New Perspectives of South East European Private Law

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INTRODUCTION
Christa Jessel-Holst and Tatjana Josipović

The First South East European Post-Doc Colloquium in Private Law took place at the Faculty of Law in Zagreb from 27th and 28th September, 2012. It was organized within the framework of the South East European Law School Network (SEELS), with the support of the GIZ Open Regional Fund for South East Europe – Legal reform.

Eligible for participation were academics from the Faculties of Law (SEELS members) in Belgrade, Kragujevac, Niš, Podgorica, Sarajevo, Skopje, Split, Tirana, Zagreb and Zenica. The candidates must either have been working at one of these faculties, or have their PhD-diploma from one of them. A further condition was, that they defended their PhD between 1 January, 2007 and 31 December, 2011. The candidate’s dissertation could have been in any field of private law, like civil law, family law, commercial law, labour law, competition law, private international law, civil procedure, including the European private law. Every academic who met the requirements had the right to be a candidate.

The choice of participants was made by a Selection Committee, in which all (then: 10) SEELS Faculties of Law were represented, on the basis of a summary in English of the candidate’s dissertation and the candidate’s CV and list of publications. Finally, seventeen academics from nine SEELS faculties (from Albania, Bosnia and Herzegovina, Croatia, Macedonia, Montenegro and Serbia) were invited to take part in the Colloquium in Zagreb with an oral presentation on a topic of their choice which was connected with their actual research.

On the Zagreb Colloquium, which was open to the public, all seventeen speakers were gathered in a square in front of the audience. Each speaker had 30 minutes for a power-point presentation in English language, followed by a discussion of the respective presentation with the other speakers and with the audience. The central idea of the colloquium was to assemble highly qualified academics from different disciplines and from different countries of the region for an exchange of ideas. The approach turned out a total success. Not only were the presentations original and stimulating, but also the discussions across disciplines proved particularly animated and inspiring.

The results of the Colloquium are documented in this publication. The intention has not been to present the main contents of the dissertations, but rather to document the actual research of the authors in the field covered by their dissertation.

The publication has been prepared in English language because the editors wish all contributions to be accessible also to a broad spectrum of readers abroad. They also hope that this conference book shall provide an incentive for postgraduates in the region for their own scientific research. Finally, the concept of a regional Post Doc Colloquium, as for the first time developed in Zagreb, may be taken up by other faculties for future follow-ups.

Zagreb and Hamburg, 18 October 2012
PART ONE
PRIVATE INTERNATIONAL LAW AND ARBITRATION
ADJUSTMENT IN SERBIAN PRIVATE INTERNATIONAL LAW
by dr. sc. Slavko Djordjevic, Assistant Professor at the University of Kragujevac, Faculty of Law

Abstract

Adjustment is an instrument of private international law by which courts modify or ignore applicable rules in cases with a foreign element. In order to determine whether this instrument can function in Serbian private international law, the present paper focuses on three issues. First, it should be explained which outcomes of the cases with a foreign element have to be avoided by adjustment. Second, it is important to determine whether adjustment is permitted and justified in Serbian private international law. Third, it has to be explained how to adjust the rules. All these issues as well as the other issues concerning adjustment method are more fully and in detail discussed in the author’s doctoral dissertation.

Key words: contradiction of norms; accidental (unintended) unequal treatment; special aim of conflict rules; constitutional background of adjustment; human rights; principle of less resistance.

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1. Introduction

According to prevailing opinion in literature the adjustment should be understood as a methodological mean (instrument) of private international law by which courts or other authorities intentionally modify, ignore or create conflict rules and applicable substantive rules in order to correct or avoid the results of application of different national laws in a given case.\(^1\)

Adjustment was “revealed” in German legal theory at the end of the 19th century\(^2\) and today has become a recognized institute of private international law in most European (continental) legal systems. Having in mind that it has been recently introduced in European private international law by the new Regulation on succession matters\(^3\), one could say that adjustment is on its way to becoming a fully recognized institute of private international law of the EU too.\(^4\)

On the other hand, the adjustment method hasn’t been properly discussed in Serbian literature and domestic courts haven’t recognized the problems which should be solved by adjustment. For most Serbian lawyers this instrument is *terra incognita*, an unknown “thing from another world” which doesn’t exist in the domestic legal system. Could adjustment become a recognized instrument of Serbian private international law in future? Most of the very few Serbian authors who have dealt with this problem would usually say ‘no’. My opinion is quite the opposite: adjustment of applicable rules is permitted and must be performed in cases with a foreign element by Serbian courts because they are obliged to do so. In the present paper I am going to focus on some of the key issues of adjustment method in private international law in order to explain and prove my opinion.

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2. In literature professor Ernst Zitelmann is considered as “inventor” of adjustment. See Zitelmann, Ernst. Internationales Privatrecht vol I. Leipzig 1897, 144.


4. Art. 31 regulates a transposition (transformation) of unknown foreign rights in rem as a special form of adjustment method and recital 17 encourages the courts of Member States to use the other forms of adjustment in the context of the application of this Regulation.
Considering that everything about adjustment is "disputable and unsecure"\(^5\), I have decided to start this paper with a very wide definition of this instrument that could be acceptable for most of the authors who deal with adjustment problems in private international law. Three main issues arise from the above-mentioned definition and represent the central subject of this paper:

First, it is very important to define which results of applying different national laws should be corrected or avoided by adjustment method. There are two main opinions. According to the first, contradiction of norms (substantive rules) as a result of application of different national laws has to be avoided by adjustment method\(^6\). The second opinion, presented by Professor Gerhard Dannemann from Germany, finds that the adjustment method is used to prevent so called accidental discrimination\(^7\). Both opinions are going to be presented and analyzed in this paper (II).

Second, the fact that the court can modify, ignore or create norms in order to correct the outcome of a case raises the question of permission and justification of the adjustment method in Serbian private international law. Serbian authors\(^8\) have opposing opinions on this matter\(^9\). Therefore, it is of great importance to explain why rules have to be adjusted (III).

Third, when it is necessary to apply the adjustment method, a judge must follow some principles in order to modify or create rules. These principles, which have been already developed in foreign literature and judicial practice, will be discussed (IV).

Considering that Serbian literature hasn’t paid enough attention to the adjustment method, I was forced to seek help in foreign literature (especially from German authors) in order to find the solutions for a large number of questions concerning the adjustment method. I then tried to interpret their application in Serbian private international law.

Generally speaking, the present paper should be comprehended as an initiative to promote discussion on implementing the adjustment method in Serbian private international law.

