that it will bring since the text is still in the preparation phase and we can only expect a new public debate on this topic in the near future.

D. Concluding Remarks

By the end of 2017, around four years after the opening of accession negotiations in Chapter 6: Company Law, Montenegro will have its company law transformed from moderately harmonised with EU and best international practices to that which is completely aligned with the highest standards of corporate governance. Hence, far more progress will be achieved in these four years since the opening of accession negotiations in Chapter 6 than was achieved in the previous twelve or since January 2002 when Montenegro took full control of its company law by enacting the initial version of the Law on Business Organisations. One direct consequence of this future fact will be the significant improvement of the investment climate in Montenegro. Namely, a future regulatory framework, which is both modern and familiar to investors originating from the developed market economies and which will represent a strong incentive for potential investors to set up their business in Montenegro. With these new regulations and with the arrival of new institutional investors and the European Commission's oversight of implementation of the new standards incorporated in national company law, "domestic business" will also profit, since the level of legal certainty with regard to their everyday business transactions will also rise considerably. Ordinary people, such as small, i.e. non-institutional investors, consumers and other non-commercial entities, will also become additionally protected and better positioned due to the general rise of corporate governance culture and along with it the level of corporate social responsibility. Finally, with the improved regulatory framework, the Montenegrin economy will become significantly more competitive than before, which is imperative in view of Montenegro becoming a part of the EU common market.

These are only few of the benefits that the strongly "enhanced" features of its company law will bring to Montenegro and its citizens.

The benefits of the accession negotiations in Chapter 6, on the other hand, are only one part of numerous benefits that will be secured for Montenegro along with overall finalisation of accession negotiations and the obtaining of the full EU membership. However, in order for this to happen before the end of this or the beginning of the following decade, these benefits should be consistently communicated to Montenegrin citizens so as to secure the prolongation of existing strong support for this process.

Bitcoin – A New Challenge for the European Monetary Structure

Jovan Zafiroski[*]

Abstract

As in all parts of our everyday life the progress of technology has arrived in the monetary field. New forms of medium of exchange based on technology and IT networks are used in transactions and are slowly taking the place of sovereign money as a traditional tool for exchange. Bitcoin is perceived as a technological breakthrough that will change the landscape of the traditional monetary and payment systems. However, the launch of the bitcoin and other cryptocurrencies is not without controversy. On one hand, it makes the transactions faster and cheaper while providing anonymity for the participants. On the other hand, its use includes significant risks not only for the stability of the financial and monetary system but also for the broader public using it. Also, there are many legal questions and legal challenges deriving from the use of the cryptocurrencies. The paper presents different problems concerning the use of the bitcoin and its treatment by the European Union law and institutions and by other national jurisdictions.

A. Introduction

Money is always a symbol and pillar of the current economic system. From the very beginning of its use money has always been on the edge of technological progress and innovation. Money is, on its own, an innovation. When barter was no longer useful, became expensive and made the economic model of that period unsustainable, money appeared. The original commodities (seeds, precious metals etc.), were replaced by another revolutionary change i.e. paper money that was backed by precious metals. At that time,

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money could be changed for a certain quantity of precious metal.[1] It offered more security for transport and was more practical for use. Nevertheless, with the rejection of the gold standard in 1971, settled by the Bretton Woods post-war monetary order, money is no longer covered by gold. That is fiat money whose value depends entirely on the trust in the monetary system and on the institution responsible for preserving its value. In the last 20 years technology made the transfer of money without physical exchange of money, notes or coins possible. This is known as electronic money, which is perceived as another revolution in the monetary domain.[2]

The development of new technologies and the wide use of the internet has brought changes in the monetary and payment systems reshaping the entire economic system, Thus, banks are offering e-banking services, shopping is done more and more online while shares and bonds are bought through orders given online. The new technologies are becoming part of our everyday life in very high speed. The question was not if but when this new technology would enter the monetary sphere, thereby challenging the traditional monetary system.

Virtual communities have created different networks that in many cases have established their own system of payments with their own currencies in their core, which are used as a unit of account or medium of exchange.

Depending on the relationship between the virtual currency and the "real" money, which is the legal tender in the country, virtual currency schemes can be divided into three types. The first of these represents closed virtual currency schemas. The second are virtual currency schemes with unidirectional flow where the virtual currency is purchased with real money by certain exchange rate and later used for buying goods and services in the virtual community. Finally, the

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1 On the history of money see: *Ferguson*, The Ascent of Money, A financial History of the World, 2008, pp. 17-31.

2 Only small amount of the monetary base is cash money. It depends on the country's development and economy. There are some opinions that the cash should no longer exist, or little portions to be left and should be changed with electronic money. See: *Rogoff*, The Curse of Cash, 2016, pp. 1-11.

third type of virtual currency scheme has bidirectional flow or the virtual currency might be exchanged for real money and vice versa.[3]

Some virtual currencies have gained importance and become widely used. Currently, there are more than 200 different virtual currencies in the world.[4] The money is like a language. The more people use it the more important and valuable it is. However, virtual currencies are out of the competences of the monetary authorities in terms of its supply and supervision. The issuer is usually a private owned non-financial company that is not connected with the monetary authority or issuer of the currency, which is the legal tender in the country. This might pose a threat to the monetary, financial and overall economic stability in the country where the virtual currency is used. In the European case, things are even more complicated. The European monetary union is a *sui generis* monetary structure where a common monetary policy for sovereign states participants is decided and conducted by the ECB as an independent and supranational central bank. This makes the European monetary system even more vulnerable to disturbances, which might be caused by the virtual currency schemes as an alternative to classical money and traditional payment systems.

This paper aims to provide an analysis of bitcoin as the most popular virtual currency schema. Firstly, the notion of bitcoin is explored through presentation of its definition and the arguments for and against its use (B). Secondly, the paper gives an overview and tries to address the question of the legal treatment of bitcoin in the EU and in different jurisdictions (C). The conclusion follows.

B. Notion of Bitcoin

The importance of one medium of exchange is proportional to the economic operators taking it as a payment tool and willing to accept and exchange goods and services for it. Even if only a small fraction

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3 ECB, Report on virtual currency schemes, 2012, pp. 13-14, https://www.ecb.europa.eu/pub/pdf/other/virtualcurrencyschemes201210en.pdf (5/10/2017).

4 There is a strong competition between different cryptocurrencies, see: *Gandal/Hałaburd*, Competition in the Cryptocurrency Market, Working Paper 2014-33, pp. 8-15, http://www.bankofcanada.ca/wp-content/uploads/2014/08/wp2014-33.pdf (1/10/2017).

of today's global trade, only 1bn per day, is performed via cryptocurrencies their importance constantly grows. The popularity of bitcoin has contributed to global retailers from different industries accepting it as a medium of exchange. Tesla, Microsoft, Bloomberg, LOT Polish Airlines, Wikipedia, Subway, PayPal etc. are just few from the long list of companies that accept bitcoins as a medium of exchange.