2. **Contradictions of Norms or Accidental Discriminations**

The great majority of authors find that the adjustment method was "invented" to prevent or avoid so-called contradictions of norms, which are caused by the combined application of substantive rules of different applicable national laws\(^10\). This is also the prevailing opinion in Serbian literature relating to private international law\(^11\).

The application of several national laws in cases with a foreign element and the occurrence of contradictions of norms arise as a consequence of the conflict rule method, which is an analytic method by its nature\(^12\). That means that all basic institutes of private international law (especially characterization of legal issues, incidental question, renvoi and conflit mobile) may cause contradic-


\(^7\) Dannemann, Ungewollte Diskriminierung, 155 etc.; Dannemann, „Accidental Discrimination“, 120 etc.

\(^8\) See Jaksic, „Prilagodjavanje“, 2039; Stanivukovic, Zivkovic, MPP, 372.


\(^10\) See footnote 2.

\(^11\) See Jaksic, Medjunarodno privatno pravo, 277; Jaksic, „Prilagodjavanje“, 2041 etc.; Stanivukovic, Zivkovic, Medjunarodno privatno pravo, 368-370.

\(^12\) Goldschmidt, Werner. „Die philosophischen Grundlagen des internationalen Privatrechts.“ In FS Martin Wolff, Tübingen: Mohr Siebeck, 1952, 208.
tions of norms. A case with a foreign element splits on several connected legal issues for which the legislator has created different conflict rules. If these conflict rules refer to different national laws, it can happen that the substantive rules of invoked national laws are not coordinated, i.e. these rules contradict each other. The application of non-coordinated substantive rules of different applicable national laws very often produces an unfair and unjust result which is unintended (unwanted) by any of these national laws. This result, including the whole situation as such, is named contradiction of norms.\(^{13}\)

The typical textbook case showing the appearance of contradiction of norms caused by diverging characterization of legal issues is the so called widow’s case: In this case a husband died intestate and left his widow with nothing because the national law applicable to matrimonial property and the national law applicable to inheritance take care of the widow’s interest in different ways. The national law, which provides the rules that govern the matrimonial property regime, finds that the widow should receive a share under the rules on inheritance law. However, the national law applicable to widow’s inheritance rights would instead leave this issue to the rules on the matrimonial property regime. Therefore, the combined application of these two national laws leads to the result that the widow is left with nothing, although both national laws agree the widow should receive a share of the husband’s assets. None of the rules providing a share for the widow have been invoked in this case. In literature this is marked as a ‘lack of norms’\(^{15}\).

It could also appear that the combined application of the national law applicable to matrimonial property and the national law applicable to inheritance produces the result that a widow receives a double share of the estate, notwithstanding the fact that both national laws agree to give her less. It happens because the conflict rules of the forum have invoked all substantive rules (of both national laws) which provide a share for a widow. Invoking “too many rules” is marked as an ‘abundance of norms’in literature and represents the other category of contradictions of norms\(^{16}\).

In 2004, German professor Gerhard Dannemann published his habilitation “Die Ungewollte Diskriminierung in der Internationalen Rechtsanwendung” in which he criticized the term ‘contradiction of norms’ and tried to develop a new view of recognizing the outcomes of cases with a foreign element which should be avoided by adjustment. According to his opinion, the results in the widow’s case should not be seen as a contradiction of norms, i.e. ‘lack of norms’ or ‘abundance of norms’, because the applicable rules do not contradict each other. It is just that their common application produces a result which is not in accordance with the intentions of any applicable national laws\(^{17}\). He also pointed out that literature hasn’t paid much attention to the results of combined (fragmented) decisions on a case with a foreign element in different jurisdictions, which could also fall into the scope of the adjustment method.\(^{18}\)

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\(^{13}\) See Kegel, Internationales Privatrecht, 147. It should be stressed out that there is no unique definition of contradiction of norms. In defining this notion authors primarily put an accent on applicable norms and its mutual contradictions, but lot of them take into consideration a result of application of these norms too. However, I find that all authors who dealt with contradictions of norms usually (not always) have in mind the same situations, despite of their (slightly) different definitions. This conclusion does not apply to so-called logical contradictions and one-sided contradictions which are not to be discussed in this paper. For more fully discussion on contradictions of norms see Djordjevic, Prilagodjavanje, 52-70.


\(^{16}\) See ibid.

\(^{17}\) See ibid.

\(^{18}\) See Dannemann, Ungewollte Diskriminierung, 154 etc, 293 etc.
According to Dannemann’s opinion, the adjustment method should be used to prevent so-called ‘accidental discrimination’¹⁹ (unintended unequal treatment). He finds that accidental discrimination occurs when the outcome of a case with a foreign element (international case) differs from the outcomes of otherwise identical cases which are connected to only one of the legal systems involved (so-called national cases) and this different treatment is not intended by any applicable rule²⁰. Simply, he compares the outcomes of international and national cases: “If the two legal systems agree on the treatment of national cases and the treatment deviates from the result which both legal systems produce when taken together, then the international case is treated differently just because it is international”²¹. As to whether there are any ‘lack of norms’ or ‘abundance of norms’, it is completely insignificant.

It is obvious that accidental discrimination has occurred in the widow’s case: if any of the applicable national laws singularly applied to all circumstances of this case, the widow would receive a share (national cases), but when they apply together (in tandem) she is left with nothing (international case). It should be stressed that many situations marked as contradictions of norms are at the same time accidental discriminations. However, the latter term is clearly oriented to the results of cases with a foreign element (i.e. not to the norms which have to be applied) and embraces not only the results of combined application of substantive rules of different national laws, but also the results of combined (fragmented) decisions on a case with a foreign element or other application of laws in different jurisdictions (countries)²². This kind of accidental discrimination occurs as a consequence of applying rules on jurisdiction and recognition and enforcement of foreign judgments. For example, the rules on jurisdiction of the Serbian court in proceedings for distribution of estates after death (Articles 71-73 of Serbian Private International Law Act – PIL Act) are based on the criteria of distinction between movable and immovable property and the citizenship of the deceased person. The consequences of application of these rules can be that the Serbian court has jurisdiction for distribution of some parts of an estate of a deceased person, while the distribution of the rest of the estate falls under the jurisdiction of the foreign court. Making decisions on the distribution of different parts of the estate of a deceased person in two jurisdictions (countries) can be more or less coordinated. Uncoordinated decision-making processes in Serbia and a foreign country often leads to an unfair and unjust result for one of the parties (successors), which would not be produced if only one of the courts (the court of one country) decided on distribution of the whole estate. This means that accidental discrimination has occurred: the result of decision-making processes in Serbia and in the foreign jurisdiction taken together deviates from the results which would be produced in each of these jurisdictions separately²³.