The theoretical foundation of bitcoin may be found in the Austrian school of economics and the idea that the government should not have the monopoly over the issuance of money.[5] The money should not interfere in the economy and in economic cycles. Ups and downs in the economy are created by the monetary authorities by control of the money supply. With its limited monetary supply, bitcoin should be an effective tool for exchange without having any effect on the prices and other economic fundamentals.

However, the definition of bitcoin differs across various disciplines and among authors while there are also different opinions on its usefulness and effectiveness.

I. Definition of Bitcoin

Even the sceptics accept the fact that the bitcoin is a technological breakthrough that creates new opportunities for cryptocurrencies as an alternative to traditional money. Nevertheless, the word bitcoin is used in different contexts for explaining different things. In the literature, bitcoin is defined as the first fully decentralised digital currency *or it is the world's first completely decentralized digital-payments system.*[6]

Thus, the protocol, the network, the currency, the open source implementation are all described with the term bitcoin. Nevertheless, the bitcoin might be defined as a decentralised virtual currency with

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5 See: *Hayek*, Denationalisation of money, 1976, pp. 82-84.

6 *Brito/Castillo*, Bitcoin. A primer for policymakers, 2013, available at: http://mercatus.org/sites/default/files/Brito_BitcoinPrimer_v1.3.pdf (1/10/2017), p. 3, and *Karlstrøm*, Do libertarians dream of electric coins? The material embeddedness of Bitcoin, Distinktion: Scandinavian Journal of Social Theory, vol. 15, no. 1, 2014, p. 27.

no authority or institution behind it – backing, supervising or controlling it. The bitcoin is not backed by any quantity of precious metal or currency. The essence of bitcoin is a computer program whose creators' identity is unknown. The public knows Satoshi Nakamoto as the creator of the bitcoin. In its famous paper[7] from 2008 Satoshi Nakamoto presents the entire concept of bitcoin, including and explaining all the features and technical details.

Bitcoin is based on a peer-to-peer network of computers (nodes) running the software while there is no central server. The bitcoin system creates bitcoins by mining. The most important novelty in technical terms is that the bitcoin has successfully solved is the double spending problem. The validating of the transaction is done by other computers in the network, which are reworded with new bitcoins. The process of creation of bitcoins is strongly linked to the transactions. No authority has control over the bitcoin and since the code is open source and belongs to the public domain even its creators do not own or control the network.[8] For many that is the most important characteristic of the bitcoin, a key to its success.[9] The decentralised structure of the bitcoin makes it resistant to possible abuses from the controller or the owner by different changes of the supply. Bitcoin's monetary policy is determined by its monetary base, which is fixed at around 21 million bitcoins after which very small amounts will be minted.

The traditional definition of money includes its three different functions as a medium of exchange, unit of account and a store of value.[10] When applying this definition to the bitcoin it may be concluded that it hardly fulfils one of the three criteria. Namely, the bitcoin serves as a medium of exchange but it could not be perceived as a unit of account nor a store of value. The latter function cannot be

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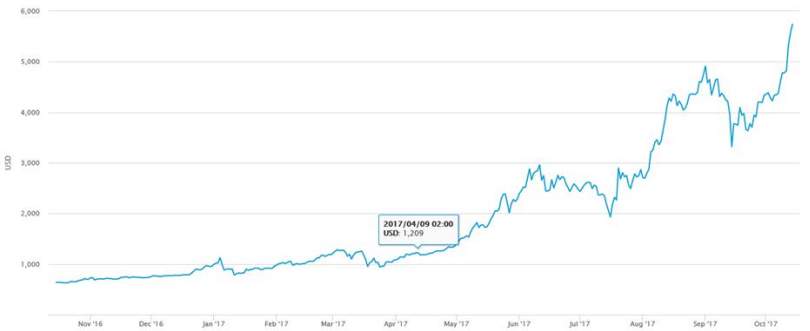
7 *Nakamoto*, Bitcoin: A Peer-to-Peer Electronic Cash System, available at: https://bitcoin.org/bitcoin.pdf (2/10/2017), pp. 1-8.

8 *Franco*, Understanding the Bitcoin, Cryptography, engineering and economics, 2015, pp. 49-73.

9 Some authors consider this characteristic of bitcoin as a key reason for its success. See: *Kelly*, The Bitcoin Big Bang, How Alternative Currencies Are About to Change the World, 2015, pp. 59-74.

10 *Proctor,* The Mann on the Legal Aspects of Money, 2012, pp. 9-12.

attributed to the bitcoin because of the high volatility of its value, which is presented in the following chart.[11]



Moreover, it is evident that the high volatility of the bitcoins' value is derived from the fact that there is neither an authority behind bitcoin nor is it covered by a certain amount of precious metal. Its value is solely based on the trust in it. In its first exchange on 30 July 2010, 1 bitcoin was exchanged for 0,05 dollars. In October 2017 its value has jumped to over 5.700 dollars while in December 2017 its value was above 11.000 US Dollars. Also, the absence of the recognition from the State takes the bitcoin outside of the legal definition of money, which puts the State as the most important factor in defining the money as the legal tender in the country.[12]

It appears that the bitcoin might be defined solely as a medium of exchange, the use of which has some advantages but also some disadvantages in comparison to sovereign money as the traditional medium of exchange.

II. Pros and Cons for Bitcoin

Bitcoin has certain advantages in comparison to traditional currencies. It is an innovative payment solution, which lowers the cost of payment. Since it is out of the banking and clearing system there are no fees or any other charges for the transactions. Also, there are

11 https://blockchain.info/charts/market-price (4/12/2017)

12 *Ibid*., p. 15.

no boundaries for any transaction and they cannot be limited by monetary or financial authorities for any reason. On the contrary, in the traditional system of payments there might be limits on transactions regarding payments, investments etc. towards foreign countries. The speed of settlement is another advantage of bitcoin transactions. However, there are some disadvantages of bitcoin in comparison to the traditional currency. Firstly, bitcoin is highly dependent on the IT network and since it is not backed by any public authority this might undermine its credibility. Secondly, the absence of transparency of the network makes counterparty risk connected to the anonymity of the payee very high. Thirdly, by abusing the anonymity of the transactions bitcoin might be used for transactions in illegal activities[13] and might be a treat for the public finances when used for tax evasion purposes. Also, bitcoin might be an obstacle for the authorities in different legal proceedings since it cannot be confiscated, restricted or seized.

Lastly, the very high volatility of bitcoin's value and possible illiquidity problem makes it very unattractive medium of exchange, which might not provide the function of the store of value as traditional money does. The chart presented above shows that bitcoin might lose half of its value in a short period while at the same time its value may soar in just a couple of hours' time.