I find that Dannemann’s view on adjustment problems and particularly creation of the notion ‘accidental discrimination’ represent crucial development in understanding the adjustment method as one of the most complicated issues of private international law. He established reliable criteria for recognizing the outcomes of the cases which should be avoided by adjustment. According to my opinion, for the first time it is mostly clear when the adjustment method must be used.

¹⁹ In German „ungewollte Ungleichbehandlung” or „ungewollte Diskriminierung”. In his article published in English in Yearbook of Private International Law (2008) Dannemann uses term „accidental discrimination”.
²⁰ Dannemann, Ungewollte Diskriminierung, 155; Dannemann, „Accidental Discrimination”, 120.
²¹ Dannemann, “Accidental Discrimination”, 120.
²² Dannemann, Ungewollte Diskriminierung, 293 etc.; Dannemann, „Accidental Discrimination”, 122. First author who pointed out that results of combined decisions-making process in different jurisdictions can produce adjustment problems was professor Jürgen Basedow (Basedow, Jürgen. „Qualifikation, Vorfrage und Anpassung im Internationalen Zivilverfahrensrecht.” In Materielles Recht und Prozessrecht und die Auswirkungen der Unterscheidung im Recht der Internationalen Zwangsvollstreckung. Hrsg P.F. Schlosser, Bielefeld, 1992: Gieseking, 151 etc.).
²³ Problems produced by Art. 71-73 of Serbian PIL Act are in detail discussed in: Djordjevic, Prilagodjavanje, 283-302.
These are the main reasons that strongly influenced my decision to introduce and to implement this notion in Serbian private international law.

However, having in mind the characteristics of Serbian private international law and the Serbian legal system in general, I was naturally forced to refine some elements of Dannemann’s definition of accidental discrimination. One of the most visible and important remarks and refinements I made targets the requirement that accidental discrimination can not be intended by any applicable rule. If these rules intentionally lead to unequal treatment, it will not amount to an accidental discrimination. The best examples of these rules in Serbian law are those requiring the existence of reciprocity for acquisition of property rights on real estate by foreigners, and the rule on special requirements for adoption of a child by a foreigner.

Discussing the aforementioned element of accidental discrimination, Dannemann did not deal with the following problem: It could appear that unequal treatment is not intended by any applicable substantive rule, but the conflict rule of the forum produces unequal treatment in a given case because it intends to achieve a special aim which is implied in this conflict rule. Is it permitted to use the adjustment method in this case? Unequal treatment in these kinds of situations represents a consequence of the achievement of a special aim, which is ratio legis of the conflict rule. When the legislator formed these kind of conflict rules, he had in mind only the achievement of a special aim, notwithstanding the consequences the conflict rule can produce. So, the legislator accepted all negative consequences of applying the conflict rule, including unequal treatment, in order to secure the achievement of the intended aim. Simply, it seems that the priority of achieving the intended special aim justifies the appearance of discrimination. That means the adjustment method should not be applied because discrimination is not accidental.

The described conflict rules are not very common. The Serbian Private International law Act (PIL Act) contains very few conflict rules of this kind. One of them is a conflict rule for tortious liability contained in Art. 28 of the PIL Act. According to the basic rule (Art 28 para. 1), the tortious liability is governed by the law of the place where the act has been performed or the law of the place where the consequences have occurred, depending on which of these two laws is more favorable to the injured person. Para. 3 of the same article regulates independently the question of unlawful character of a tortious act in the following manner: “The law governing the unlawful character of a tortious act shall be the law of the place where the act has been performed or its consequences have occurred, and if the act was performed or the consequences have occurred at more than one place – it is sufficient that the act is unlawful according to the law of any of those places.”

The basic conflict rule taken by itself doesn’t make problems, but taken together with the special conflict rule for a tortious act (Art. 28 para. 3) it obviously can produce accidental discrimination. For example, an act has been performed in country A whose law considers the performed act as lawful, and consequences have occurred in country B whose law has the opposite stance – the act is unlawful. It can be further imagined that according to the law of B the period of time in which a

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24 In his habilitation Dannemann discussed a lot of cases in which unequal treatment is justified. See G. Danneman, Ungewollte Diskriminierung. 193 etc.
25 See Art. 82-85b of Act on Basis of Ownership and Proprietary Relations (Zakon o osnovama svojinskopravnih odnosa), Official Gazette SFRY No. 6/80, 36/90, Official Gazette FRY No. 26/96, Official Gazette RS No. 115/05.
28 English translation of Private International Law Act of Croatia/Serbia/Bosnia and Herzegovina (i.e. Act Concerning the Resolution of Conflicts of Laws with Provisions of Other States in Certain Matters 1982) can be found in Davor, Babic, Christa, Jessel-Holst, Medunarodno privatno pravo – zbirka unutarnjih, europskih i medunarodnih propisa, Zagreb: Narodne novine, 2011, 4 etc.
plaintiff has to commence the proceeding (limitation period) has expired and according to the law of A the limitation period still runs. Considering that Art. 28 para. 3 refers to any of these laws in order to determine the unlawfulness of the performed act, the court will simply declare that the act is unlawful according to the law of B. However, all other issues from the domain of tortious liability are governed by the more favorable law applicable pursuant to Art. 28 para. 1 (basic conflict rule) and that is the law of A because under its substantive rules the limitation period has not yet expired. Therefore, the combined (fragmented) application of two different national laws (i.e. law of the place of act and law of the place of consequences) caused by the special conflict rule contained in Art. 28 para. 3 has produced the result that the defendant is liable for damage, although any of these laws, separately applied on all issues of the tortious liability, wouldn’t consider the individual liable for damage.

Enacting the special conflict rule for unlawful acts, the Serbian legislator was mostly aware of the consequences which could be produced by its application. The legislator clearly wanted to privilege and protect the injured person at any price, even if it wouldn’t be possible according to any of the national laws involved. Therefore, one can say that this unequal treatment (discrimination) is not accidental and should be considered as a consequence of achieving the special aim of Art. 28 para. 3 and ignored due to the legislator’s will. There is no need for adjustment.

However, a serious question can be raised. Does the achievement of a special aim contained in Art. 28 of the PIL Act represent a good enough reason for justifying unequal treatment of international and national cases? The importance of asking this question becomes obvious, if one takes into account the extent to which ubiquity rule and the principle of more favorable law can really be discriminatory. Allowing the injured person to choose a more favorable law, the ubiquity rule puts a person injured in a so called distance tortious event in a better position than a person injured in local tortious event (i.e. an event where the act and consequences have occurred in the same country) or in a purely domestic local tortious event. Additionally, a person liable for damage occurred in a distance tortious event is in a worse position than a person liable for damage that occurred in a local tortious event or in a purely domestic tortious event.

When the conflict rule for unlawful character of a tortious act (Art 28 para. 3) joins the ubiquity rule, the described inequality becomes more and more obvious and truly unreasonable, and it depends exclusively on the constellation of circumstances of a case which is usually accidental. So, I find that the achievement of a special aim implied in Art. 28 para. 3 of the PIL Act can not be reasonable enough to justify unequal treatment produced in the above-presented case. Simply, I can’t accept the fact that a defendant is liable for damage just because a claimant can rely on the combined application of two national laws, which incidentally agree that there would be no liability, if any one of them applied to all the circumstances of the case. For a defendant, unequal treatment produced by Art. 28 para. 3 is truly accidental. His reasonable and legitimate expectations are failed. So, I find that adjustment should be applied.

Therefore, when unequal treatment is produced as a consequence of the achievement of a special aim implied in a conflict rule of the forum, the court must examine and value to what extent the achievement of this aim is important and reasonable for parties in a given case. If this examination shows that achievement of a special aim is not reasonable enough to justify unequal treatment, adjustment must be applied and vice versa. Art 32 of the Serbian PIL Act may serve as a good example for justified unequal treatment caused by the conflict rule of a forum: “The conditions for the conclusion of marriage shall be for each person governed by the law of the State of which the person is a national at the time of conclusion of the marriage”. This so called ‘distributive’ application of two

29 See in detail Djođjević, Prilagodjavanje, 102-105.
30 For a more profound critique of the ubiquity rule see von Hein, Jan. Das Günstigkeitsprinzip im internationalen Deliktsrecht. Tübingen: Mohr Siebeck, 1999, 97-102. We should not be surprised that ubiquity rule does not prevail in contemporary international tort law. Simply, it can’t be a model of reasonable regulation of tort liability with foreign element.
national laws could produce a result that the marriage is valid, although it wouldn't be valid if any of these laws governs the conditions for conclusion of marriage for both spouses. The *ratio legis* (aim) of Art 32 is to facilitate the conclusion of marriage (i.e. to make it easier for future spouses to enter into marriage) and it represents a reflection of constitutional right on freely entering into marriage. This aim should be considered reasonable enough to justify the unequal treatment of international and national cases. Of course, it must be examined in each case.

At the end of this chapter I would like to briefly point out another problem which could arise in the determination of accidental discriminations. Having in mind that accidental discrimination occurs when two involved legal systems agree on the treatment of national cases and that treatment deviates from the result which both legal systems produce when taken together, one can ask to what extent the outcome of an international case has to deviate from the outcomes of national cases. This question often arises in cases involving pecuniary claims such as the widow’s case. When a claimant, due to the combined application of two national laws, receives more or less than he would receive when these laws apply in tandem, there is no doubt that accidental discrimination has occurred. However, in some cases it could happen that the combined application of two national laws gives to the claimant less than one national law and more than another national law intends. This result has to be understood as a compromise of applicable national laws and should not be avoided by adjustment.

3. Permission and Justification of the Adjustment Method in Serbian Private International Law

Having in mind that judicial practice in Serbia hasn’t yet recognized the problems which should be solved by the adjustment method (despite the fact that these problems arise in practice), Serbian authors have opposing opinions on the permission of using the adjustment method in Serbian private international law.

According to Professor Aleksandar Jaksic, the need for adjustment of applicable rules derives from the principle of unity of the legal system, which cannot permit the existence of contradictions of norms caused by the combined application of different national laws. Consequently, the courts are entitled to use the adjustment method in order to achieve the substantive result which would be accomplished if the rules of only one of the national laws involved applied in a given case. Jaksic particularly emphasizes that justice must be exercised on both levels, i.e. the level of private international law (PIL justice) and the level of substantive applicable law (substantive justice). That means private international law should outgrow its initial subject and in the phase of application of substantive law prevent contradictions of norms.

On the other hand, professors Stanivukovic and Zivkovic have a view that adjustment of conflict and substantive rules, i.e. its modification, ignorance or creation in concreto, is contrary to the legality principle. If the court decides to use the adjustment method, it would be contra legem.

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33 Jaksic, “Prilagodjavanje”, 2039 etc.
34 The same view was presented by professor Jochen Schröder (Schröder, Jochen. Anpassung von Kollisions- und Sachnormen. Berlin: De Gruyter, 1961, 32-33).
35 Ibid., 2040-2041.
36 Stanivukovic, Zivkovic, Medjunarodno privatno pravo, 372.
because there is no rule in the Serbian PIL Act which entitles the courts to modify or ignore conflict rules or applicable substantive rules in special situations\(^\text{38}\).

According to my opinion, the adjustment method is necessary and has to be permitted in Serbian private international law.

The standpoint of classical PIL scholars, that private international law exclusively has an assignment to determine applicable national law without any possibility to affect the final substantive result of the case with a foreign element, should be considered archaic and mouldy in contemporary private international law\(^\text{39}\). Referring to the most closely connected national law and applying the substantive rules of that law should not have strictly separate paths, since the aim of referring (i.e. the aim of conflict rule) can be solely achieved if the aim of the applicable national law has been achieved at the same time\(^\text{40}\). The appearance of accidental discriminations is a clear sign that these aims haven’t been achieved. For that reason it is necessary to adjust conflict rules or rules of the applicable national law in order to avoid accidental discriminations and re-establish substantive justice \textit{in concreto}.

Considering that accidental discriminations obviously are not in accordance with the basic concept of justice and fairness, it is not hard to conclude that these results amount to infringement of the constitutional principles of equal treatment (Art. 21 of the Constitution of Republic of Serbia - CRS\(^\text{41}\)) and rule of law (Art. 3 of CRS\(^\text{42}\)). This view has already been discussed by several German authors, i.e. Sonnentag\(^\text{43}\), Looschelders\(^\text{44}\) and particularly Dannemann\(^\text{45}\). I have refined their ideas and views (especially those of Dannemann) in order to develop a strong standpoint in favor of permission and justification of the adjustment method in Serbian private international law\(^\text{46}\).

The principle of equal treatment in the legal system of Serbia should be understood as prohibition of treating the same or very similar cases unequally or treating different cases equally, without justified and legitimate reasons\(^\text{47}\). Considering that, in essence, this principle lies in the achievement of justice, its role is to secure the justified and fair application of norms (rules) \textit{in concreto}. This means that a judge can exceptionally, in the name of justice and fairness, complement, adjust or correct a rule if its application in a given case would otherwise lead to an obviously unjust and

\(^{38}\) Ibid.


\(^{40}\) Looschelders, Anpassung, 85; Sonnentag, Renovi, 152 etc.