C. Legal Status of the Bitcoin

Cryptocurrencies, and the bitcoin as the most famous type of such currency, might be the revolution that will reshape the notion of money but it might also be a balloon that, upon bursting, will create financial losses and cause problems for the economy. If this is true, it is the public authorities that are responsible for taking care of the mess created in the financial and monetary system. Also, digital currencies might affect the work of the central bank as the operator and overseer of the payment system and as the ones responsible for monetary and financial stability. Thus, the digital currencies might possibly have an impact on financial market infrastructure, broader

[13] As was the case with the *Silk Road* where many illegal activities and products were available online. See: *Vigna/Casey*, The Age of Cryptocurrency, How Bitcoin and Digital Money are Challenging the Global Economic Order, 2015, pp. 102-106.

financial intermediaries and markets, central bank seigniorage revenue and for the implementation of the monetary policy decided by the central bank.[14] That is why the central banks and other monetary authorities should pay more attention to the phenomenon of virtual currency schemes while supporting the innovation represented by new technological opportunities. Usually, the authorities react only if the core functions are under threat. The reaction of the public authorities is different across countries and include different measures from public warnings, regulation of the currency administrators, overall regulation to the prohibition of the digital currency use.

I. The Bitcoin in the European Monetary Framework

The European monetary union is a *sui generis* monetary construction. The monetary policy for the Eurozone countries is decided by the ECB as a highly independent institution responsible for the monetary policy and financial stability of the Member State participants. Also, there are EU Member States that have not introduced the euro as their national currency. Moreover, there are European states, such as Kosovo and Montenegro that have unilaterally introduced the euro as a national currency without being part of the ESCB. This makes the use and the regulation of the cryptocurrencies an important task for the authorities. The monetary structure of the EU makes the union more vulnerable to both internal and external economic and financial shocks. Currently, as explained before, the cryptocurrencies are used in only a small portion of transactions, so they cannot have significant effects on the EU monetary and financial system. However, it is undeniable that each day cryptocurrencies are gaining more importance. The bitcoin's value has surged in the last years while it is widely used by the economic operators on the European soil. A common European response is necessary in order for citizens and companies to be protected and for financial stability to be preserved while fostering innovation in the payment system.

[14] *Bank for International Settlements*, Committee on Payments and Market Infrastructures, Digital currencies, 2015, pp. 13-16.

The fact that they are based on new technology, which does not have boundaries and make no difference in terms of different responsible authorities, mean that cryptocurrencies are posing many regulatory and policy challenges for the authorities.[15] The national authorities in the European states have remained silent on the question of regulation of cryptocurrencies. On the EU level the reaction came from the institution responsible for monetary and financial stability i.e. the ECB. Thus, in its broad and widely accepted definition ECB defines the virtual currencies as "a type of unregulated, digital money, which is issued and usually controlled by its developers, and used and accepted among the members of a specific virtual community".[16] Nevertheless, the ECB has decided to amend this definition by deleting the word "money" because the virtual currencies do not achieve the level of acceptance of money. Also, the word "unregulated" has been removed because many authorities have now regulated the virtual currencies schemes. The new definition defines virtual currency as "digital representation of value, not issued by a central bank, credit institution or e-money institution, which, in some circumstances, can be used as an alternative of money".[17] As it is not yet clear even for the regulator what the bitcoin and other VCS are one might better understand the letter of the ECB president: a response to a question from the Member of the European parliament in which he states that "VCS are not scriptural, electronic, digital or virtual forms of a particular currency. They are something else, different from known currencies".[18] The idea that "they are something else" without defining what this may be confirms the confusion that is present for regulators as far as cryptocurrencies are concerned. On the EU level the situation is much more complicated since different jurisdictions or Member States do not

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15 *He et al*, Virtual Currencies and Beyond: Initial Considerations, IMF Staff Discussion Note, SND/16/03, 2016, pp. 25-35.

16 *ECB*, Report on virtual currency schemes, 2012, https://www.ecb.europa.eu/pub/pdf/other/virtualcurrencyschemes201210en.pdf (5/10/2017), p. 13.

17 *ECB*, Virtual currency schemes - a further analysis, 2015, http://www.ecb.europa.eu/pub/pdf/other/virtualcurrencyschemesen.pdf (5/10/2017), p. 25.

18 *Draghi*, ECB President, Letter, 20 October 2015, http://www.ecb.europa.eu/pub/pdf/other/151022letter_kaili.en.pdf (5/10/2017).

have the same approach towards bitcoin. They do not define it as illegal but at the same time there is no legal framework regulating it.[19]

However, different situations in the everyday use of bitcoin makes the regulation of cryptocurrencies even more necessary. Even if the central banks would like to ignore them because they could become a competition for their conventional money, the bitcoin has gained the status of means of payment. Namely, the Court of Justice of the European Union has allocated this role to the bitcoin. The request in the proceedings between the Swedish tax authority and the other party was relating to the preliminary decision of the authority on whether the transaction to exchange a traditional currency to virtual currencies, in that case bitcoin, were subject to Value Added Tax. In its judgement[20], the Court carefully defined the bitcoin as a virtual currency and gave it a status of means of payment.[21]

However, the modest attempts to understand the phenomenon of cryptocurrencies and different efforts for defining them for various practical reasons, as in the case before the Court, does not solve the problem and does not fill the gap in the regulation concerning the use of the cryptocurrencies in the EU. While the national authorities remain silent, there is no regulation and only general statements on the use of the cryptocurrencies underlining the risk of investing in it, the ECB as the institution fully responsible for the regulation of the payment system and what is more important for the overall financial stability in the Eurozone. Nevertheless, in his statement in front of the European Parliament's Committee on Economic and Monetary Affairs, the President of the ECB Mario Draghi has said that "it would actually not be in our powers to prohibit and regulate" bitcoin and other digital currencies.[22] Thus, it is evident that there is no will for

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[19] The Law Library of Congress, Global Research Center, Regulation of Bitcoin in Selected Jurisdictions, 2014, https://www.loc.gov/law/help/bitcoin-survey/regulation-of-bitcoin.pdf (5/10/2017).

[20] CJEU, case C-264/14, *Request for a preliminary ruling under Article 267 TFEU, from the Högsta förvaltningsdomstolen (Supreme Administrative Court, Sweden)*, ECLI:EU:C:2015:718, para. 10-58.

[21] *Ibid*., para. 24.

[22] Hearing of the Committee on Economic and Monetary Affairs of the European Parliament. Introductory Statement by Mario Draghi, at the ECON committee of the

regulation of cryptocurrencies as from the national authorities as well as from the ECB. The future practical problems coming from the wide use of cryptocurrencies will force the ECB to change this position and to take an active role in the regulation of bitcoin and other cryptocurrencies.