\(^{41}\) Art. 21 para. 1-3 of CRS of 2006: “All are equal before the Constitution and law. Everyone shall have the right to equal legal protection, without discrimination. All direct or indirect discrimination based on any grounds, particularly on race, sex, national origin, social origin, birth, religion, political or other opinion, property status, culture, language, age, mental or physical disability shall be prohibited.”

\(^{42}\) Art. 3 of CRS: “Rule of law is a fundamental prerequisite for the Constitution which is based on inalienable human rights. The rule of law shall be exercised through free and direct elections, constitutional guarantees of human and minority rights, separation of power, independent judiciary and observance of Constitution and Law by the authorities.”

\(^{43}\) MünchKomm/Sonnenberger, Einl zum IPR, Rn 336-343.

\(^{44}\) Looschelders, Anpassung, 80 etc.

\(^{45}\) Dannemann, Ungewollte Diskriminierung, 346 etc., particularly 365-369 and 374-378.

\(^{46}\) Actually, I accepted Dannemann’s basic idea and transposed it into Serbian legal system which was naturally followed with some refinements and changes. See Djordjevic, Prilagodjavanje, 131-144.

unfair result. ‘Obviously unjust result’ may be defined as a result which produces unequal treatment of the same or very similar cases, or equal treatment of different cases. So, when the result of combined application of different national laws (result of an international case) deviates from results which would be produced by application of any of these laws (results of national cases) and when the result of fragmented decision-making in different jurisdictions (international case) deviates from results which would be produced in any of these jurisdictions (national cases), it may be said that we are presented with unequal treatment of international and national cases without justified reason: both national laws agree on treatment of a case, but when they are collectively applied the case is treated differently just because it is international. This should be considered as infringement of Art. 21 CRS.

Therefore, adjustment of rules is needed and justified in order to avoid infringement of the constitutional principle of equal treatment.

The rule of law principle is a fundamental prerequisite of the Serbian constitution, which is based on inalienable human rights. Its role is to provide legal certainty inside the domestic legal system. There is no doubt that the rule of law principle should build a reliable legal system which provides for parties a possibility to foresee the consequences of their acts. This foreseeability can fail not only because of indeterminate content of norms in the Serbian legal system, but also because of determinate content of norms of different legal systems or decision-making processes in different jurisdictions, whose combined application or uncoordinated decision-making produces a result which fails to secure the reasonable expectations of the parties. In the mentioned widow’s case, the widow legitimately expected to receive a share of her husband’s assets because both national laws possess the rules which secure her a share. However, when these laws are applied in tandem the widow is left with nothing. Her legitimate and reasonable expectations have been failed, i.e. the rule of law principle failed to fulfill its assignment. The same happens in situations involving an uncoordinated sequence of decisions in different jurisdictions. If the court of one of the jurisdictions involved decides on distribution of the whole estate, the successor receives a share. However, when decisions on distribution of different parts of the estate of the same deceased person are made in two jurisdictions (countries), the successor receives less or is left with nothing. His legitimate and reasonable expectations have been failed. Therefore, these results, i.e. accidental discriminations, should be corrected by the adjustment method and brought in accordance with the rule of law principle.

Bearing in mind that principles of equal treatment and the rule of law are cornerstones of human and minority rights guaranteed by the Constitution of Republic of Serbia, there is no doubt that unjust and unfair results from the combined application of different legal systems and results from fragmented decisions in different jurisdictions (i.e. accidental discriminations) could infringe other guaranteed human rights and the adjustment method could be a remedy, i.e. an instrument for healing these infringements. In the widow’s case accidental discrimination also amounts to infringement of the right of inheritance guaranteed by Art 59 of CRS.

According to Art. 18 para. 1 CRS, all provisions which guarantee and protect human and minority rights have to be directly applied in a given case. These rules also have a rank of constitu-

48 In this manner also Kostic, Maja. „Generalna klauzula odstupanja od redovno mjerodavnog prava.“ PhD diss., University of Belgrade, 2001, 27 etc.
49 See again Dannemann, “Accidental Discrimination”, 120.
50 This view is not confirmed in Serbian constitutional and judicial practice. As it has been said previously, it is inspired by Danneman’s ideas.
51 Art. 3 of Serbian Constitution.
53 Right on equal treatment (principle of equal treatment) is human right by its self.
54 See Art. 3, 18 and 21 of CRS.
tional norms notwithstanding the source (constitution, act or international agreement) from which they originate. That means all other norms (rules) and results of their application have to be in accordance with the rules on human rights – *lex superior derogate legi inferiori*. Therefore, if the result of combined application of different national laws and the result of fragmented decision-making in different jurisdictions have as a consequence the infringement of human rights (including of course infringement of the rule of law principle), Serbian courts have the duty and power to modify the conflict rule, jurisdiction rule or applicable substantive rule in order to achieve the result which is in accordance with the infringed ‘higher’ norm. The duty of courts to intervene in these situations comes from the Constitution and is implied in the *lex superior derogate legi inferiori* rule, which is only one of those used to protect the principle of constitutionality and legality. So, the adjustment method is not contrary to the legality principle. I would rather say that it serves to secure its protection in a given case.

4. Principles of Adjusting the rules

The courts are conferred with a power to adjust the rules, i.e. to modify, ignore or create the conflict rules (including the rules of jurisdiction) and substantive rules of applicable national laws in order to prevent accidental discriminations. So, they have to choose one of these solutions in a given case, i.e. conflict solution (modifying or creating the conflict or jurisdiction rules) or substantive solution (modifying, ignoring or creating new substantive rules).

The solution which should be chosen depends on the so called principle of least resistance established by German professor Gerhard Kegel. This principle orders that the advantage has to be given to stronger interests in order to achieve a fair result in a given case with a foreign element. This means adjustment should be taken in the legal system which possesses rules least resistant to adjustment. These are the rules which are the most convenient for adjustment *in concreto*. Also, the judge has to ensure that modification or creation of new rules doesn’t produce a new accidental discrimination. Finally, it should be kept in mind that the purpose of adjusting the rules is to provide the achievement of those aims which are common to and intended by all applicable legal systems, but which couldn’t be achieved because of their combined (fragmented) application.

Although all authors refer to the “almighty” principle of least resistance, they very often suggest completely different solutions for the same case. I find that the conflict solution is preferred in the widow’s case. In order to avoid the result that she is left with nothing, the scope of the conflict rule for matrimonial property should be expanded to cover the inheritance issue. This is naturally followed by reducing the scope of the conflict rule for inheritance. After the expansion-reduction

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55 See Art. 18 para. 1 and 2 CRS.
59 Dannemann, Ungewollte Diskriminierung, 436.
60 Djordjevic, Prilagodjavanje, 153-158. Dannemann’s formulation of purpose of adjustment is quite similar: „Nach der hier vertretenen Auffassung ist das Ziel einer Anpassung ... die Verfehlung eines von den beteiligten Rechtsordnungen übereinstimmend verfolgten Zwecks zu verhindern“ (Dannemann, Ungewollte Diskriminierung, 446). As can be seen, he gave ‘negative’ formulation which has the same meaning as mine.
61 About all possible solutions in widow’s case see Djordjevic, Prilagodjavanje, 230-248.
In the end, it's very important to state that the adjustment method should be understood narrowly as a last resort. Further, it should be clearly distinguished from regular interpretation and application of the rules, and especially from other similar but at the same time clearly different methods in private international law such as substitution and transposition. 

5. Summary

1. Adjustment should be understood as an *ad hoc* methodological mean (instrument) of private international law by which courts or other authorities intentionally modify, ignore or create conflict rules, rules on jurisdiction and applicable substantive rules in order to avoid so called accidental discriminations.

2. Accidental discrimination occurs when the outcome of a case with a foreign element (international case) deviates from the outcomes of otherwise identical cases which are connected to only one of the legal systems involved (so called national cases) and this different treatment is not intended by any applicable rule. If different treatment is produced by the conflict rule of the forum as a consequence of achievement of a special aim implied in this rule, the court must examine to what extent achievement of this aim is reasonable to justify unequal treatment in a given case. If it is not reasonable, it should be considered that the resultant discrimination is accidental.

3. Accidental discriminations cover not only the results of combined application of substantive rules of different national laws, but also the results of combined (fragmented) decisions on a case with a foreign element or other application of laws in different jurisdictions (countries).

4. The adjustment method is permitted in Serbian private international law. It represents a remedy for healing infringements of the rule of law principle, the principle of equal treatment and other human rights guaranteed by the Serbian Constitution. The rules on human rights, notwithstanding the legal source from which they originate, have a rank of constitutional norms in the Serbian legal system and have to be directly applied in a given case. Having in mind that accidental discrimination amounts to infringement of these rules, Serbian courts have a duty and power to modify conflict rules or applicable substantive rules in order to achieve the result which is in accordance with the “higher” (constitutional) norms.

5. The court can choose the conflict solution (modifying or creating the conflict or jurisdiction rules) or the substantive solution (modifying, ignoring or creating new substantive rules) in order to prevent accidental discrimination. The solution which should be chosen depends on the so called principle of least resistance, which provides some instructions for the court on how to adjust the rules *in concreto*. The main purpose of adjusting the rules is to achieve those aims which are common to and intended by all legal systems involved, but which couldn’t be achieved because of their combined (fragmented) application.

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62 Unfortunately, these issues could not to be discussed in this paper because of its limited volume. A special part in my dissertation is dedicated to similar instruments of private international law, i.e. transposition, substitution, escape clause and ordre public, and to their relations and connections with adjustment method. See Djordjevic, Prilagodjavanje, 186-217.
MULTIPARTY ARBITRATION – PROBLEM OVERVIEW
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Abstract

The author presents key issues related to participation of multiple subjects with party capacity in the arbitration procedure. Consolidation of arbitration proceedings, resulting in a multi-party procedural relationship, as well as joinder and intervention of third-person, non-signatories to the arbitration agreement, are viewed only from the surface for the purpose of identifying possible problems their emergence in arbitration may cause. The development of a judicial approach to procedural questions raised by participation of multiple subjects in contractual relationships is showcased through the analysis of the 2010 United States Supreme Court Decision, which set grounds for restricting multi-party arbitration only to situations where participation of multiple parties in a single proceeding is expressly provided for in the arbitration agreement.

Key words: multi-party arbitration, arbitration agreement, consolidation, joinder, intervention.

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MULTIPARTY ARBITRATION – PROBLEM OVERVIEW

1. Introduction

The reasons multiparty arbitration is an interesting and significant topic could be boiled down to three fundamental ones: legal-political, normative and practical. The legal-political reason is in ever-growing importance in the realm of modern legal communication, which becomes more intense and more complex, with more transactions involving multiple participants, from which disputes eligible for resolution by the means of arbitration may derive.¹

On the other hand, the normative significance of the subject matter stems from the fact that arbitration procedural rules, contained in national regulations, international conventions or autonomous arbitral sources, in most cases do not provide directly applicable solutions for the majority of problems which may occur in the course of resolving complex or multiparty disputes. Most of these issues may be addressed only indirectly – through the extensive interpretation or the accordant application of provisions which were tailored exclusively for the ordinary, bipolar, two-party procedural scheme of arbitral proceedings.

Neither in international arbitration practice have standpoints on this matter been harmonized, nor principles with universal application for creating acceptable solutions to the problems that may arise have been established.²

The practical importance of the subject matter may be seen in the need for identifying and analyzing problems which have emerged, or may appear, in the course of the practical application of particular solutions contained in national, foreign, autonomous or international arbitration sources, as well as in the necessity to anticipate potential complications which may occur should some of the solutions originating from the arbitration jurisprudence or judicature be accepted on the broader level. Likewise, of utmost importance is the application of the results of academic research for the purpose of directing possible pathways for overcoming both theoretical and practical difficulties related to the participation of multiple subjects with party capacity in arbitral proceedings.

¹ See Carole J. Buckner, Toward a Pure Arbitral Paradigm of Class wide Arbitration: Arbitral Power and Federal Preemption, 82 DENV. U.L. REV. 301, 301-03 (2004) (highlighting class arbitration’s growing importance for consumer and employment contracts); Thomas J. Stipanowich, Punitive Damages and the Consumerization of Arbitration, 92 NW. U. L. REV. 1, 3 (1997) (“Arbitration is suddenly everywhere. A veritable surrogate for the public justice system, it touches the lives of many persons who, because of their status as investors, employees, franchisees, consumers of medical care, homeowners, and signatories to standardized contracts, are bound to private processes traditionally employed by commercial parties.”).

² See Lew, J. – Applicable Law in International Commercial Arbitration, 1978, p. 80, where the author states that in the international arbitration arena certainty is important, uniformity is desirable, and the predictability is necessary.
PART ONE • Private International Law and Arbitration

2. Arbitration Agreement

Arbitral agreement is the most common and universally accepted ground for instituting multiparty arbitration. In this context, the emphasis needs to be placed on multiparty agreements on arbitration as well as on the subjective scope limits of the arbitral agreement, i.e. the issue of its effect on non-signatories.

The consensus with respect to arbitral resolution of disputes derived from multiparty or complex contractual relations is very hard to achieve. The difficulties are much greater when it comes to complex transactions, in comparison to multilateral ones, since the relations between parties are regulated by multiple separate contracts.