II. The Bitcoin in some other Jurisdictions

Although the world's three largest banks are Chinese and while China's banking system has surpassed that of the Eurozone to become the biggest in the world in terms of assets,[23] the USA is still the most developed and thus a very important part of the global financial system. The importance of the US Dollar as a dominant reserve currency and the geopolitical power of the US gives this financial system a central role in the current global financial structure. For that reason, the US position on virtual currencies is extremely important for the future of bitcoin as a medium of exchange. Also, the financial market in the US is the most advanced in the world in terms of innovation and new technologies. However, there is no clear position from central authorities with respect to the use of bitcoin. The increased use of bitcoin and possible effects for investors has required the Security and Exchange Commission to issue an Alert highlighting all the risks involved in investments in cryptocurrencies.[24]

To protect its financial and economic order and to disrupt the rise of speculation and illegal financial activities China has banned the use of virtual currencies. Defending its decision with the negative consequences of multiple risks in coin offering fundraising and trading, including risk of false asset, risk of operation failure, risk of speculation etc. the authorities have taken a hard stance towards bitcoin and other virtual currencies. In September 2017, the Chinese authorities declared virtual currencies illegal and banned

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European Parliament, Brussels, 20 November 2017, https://www.ecb.europa.eu/press/key/date/2017/html/ecb.sp170925_2.en.html (30/11/2017).

23 *Financial Times*, China overtakes eurozone as world's biggest bank system, March 2017, https://www.ft.com/content/14f929de-ffc5-11e6-96f8-3700c5664d30 (4/10/2017).

24 See: *U.S. Securities and Exchange Commission*, Investor Alerts and Bulletins: Initial coin offerings, 25 July 2017, https://www.sec.gov/oiea/investor-alerts-and-bulletins/ib_coinofferings (4/10/2017).

fundraising through coin offering. Thus, individuals and organisations that have completed fundraising through coin offering should return any funds that were raised. Also, the platforms that provide trading and exchange services for coin offering shall not engage in exchange businesses between legal tender and virtual currencies. The decision will be accompanied with sanctions for non-adherence to the decision and with campaigns for public awareness of the risks.[25]

The position of Russian authorities towards bitcoin and other cryptocurrencies is ambiguous. On one hand, the Moscow Stock Exchange is proposing and working on building an infrastructure to allow cryptocurrencies to be traded on the exchange. On the other hand, the Russian central bank is more cautious and considers that cryptocurrencies should not be accepted for treading in Russia in the near future. In its statement the Russian central bank highlights the risks of the use of the cryptocurrencies and considers the acceptance of the cryptocurrencies in circulation and its use at organised trades as premature.[26]

In its Federal Council report the Swiss Federal Council considers that the economic importance of virtual currencies as a means of payment is currently insignificant and believes that this will not change in the foreseeable future. Virtual currencies have no influence on the mandate of the Swiss National Bank.[27] Also, Supervisory law in Switzerland does not contain specific provisions relating to bitcoin or other virtual currencies. Trading is supervised and in some cases authorisation is required, depending on the business model in question.[28]

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[25] See: *The People's Bank of China,* Public Notice of the PBC, CAC, MIIT, SAIC, CBRC, CSRC and CIRC on Preventing Risks of Fundraising through Coin Offering, September 2017: http://www.pbc.gov.cn/english/130721/3377816/index.html (4/10/2017).

[26] *Central Bank of the Russian Federation*, Statement, 4 September 2017, https://www.cbr.ru/press/pr/?file=04092017_183512if2017-09-04T18_31_05.htm (4/10/2017).

[27] *Federal Council*, Report on virtual currencies in response to the Schwaab (13.3687) and Weibel (13.4070) postulates, June 2014, http://www.news.admin.ch/NSBSubscriber/message/attachments/35355.pdf (4/10/2017), p. 3.

[28] *FINMA*, How investors can protect themselves against unauthorised financial market providers, Bern, 1 August 2017, pp. 14-15.

As an institution responsible for deciding and implementing the monetary policy, for supervision of the credit institutions and for the oversight of the payment system, the National Bank of the Republic of Macedonia made a public statement on the use of virtual currencies and bitcoin by Macedonian residents and companies. In its statement the Central bank refers to the Macedonian legal framework relating to foreign exchanges, which forbids any direct investment from residents in foreign financial markets. Thus, the Macedonian central bank considers bitcoin to be a very risky investment and strongly advises the broader public to avoid its use and to refrain from investments in cryptocurrencies.[29]

D. Conclusion

The bitcoin and other cryptocurrencies are becoming a widely used means of payment even if they do not fulfil the three criteria or functions of money as a medium of exchange, unit of account and a store of value. There are positive aspects of using bitcoin including the speed and anonymity of the transactions as well as the low or non-existent transaction costs. However, the use of bitcoins involves substantial risk for both the private parties using it and for the authorities responsible for providing monetary and financial stability. The response of the regulators differs from one country to another. In the European monetary framework the situation is much more complicated since it is a *sui generis* monetary union. The national authorities in the EU Member States remain silent on the question of regulation of bitcoin and other cryptocurrencies while limiting their statements to the question of risk of investing Even if there are some modest attempts for the ECB to define cryptocurrencies, in his recent statement the ECB's President Mario Draghi stated that the ECB has no powers to prohibit and regulate bitcoin and other cryptocurrencies. However, the use of bitcoin has opened some practical problems in the field of taxation, which were brought in front of the Court of Justice of the EU, which has carefully defined bitcoin while admitting its function as a medium of exchange. As in this case, the wide use of cryptocurrencies will force the ECB to have

[29] *NBRM*, Press release, 28.09.2016, http://nbrm.mk/ns-newsarticle-soopshtieniie_na_nbrm_28_9_2016.nspx (4/10/2017).

a more active role in the process of regulation. Nevertheless, other jurisdictions across the globe have different approach towards bitcoin. Some have issued general statements highlighting the risk of the use of cryptocurrencies while others are trying to regulate it and even forbid the trading platforms from exchange of the cryptocurrencies.

Consultations and Early Settlement of Disputes in the World Trade Organization

Uroš Zdravković[*]

Abstract

Consultations are the first formal step in legal protection before the World Trade Organization (WTO). The purpose of consultations is to reach a mutually satisfactory solution to a dispute and early settlement. According to the Dispute Settlement Understanding (DSU), before resorting to litigation, the WTO members must attempt to obtain satisfactory adjustment of the matter. Through consultations, the WTO members in dispute exchange information, assess the strengths and weaknesses of their cases, narrow the scope of the differences between them and, in many cases, reach a mutually agreed solution. If consultations fail to settle a dispute, the complaining party may initiate litigation before the WTO judicial bodies (panels and the Appellate body). Consultations also have some negative aspects. They provide conditions for the settlement of disputes in grey areas with unknown outcomes and without any guarantee that the WTO-violator might change its behaviour.