The arbitrator, encountering the request for consolidation or the problems of joinder or intervention in arbitration, primarily will look into the provisions of the arbitration agreement. With respect to this, three possible situations may arise:

a) that the arbitration agreement expressly provides for consolidation, joinder or intervention of third parties in the arbitration proceedings;

b) that the arbitration agreement expressly excludes consolidation, joinder or intervention; and

c) that the arbitration agreement does not contain express provisions on consolidation, joinder or intervention, or it’s vague on these issues.

The issue of effect of the arbitration agreement on non-signatories needs to be viewed both through the examination and critical analysis of the existing normative solutions and through the analysis of arbitration and state court practice, which is of utmost importance in this area due to the regulatory insufficiency.

The arbitrator’s authority to resolve disputes is based exclusively on the parties’ agreement to arbitrate. Therefore, generally speaking a third party who did not consent to participation in arbitration between two initial parties can not be forced to do so. However, in international arbitration practice it is not uncommon for the arbitration proceeding to be initiated by or against non-signatories to the arbitration agreement. Such a situation raises the question whether, and under which conditions, an arbitration agreement may be extended to be applied to such persons.

Tightly connected to the issue of the arbitration agreement’s effect on non-signatories is the so-called “Group of Companies” doctrine. Although the legal individuality of subject, among other things, means that one member of the Group is not entitled to make legal commitments on

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5 According to American jurisprudence, there are three types of situations in which non-signatories to the arbitration agreement may be coerced to partake in arbitration, or in which such participation may be allowed: 1) when a non-signatory is deemed bound by the arbitration agreement even though it was not a signatory thereto (alter ego doctrine, transfer of the arbitration agreement, commission etc), 2) when non-signatories enter with one of the parties into a related contract, which by reference includes the arbitration clause contained in the initial contract, 3) when, due to their actions, persons may be deemed bound to resolve their disputes in arbitration without their explicit consent to a specific arbitration. See Lamm, C. – Aqua, J. – Defining the Party – Who is a Proper Party in an International Arbitration Before the American Arbitration Association and Other International Institutions, Geo. Wash. Int’l L. Rev., No. 34, 2002-2003, pp. 722 – 733.

behalf of the others, which also involves the exclusion of liability for the obligations of the others towards third persons, in real life, especially in international business relations, groups of companies very often act as a single legal entity and form compact economic units, notwithstanding their legal pluralism. Therefore, it is not just to insist on legal identity separability in order to avoid arbitration, in cases when such separation is artificial and the effects of enforcing it would cause the breach of fairness in international business dealing.\(^7\)

3. Court Decision

The state court decision may be a ground for participation of multiple parties in arbitrations proceedings, in cases when such participation is not expressly provided for by the terms of the arbitration agreement. However, treating a court decision as an autonomous ground for instituting multiparty arbitration may only be conditional, since even the most liberal legal regimes still insist on party consensus as a primary basis for allowing the participation of multiple subjects in arbitration.\(^8\) This consensus, however, is not necessarily directed strictly to resolution of dispute or disputes in multiple party proceedings, but in most cases, by the means of broad interpretation and “legal gymnastics”, the grounds for instituting multilateral arbitral procedural relationship is construed by court decisions.\(^9\)

However, international legal relations are becoming more developed and more complex. As international transactions are growing in complexity, certain procedural problems in international arbitration are becoming more frequent and more apparent. Certainly, among the most complex issues in this field are those pertaining to consolidation, joinder and intervention of third parties in arbitration proceedings. Numerous state courts and arbitral tribunals have taken a position, supported by the majority of scholars, that third parties have no right to intervene in the pending arbitration proceedings, nor are consolidation or joinder possible in the absence of all potential parties.\(^10\) However, the frequency of multilateral business transactions calls for re-examination of this position. The necessity is most apparent with respect to complex multi-party transactions, where all subjects involved are often not signatories to a single arbitration agreement, nor is it likely that consensus on a single multi-party arbitration agreement could be subsequently achieved.\(^11\) Therefore, it is necessary to critically analyze the existing consolidation, joinder and intervention regimes, and examine the options for broadening the grounds for their admissibility in light of basic arbitration.

\(^7\) See Carte Blanche Pte. Ltd. v. Carte Blanche International Ltd. 888 F.2d 260.

\(^8\) See Schaeffer, E. – Compulsory Consolidation of Commercial Arbitration Disputes, Saint Louis Univ. L. J., No. 33, 1988/1989, p. 498, where the author holds that coercible consolidation causes injustice for those who refuse to contractually consent to multiparty arbitration. See also Knežević, G. – The Annullment of the Foreign Trade Arbitration Awards, The International Trade Arbitration – Status and Perspectives, Belgrade, 1997, p. 239, where the author points that the arbitrators’ authority stems from parties’ agreement and not state’s power.

\(^9\) Most of the authors hold that coercive application of institutes on which multi-party arbitration may be grounded represents total negation of justice, by overseeing the fact that arbitration, above all, is a creature of contract. See Hascher, D. – Consolidation of Arbitration by American Courts: Fostering or Hampering International Commercial Arbitration?, J. Int’l Arb., No. 1, 1984, p. 127.


principles, as well as on the basis of the existing national, institutional and international regulations, independently of the content of the arbitration agreement.\textsuperscript{12}

4. Two Different Approaches to the Legal Nature of Arbitration

Those who see arbitration as a purely contractual phenomenon\textsuperscript{13} with no common features with litigation, hold that third persons, as aliens to the arbitral agreement, have absolutely no right to intervene or join the parties to the arbitration proceedings. Likewise, the court may not consolidate arbitration proceedings if such an option is not included in the parties’ agreement to arbitrate. On the other hand, those who hold that an option to consolidate proceedings and the right to join or intervene should exist in a certain, limited scope, independently of the wording of the arbitration agreement, also view arbitration as an individualized mechanism for resolving disputes in which party autonomy dominates, but insist that certain pragmatic reasons and procedural principles, taken over from litigation, may influence its physiognomy.\textsuperscript{14}

It is not justified to insist on equalization of the terms of application of procedural institutes in litigation and arbitration, since the contractual nature of arbitration preconditions numerous significant differences. Therefore, the imitation of litigation may not be a main feature of arbitration.

5. Forms of Participation of Multiple Subjects with Party Capacity in Arbitration Proceedings

The participation of multiple parties, as well as the existence of multiple claims, is a universal feature of multi-party arbitrations. The most efficient way to decide on rights and duties of all the parties, which ensures the highest level of legal certainty, is to apply procedural institutes which provide for the integrative decision making in a single proceeding, i.e. consolidation of arbitration proceedings, joinder and intervention.\textsuperscript{15}

Consolidation of arbitration proceedings is an institute mostly dealt with in legal writings on multi-party arbitration. Special attention is drawn to the problems of consolidation of arbitration proceedings based on arbitration agreement, then to those pertaining to compulsory consolidation, and finally to the issues related to consolidation of arbitration and state-court proceedings.