A. Consultations in the WTO Dispute Settlement System – Basic Remarks

The dispute settlement procedure under the World Trade Organization (WTO) is considered officially commenced when one WTO member submits a request for consultations to another member, pursuant to Article IV of the Dispute Settlement Understanding (DSU).[1] A request for consultations represents a first formal step in initiating the procedure of legal protection before the WTO. When the WTO

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[1] Understanding on Rules and Procedures Governing the Settlement of Disputes (Annex II of Agreement Establishing the WTO). It is often referred as Dispute Settlement Understanding (DSU). The DSU is main legal source and legal basis for settling disputes between the WTO members regarding fulfillment of prescribed obligations under the WTO law.

member submits a request for consultations, a dispute becomes registered in the WTO Secretariat with its full official and short title, official number and other formal designations.

Consultations are the initial method for the settlement of disputes between members of the WTO. The WTO dispute settlement system is explicitly inclined to having consultations and the early settlement of disputes. The priority of the DSU mechanism is not obtaining formal decision by the Dispute Settlement Body (DSB)[2], but rather the substantial removal of trade conflicts. The purpose of consultations is to reach a mutually satisfactory solution, indeed this is first on the hierarchical list of the DSU aims, in accordance with Article III (7) of the DSU. [3] According to Article IV (5) of the DSU, in the course of consultations, before resorting to further action under the DSU, members should attempt to obtain satisfactory adjustment of the matter.

Consultations represent (in most cases bilateral) negotiations between the WTO disputed members. At first sight, this might be considered contradictory to WTO principles, which prefer multilateral methods for the settlement of disputes, followed by strict application of WTO law (*rule oriented approach*). At some level, consultations maintain a diplomatic character and can include a number of non-legal issues, which may be construed as a relic of the diplomatic/power oriented dispute settlement system existing during the first decade of

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[2] The Dispute Settlement Body is the highest authority in the institutional framework of the WTO dispute settlement system. It makes a final adoption of reports (judgments) prepared by the WTO judicial bodies (panels and the Appellate Body).

[3] According to the Article III (7) of the DSU, the preferred aim of the DSU is solution mutually acceptable to the parties to a dispute and consistent with the covered agreements. In the absence of a mutually agreed solution, the first objective of the dispute settlement mechanism is usually to secure the withdrawal of the measures concerned if these are found to be inconsistent with the provisions of any of the covered agreements. The provision of compensation should be resorted to only if the immediate withdrawal of the measure is impracticable and as a temporary measure pending the withdrawal of the measure, which is inconsistent with a covered agreement. The last resort, which this Understanding provides to the Member invoking the dispute settlement procedures, is the possibility of suspending the application of concessions or other obligations under the covered agreements on a discriminatory basis vis-à-vis the other Member, subject to authorisation by the DSB of such measures.

the GATT era.[4] During negotiations for the new dispute settlement system under the Uruguay round, this contradiction has often been presented as an obstacle, which prevents coexistence between bilateral and diplomatic negotiations and legal methods for the settlement of disputes under the same mechanism. Nevertheless, the prevailing opinion is that it is a false dichotomy and that both models can function together.[5] The WTO members should be provided with an opportunity to settle their disputes without resorting to litigation and with fewer costs.[6] Regardless of aspiration for disputes to be resolved through a multilateral forum (which existed among the Uruguay round negotiators), it was also necessary to enable the WTO members to avoid an "audience" and to resolve their disputes in a more "elegant" way. Some long and exhausting disputes (especially between the EU and the US) have shown that litigation cannot always offer a solution. It is, therefore, sometimes more useful for parties to try to settle difficult disputes through consultations, without resorting to litigation. At the same time, if a dispute cannot be resolved through negotiations, the member that requested consultations always has the possibility to initiate litigation by submitting a request for the establishment of a panel. In this regard, this issue should be perceived in the context of transformation of the dispute settlement system from the GATT era to the WTO. In contemporary circumstances, a member receiving the request for consultations, becomes more inclined to look at the problem objectively and to reconsider its internal measures. Otherwise, it could be faced with litigation before the WTO judicial bodies and with a potential binding decision.

Besides consultations, the DSU also provides other alternative methods for settlement of disputes between the WTO members, such

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4 The GATT era represents a period between first GATT (General Agreement on Tariffs and Trade) which was signed in 1947 and establishment of the WTO, after Uruguay Round of negotiations, in 1995.

5 *Schoenbaum*, WTO Dispute Settlement: Praise and Suggestions for Reform, International and Comparative Law Quarterly 47/3/1998, pp. 648-649.

6 The legal fees alone average $1.5 million for a typical case that goes through panel proceedings and may be higher for complex and lengthy disputes. See: *Davis*, The Effectiveness of WTO Dispute Settlement: An Evaluation of Negotiation Versus Adjudication Strategies, Prepared for presentation to the Annual Meeting of the American Political Science Association Boston, MA, 2008, p. 9.

as good offices, conciliation and mediation[7] or arbitration.[8] Consultations are, unlike mentioned methods, a mandatory phase in the DSU procedure. Nevertheless, consultations still share some similarities with other alternative methods for dispute settlement provided in the DSU: they do not go outside the bilateral framework and they represent confidential and insufficiently transparent procedures.

Consultations usually take place on a bilateral basis, but not exclusively. This is only one of the possibilities predicted in the DSU. Consultations with a particular WTO member may be requested by two or more WTO members if they consider that their rights and benefits are being nullified or impaired by application of measures allegedly inconsistent with WTO law and principles. In that case, two or more WTO members may submit a joint request for consultations. This kind of collaboration between WTO members is often present in the dispute settlement practice.[9]

The goal of the Article is to discover and present some important issues pertaining to consultations and early settlement of disputes in the WTO. Particularly, the purpose of the Article is the research and presentation of relevant benefits, as well as relevant disadvantages of the concept of consultations in the WTO. Recognising the goal and purpose of the Article, the author will try to analyse how this concept is defined and contemplated in the DSU text, and how it works in practice. The author also expects to provide additional scientific contribution to the topic, through an indication of some problems and, also, through corresponding recommendations for certain reforms which can lead to the better functioning of the DSU system in the pre-litigation stage.

B. Benefits of Consultations and Early Settlements of Disputes

Parties in consultations are expected to establish a delicate balance between bilateralism and confidentiality, on the one side, and the need

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7 Article V DSU.

8 Article XXV DSU.

9 *Guohua/Mercurio/Yongjie*, WTO Dispute Settlement Understanding: A Detailed Interpretation, Kluwer Law International, 2005, p. 44.

for the consultations process and mutually acceptable solutions to correspond to the broader multilateral context of the WTO, on the other. [10] That aim can be ascertained from an obligation that a mutually agreed solution must be in accordance with the WTO rules[11], as well as from the obligation of the parties in the dispute to inform the WTO institutions about the content of agreed solutions. [12]

The WTO members often use consultations as a method for settlement of their disputes. Until the end of 2015, about 20 per cent of all non-pending disputes have been settled through mutually agreed solutions (88 disputes in total). According to some writers, early settlement of disputes is more certain if the potential claimant is weaker than the potential respondent, if it has a worse reputation than the respondent and, finally, where there is insufficient capacity for efficient countermeasures.[13] This circumstance also raises questions of equity of all WTO members regarding access to the DSU system.

Consultations provide many benefits, not just for the parties in dispute, but also for the dispute settlement system in general. Through consultations, parties in dispute exchange information, assess the strengths and weaknesses of their respective cases, narrow the scope of the differences between them and, in many cases, reach a mutually agreed solution.[14] For the initiator of the consultations, this phase of the dispute settlement procedure also presents a certain "test" for eventual success in forthcoming litigation. The Member that requests consultations, approaches that process more relaxed because of the possibility to withdraw its request at any moment and to terminate the dispute without significant consequences. Moreover, even where no solution is reached, consultations provide the parties with an

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[10] *Pauwelin*, The Limits of Litigation: "Americanization" and Negotiations in the Settlement of WTO Disputes, Ohio State Journal for Dispute Resolution, 19/1/2003, p. 134.

[11] Article III (5) DSU.

[12] Article III (6) DSU.

[13] *Dukgeun/Jihong/Jee-Hyeong*, Understanding Non-Litigated Disputes in the WTO Dispute Settlement System, Journal of World Trade, 47:5/2013, pp. 985-1012, *passim*.

[14] See: Report of the Appellate Body in dispute *Mexico – Corn Syrup (Article 21.5-US),* para. 54. Full title of the case: *Mexico – Anti-Dumping Investigation of High Fructose Corn Syrup (HFCS) from the United States – Recourse to Article 21.5 of the DSU by the United States*, WT/DS132/AB/RW, adopted 21 November 2001, DSR 2001:XIII, 6675.

opportunity to define and delimit the scope of the dispute between them. [15]

Through consultations, the WTO members could obtain early settlement of their dispute, and thus avoid high procedural costs. Many writers noticed that the transition from the GATT to the WTO brought strong legalisation of the dispute settlement system. However, legalisation also increased the complexity of procedures, which offsets the potential benefits by imposing procedural costs on countries.[16] Consultations provide an opportunity for parties to settle their trade dispute without resorting to costly litigation.

Consultations are confidential and usually take place in Geneva, between the parties (and sometimes, interested third parties) with no WTO Secretariat or other referee present to mediate or create an official record.[17]

During consultations, parties exchange information necessary for defining the contours of dispute. If consultations fail and the dispute moves to the litigation stage, the claimant can later use the defined contours of the dispute in the request for establishment of a panel. Therefore, the exchange of information and ascertainments collected during consultations can have an important impact on the formation of a future request for establishment of the panel. Throughout the procedure of consultations, the potential claimant may become aware of additional circumstances, which were not previously known. For example, the claimant can learn more information regarding the operation of a disputed measure, which can change its position concerning provisions of covered agreements, which it considers violated by application of that measure.[18] Such a revision may lead to

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[15] *Ibid*. See also: *Schuchhhardt*, Consultations under the WTO Dispute Settlement Understanding, WTO Jurisprudence and Policy: Practitioners' Perspectives, 2004, pp. 74-75.

[16] *Moonhawk*, Costly Procedures: Divergent Effects of Legalization in the GATT/WTO Dispute Settlement Procedures, International Studies Quarterly, 52, 2008, pp. 657-686, p. 679.

[17] *Porges*, Settling WTO Disputes: What Do Litigation Model Tell Us?, Ohio State Journal on Dispute Resolution, Vol. 19:1, 2003, pp. 141-184.

[18] Covered agreements are the group of agreements under the WTO legal framework, which can be applied by the WTO judicial bodies (panels and the Appellate Body). The WTO member can initiate a dispute settlement procedure if it considers that another

a narrowing of the complaint, or to a reformulation of the complaint that takes into account new information.[19] In other words, during consultations the complainant member can shape its future panel request.

The confidential character of consultations, especially when they are placed on a bilateral level, presents a particular benefit for parties in dispute because it prevents the intervention of various third entities (whether it is other WTO members or non-government organisations). In any circumstance, confidentiality creates a favourable atmosphere for reaching agreement at an early stage of dispute.[20]

Finally, initiation of consultations is useful for the whole WTO community. It draws other WTO members' attention to the problem, so they can later decide whether to commence the DSU procedure pertaining to same issue, or to join existing procedure as a complainant or third party.

C. Obligations of Parties during Consultations

According to the provision Article IV(2) DSU, each WTO member is obliged "*to accord sympathetic consideration to and afford adequate opportunity for consultation regarding any representations made by another Member concerning measures affecting the operation of any covered agreement taken within the territory of the former.*"

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member, by its internal measures, is violating the norms and principled contained in the covered agreements. Article 1.1 of the DSU in its first sentence states: "*The rules and procedures of this Understanding shall apply to disputes brought pursuant to the consultation and dispute settlement provisions of the agreements listed in Appendix 1 to this Understanding.*" The DSU marks those agreements as *covered agreements*. All covered agreements are listed in Appendix 1 to the DSU. See more in: *Zdravković*, Coverage and application of the WTO dispute settlement mechanism, in: Belov (ed.), Central and Eastern European Forum for Legal, Political, and Social Theory Yearbook, vol. 6, Global Governance and Its Effects on State and Law, 2016, pp. 213-228.

19 See Report of the Appellate Body in case *Mexico – Anti-Dumping Measures on Rice,* para. 138. Full title of the case: *Mexico – Definitive Anti-Dumping Measures on Beef and Rice, Complaint with Respect to Rice*, WT/DS295/AB/R, adopted 20 December 2005, DSR 2005:XXII, 10853.

20 *Busch*/*Reinhardt*, Bargaining in the Shadow of the Law: Early Settlement in GATT/WTO Disputes, Fordham International Law Journal, 24/1/2000, pp. 158-172, *passim*.

Unlike other alternative methods for settlement of disputes provided in the DSU (good offices, conciliation, mediation and arbitration), the obligation of members to afford adequate opportunity for consultation is absolute and cannot be subject to any preconditions. According to the Panel in the case of *Brazil – Desiccated Coconut,* members' duty to consult is absolute, and is not susceptible to the prior imposition of any terms and conditions by a member. The Panel has also stated that compliance with the fundamental obligation of WTO Members to enter into consultations where a request is made under the DSU is vital to the operation of the dispute settlement system.[21]

Parties to a dispute are obliged to join into consultation in good faith.[22] They also need to make their assertions and arguments clearly and to disclose to each other all facts known to them. [23]

Consultations are an obligatory precondition for eventual initiation of litigation through submission of request for establishment of a panel. Before it requests establishment of a panel, a WTO member must first request consultations and consultations must be held.[24] Nevertheless, there are exemptions from the condition that consultations must be held. It is logical that the WTO member can

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21 Panel Report, *Brazil – Measures Affecting Desiccated Coconut*, WT/DS22/R, adopted 20 March 1997, as upheld by Appellate Body Report WT/DS22/AB/R, DSR 1997:I, 189. See para. 287 of the Report.

22 See Article IV (3) DSU.

23 See more about interpretation of this obligation in the reports of the Appellate Body in the following cases: *India – Patents (US),* para. 9, full title of the case: *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products*, WT/DS50/AB/R, adopted 16 January 1998, DSR 1998:I; *US – Continued Suspension*, para. 313, full title of the case: *United States – Continued Suspension of Obligations in the EC – Hormones Dispute*, WT/DS320/AB/R, adopted 14 November 2008. See also the Report of the Panel in the case *EC – Bed Linen*, paras. 6.32-6.35, full title: *European Communities – Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India*, WT/DS141/R, adopted 12 March 2001, as modified by Appellate Body Report WT/DS141/AB/R, DSR 2001:VI, 2077.

24 See reports of the Appellate Body in cases: *Brazil – Aircraft,* para. 131, full title: *Brazil – Export Financing Programme for Aircraft*, WT/DS46/AB/R, adopted 20 August 1999, DSR 1999:III, 1161; *US – Continued Zeroing*, para. 222, full title: *United States – Continued Existence and Application of Zeroing Methodology*, WT/DS350/AB/R, adopted 19 February 2009; *US – Upland Cotton,* para. 287, full title: *United States – Subsidies on Upland Cotton*, WT/DS267/AB/R, adopted 21 March 2005, DSR 2005:I, 3.

submit a request for establishment of a panel to the DSB without previous consultations if the other member does not respond to a request or refuses to participate in consultations.[25]

Request for consultations must be submitted in writing and the DSB and the relevant Councils and Committees must be notified of all such requests by the requesting Member.[26] Nevertheless, what happens during consultations is confidential.[27] The DSU stipulates only one condition before the submission of the request for establishment of a panel: that consultations really took place.[28] The panel does not have a right to be informed or to investigate what really happened during consultations.[29] Consultations take place outside the WTO institutions and its judicial bodies, and parties to the dispute have discretion regarding the content of consultations and methods of procedure. In addition, everything that parties do during consultations is without prejudice to their rights in any further proceedings. [30]

In its request for consultations, the WTO member must provide a reason for making the request, including identification of measures at issue and an indication of the legal basis for the complaint.[31] Nevertheless, if the member does not possess detailed information

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25 See the Report of the Appellate Body in the case *Mexico – Corn Syrup (Article 21.5 – US),* para. 58-64, full title of the case: *Mexico – Anti-Dumping Investigation of High Fructose Corn Syrup (HFCS) from the United States – Recourse to Article 21.5 of the DSU by the United States*, WT/DS132/AB/RW, adopted 21 November 2001, DSR 2001:XIII, 6675. See also: *Palmeter/Mavroidis*, Dispute Settlement in the World Trade Organization: Practise and Procedure, 2004, pp. 86-93.

26 Article IV (4) DSU.

27 Article IV (6) DSU.

28 See Panel Report in the case *EC – Bananas III (Ecuador),* para. 7.19. Full title of the case: *European Communities – Regime for the Importation, Sale and Distribution of Bananas, Complaint by Ecuador*, WT/DS27/R/ECU, adopted 25 September 1997.

29 See Report of the Appellate Body in the case *US – Upland Cotton,* paras. 286-287, full title of the case: *United States – Subsidies on Upland Cotton, Recourse to Article 21.5 of the DSU by Brazil*, WT/DS267/AB/RW, 2 June 2008. See also report of the Panel in the case *Korea – Alcoholic Beverages,* para 10.19, full title: *Korea – Taxes on Alcoholic Beverages*, WT/DS75/R, WT/DS84/R, adopted 17 February 1999, as modified by Appellate Body Report WT/DS75/AB/R, WT/DS84/AB/R, DSR 1999:I, 44.

30 Article IV (6) DSU.

31 Article IV (4) DSU.

regarding the measure, it will not be obliged to precisely identify a concrete measure. In that situation, it is enough to identify a measure in a descriptive way.[32] With respect to the legal basis for the complaint, the member only needs to refer to relevant WTO norms, which it considers were violated by the internal measure of another member. It does not have an obligation to provide an explanation of the violation. This more relaxing solution corresponds to the nature of consultations, as a process with less formalities and strictness, compared to conditions, which apply to the request for establishment of a panel.[33]

If consultations fail to settle a dispute within 60 days of the date of receipt of the request for consultations (or 20 days in cases of urgency, including those that concern perishable goods), the complaining party may request the establishment of a panel. The complaining party may also request a panel during the 60-day period if the consulting parties jointly consider that consultations have failed to settle the dispute.[34]

D. Participation of Third Parties

During consultations, if a member other than consulting members considers that it has a substantial trade interest pertaining to the subject of dispute, such member may notify the consulting members and the DSB of its desire to be joined in the consultations within 10 days after the date of the circulation of the request. This member can join in the consultations, provided that the member to which the request for consultations was addressed agrees that the claim of substantial interest is well-founded. If the request to be joined in the

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[32] See Panel Report in the case *EC – Large Civil Aircraft,* para. 7.126. Full title of the case: *European Communities and Certain Member States – Measures Affecting Trade in Large Civil Aircraft*, WT/DS316/R, 30 June 2010.

[33] See reports of the panels in cases: *US – Poultry (China),* paras. 7.30-7.34 and 7.43, full title: *US – Certain Measures Affecting Imports of Poultry from China,* WT/DS392/R 29 September 2010; *EC – Fasteners,* para. 7.207, full title: *European Communities – Definitive Anti-Dumping Measures on Certain Iron or Steel Fasteners from China*, DS397, 3 December 2010.

[34] See Articles IV (7) and (8) DSU.

consultations is not accepted, the applicant member will have a right to independently request consultations.[35]

Some writers criticise the possibility for the participation of third parties in the consultations process. According to their argumentation, consultations have a confidential nature and "more voices" in that process could cause difficult in reaching a mutually acceptable solution and the early settlement of the dispute.[36] The participation of third parties in consultations could also negatively affect a claimant's position: if consultation parties reach a mutually acceptable solution, compensation offered by the respondent party cannot always remain on a bilateral level because the other participants who know about "the deal" will also expect concessions from the respondent. On the other hand, we should also recognise the argument that the participation of third parties in the consultation process can have positive effects on the WTO normative system. The presence of a third party enables better surveillance concerning the conformity of mutually acceptable solutions with WTO law.[37]

E. Negative Aspects of Consultations

During the 22 years that the DSU system has been functioning, 524 requests for consultations have been submitted and registered before the WTO Secretariat. At first sight, we may conclude that this is a huge number of disputes that have been, or ought to be legally resolved in accordance with the WTO rules. Nevertheless, even when members formally initiate the consultation procedure, it does not guarantee that the dispute will actually be resolved in accordance with the WTO rules. Until the end of 2015, 161 consultations remained in the "shadow" and we do not have any official information regarding their outcome. In other words, consultations have been initiated, but parties did not inform the WTO institutions and public at large about the outcomes.

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35 Article IV (11) DSU.

36 *Davey/Porges*, Comments on Performance of the System I: Consultations and Deterrence, International Lawyer, 32 (3)/1998, p. 695 et seqq; *Bown*, Trade Policy under the GATT/WTO: Empirical Evidence of the Equal Treatment Rule, Canadian Journal of Economics, 37 (3)/2004, p. 678 et seqq.

37 *Johns/Pelc*, Who Gets to Be In the Room? Manipulating Participation in WTO Disputes, International Organization, 68/3/2013, p. 668.

With respect to these disputes, there is not any official data about how they have been resolved or whether agreed solutions correspond to WTO norms. We can only assume that a great number of these disputes have been resolved through diplomatic methods.

In a fewer number of cases parties fail to notify DSB and other WTO institutions about mutually agreed solutions, even though that obligation is predicted by Article III(6) of the DSU.[38] Moreover, members sometimes quit further litigation proceedings before a panel if a mutually acceptable solution cannot be reached. This behaviour is characteristic of developing countries, which often initiate consultations and afterwards cease from further settlement of the dispute due to lack of resources and capacity to finish their legal battle.[39] The exact number of all trade disputes that have been resolved through diplomatic activities cannot be determined nor assumed because the great majority of disputes remains unregistered before the WTO and, at the same time, invisible for WTO institutions and the broader international community.

In terms of arguments in favour of consultations, we must emphasise that they have a two-fold effect on the realisation of justice during the initial stage of dispute settlement. On the one hand, consultations give an opportunity for the WTO members to settle their disputes at an early stage and in a mutually acceptable way. On the other hand, consultations provide conditions for settlement of disputes in grey areas with unknown outcomes and without any guarantee that the WTO-violator will change its behaviour. Consultations are an "archaic" process involving bilateralism and confidentiality. From that aspect consultations have negative potential in regard to aspirations that the WTO members should resolve their problems in a legal and transparent manner.

According to Article III (5) of the DSU, mutually acceptable solutions agreed through consultations must be consistent with the covered agreements. Nevertheless, a particularly "neuralgic" point is the fact that conformity of mutually agreed solution with WTO law is being controlled by the WTO political institutions composed of

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[38] *Reynolds*, Why Are So Many WTO Disputes Abandoned?, American University, Department of Economics, Working Paper Series, no. 2007-05, June 2007, pp. 2-3.

[39] *Ibid*.

representatives of the WTO members: DSB and other relevant councils and committees.[40] In the given circumstances, mutually agreed solutions are not subject to any preliminary control by independent experts who could notice possible inconsistency with the WTO rules. Without that kind of control, instead of changing a violator's behaviour (from which all WTO members would have benefits), disputes are being resolved through bilateral concessions. In that regard, the DSU should be reformed by imposing preliminary control of mutually agreed solutions by expert bodies. Expert bodies should prepare relevant reports about conformity of mutually agreed solutions with WTO law, and the DSB would adopt these reports the same way it adopts reports of panels and the Appellate Body. This would undoubtedly be a step towards further collectivisation of the WTO community, but it would also contribute to the level of compliance with WTO law.

Regarding consultations, one can also ask whether the DSU is, by itself, inclined enough to distribute justice in the WTO if it favours mutually acceptable solutions through consultations. Moreover, Article III (7) of the DSU states that the aim of the dispute settlement mechanism is to secure a *positive solution to a dispute*. That dilemma would perhaps not exist if the proclaimed aim of the DSU would be "*securing positive solution to a dispute in accordance to the covered agreements*" or "*establishment and promotion of behavior that is consistent with the WTO law*." "Positive solution to a dispute" in its broader meaning refers also to a political dialogue and does not guarantee whether the outcome of a dispute will correspond to WTO norms. The problem is also the fact that the withdrawal of measures inconsistent with the provisions of the covered agreements is a second aim in the hierarchical structure of the DSU aims. The preferred aim of the DSU is a solution mutually acceptable to the parties to a dispute (reached during consultations).[41] This leads to the conclusion that the WTO founders did not just leave a possibility for that, but that they also preferred settlements of disputes, which do not necessarily mean

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[40] Article III (6) of the DSU states: "Mutually agreed solutions to matters formally raised under the consultation and dispute settlement provisions of the covered agreements shall be notified to the DSB and the relevant Councils and Committees, where any Member may raise any point relating thereto."

[41] See Article III (7) of the DSU.

compliance of the WTO members' trade policy with the WTO norms and principles. In most cases, a mutually acceptable solution is being reached throughout bilateral and confidential negotiations after which the WTO member may continue with application of inconsistent measures.

In the end, we must conclude that, irrespective of all mentioned arguments, consultations represent reflections of the WTO members' sovereignty. The WTO legal system cannot reach that level of "perfection" which could provide full control of the WTO members' autonomy to settle their disputes in the manner that they consider appropriate. Although consultations at some point represent mechanisms for reaching agreements, which are not fully compatible with the WTO rules, they enable the WTO members to avoid long and expensive litigation.

F. Conclusion

Consultations are the initial method for the settlement of disputes between members of the WTO and their goal is the substantial removal of trade conflicts through a mutually satisfactory solution. Consultations are an obligatory precondition for eventual initiation of litigation through the submission of a request for establishment of a panel. Consultations provide many benefits for parties in dispute. Some of them are: exchange of information, narrowing the scope of dispute, assessing eventual success in forthcoming litigation, preventing the intervention of various third entities and, finally, reaching a mutually agreed solution.

Apart from their positive aspects, consultations also provide conditions for settlement of disputes in grey areas with unknown outcomes and without any guarantee that the WTO-violator will change its behaviour. They are bilateral and confidential and mutually agreed solutions are not subject to any preliminary control by independent experts who could notice possible inconsistency with the WTO rules. In that regard, the DSU should be reformed by imposing preliminary control of mutually agreed solutions by expert bodies.

In the end, we must conclude that, irrespective of all mentioned arguments, consultations represent reflections of the WTO members' sovereignty. The WTO legal system cannot reach that level of

"perfection" which could provide full control of the WTO members' autonomy to settle their disputes in the manner that they consider appropriate. Although consultations at some point represent mechanisms for reaching agreements, which are not fully compatible with the WTO rules, they enable the WTO members to avoid long and expensive litigation.

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