The analysis of agreement-based consolidation is mostly focused on the UNCITRAL legal framework. One step forward towards further adjustment thereof to the needs of multi-party arbitration would be drafting the model arbitration clause for multi-party arbitrations, which would be tailored in accordance with the 1976 Arbitration Rules.

The results of research on compulsory consolidation, on the other hand, show that neither the national legislations nor the leading arbitration institutions accept this form of consolidation.


\textsuperscript{14} See Motomura, H. – \textit{Arbitration and Collateral Estoppel: Using Preclusion to Shape Procedural Choices}, Tul. L. Rev., No. 63, 1988, pp. 77 – 78 and 80 – 81, where the author opposes the approach which pushes arbitration towards litigation, but notices the trend of viewing arbitration as a substitute and not alternative to state court proceedings.

However, even when explicit omni-party consent to arbitration is missing, in some countries by the means of the so called privity concept, which includes a specific relationship between subjects as a ground for broadening the subjective scope of contract to which only one of them is a party to the rest of them, the consolidation may occur. Likewise, some courts have found grounds for consolidation in the implicit consent or the “Group of Companies” theory.

When it comes to consolidation of arbitration and state-court proceedings, even though it may be desirable, numerous conceptual and procedural difficulties appear. The party autonomy principle imposes the requirement that all potential parties to the consolidated proceeding agree to consolidation. Excessive court intervention, which would undermine the rule of consensualism with respect to consolidation, is definitely not desirable, even though it is often justified by the interests of efficiency and legal certainty.

The specific features of joinder and intervention in arbitration, in comparison with their correspondents in litigation, derive from the contractual construction of arbitration and are reflected, among other things, in the manner of their realization, possible forms, and terms of admissibility.

When it comes to admissibility of intervention, by majority opinion in both jurisprudence and judicature, and consistent with the contractual construction of arbitration, if the interested parties are not signatories to the arbitration agreement, they shouldn’t have the right to intervene in the arbitration proceedings. However, at least in international arbitration, such an a priori position is disputed by many, holding that the omni-present liberalization of arbitration makes this restrictive approach to interpretation of arbitration clauses obsolete.16

6. Specific Forms of Multiparty Arbitration and Judicial Review of Arbitration Awards

Class arbitration is a specific form of legal protection of a large number of subjects. To this group also belong concurrent, parallel and consecutive arbitrations, whose peculiarities are reflected in the fact that these forms actually do not include the conduct of a single proceeding with multiple parties, but rather multiple proceedings with different parties and related subject matters, conducted before arbitral tribunals with the same personal composition, which results in increased efficiency in resolving multiple disputes and the consistency of the arbitral awards rendered in separate proceedings.

As far as judicial review of arbitration awards is concerned, since reaching an agreement as to two-instance arbitral dispute resolution by multiple parties is highly improbable, attention has to be directed to the proceedings for annulment of arbitral awards, as well as to the terms and procedures for recognition and enforcement of foreign arbitral awards.

In this respect the effects of arbitral proceedings consolidation on the prospects for recognition of the award rendered in a consolidated proceeding raises numerous problems.

7. Regulations

Since national legislations still have a major impact on international arbitration, of great importance is the content of different national laws and practices as a source of international arbitration law, primarily of those countries that are traditionally viewed as popular arbitration fora, or those with innovative legislation in this field (USA, England, Hong Kong, Netherlands, Australia,

Canada and France). The emphasis, understandably, is held on the provisions and decisions pertaining to consolidation, joinder and intervention.

On the other hand, due to the increase in competition during the last couple of decades, numerous institutions have modified their arbitration rules, adjusting them to the altered international legal reality and, in many cases, have even triggered reforms of the national legislations on proceedings before state courts and arbitral tribunals.

Because of their specific organizational structure, the arbitration institutions can amend their rules more promptly, in order to adjust them to situations which remain uncovered by the national legislations.

Therefore, it is realistic to expect that general modernization in the approach to the problems related to multiparty arbitration will firstly occur in the domain of the autonomous arbitration rules of the leading arbitration institutions.

8. 2010 U.S. Supreme Court Decision

In Stolt-Nielsen, the United States Supreme Court found that the arbitration panel exceeded its powers by imposing class arbitration on parties whose contractual arbitration clause was silent on that issue.

By the Court’s reasoning, the arbitral tribunal was wrong to impose its own policy instead of “identifying and applying... the... law.”

The Court observed, “Rather than inquiring whether the FAA, maritime law, or New York law contains a “default rule” under which an arbitration clause is construed as allowing class arbitration in the absence of express consent, the panel proceeded as if it had the authority of a common-law court to develop what it viewed as the best rule to be applied in such situation.”

The Court’s decision was based on two lines of arguments:

- First, the Law imposes a “basic precept that arbitration is a matter of consent not coercion.” The Court opined that the parties “may specify with whom they choose to arbitrate their disputes.” Hence, it found that a “party may not be compelled... to submit to class arbitration unless there is a contractual basis for concluding that the party agreed to do so.”

- Second, the Court drew the sharp, distinctive line between bilateral arbitration and the class action arbitration and found that the “fundamental changes” are of such a degree that “it cannot be presumed that the parties consented to class action arbitration by simply agreeing to submit their disputes to an arbitrator.”

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19 For previous judicature, see, e.g., Certain Underwriters at Lloyd’s London v. Westchester Fire Ins. Co., 489 F.3d 580, 590 (3d Cir. 2007) (holding silence does not preclude consolidation and arbitrators have discretion to allow consolidation); Rollins, Inc. v. Garrett, 176 F. App, 968, 969 (11th Cir. Apr. 19, 2006) (holding silence does not preclude class arbitration and prohibition of class arbitration is unconscionable); Pedcor Mgmt. v. Nations Pers. of Tex., 343 F.3d 355, 363 (5th Cir. 2003) (requiring arbitration clauses silent on clause arbitration submission to arbitrator). In Westchester Fire Ins., the Third Circuit determined that imposing class arbitration is a procedural issue and should be resolved by the arbitrator. 489 F.3d at 590. In reaching this decision, the court considered the following factors: prior federal case law (including the Bazzle decision), the agreement by both parties to arbitrate disputes, the silence in the contract with respect to class arbitration, and the federal policy strongly in favor of utilizing arbitration. Id. at 586-90.
The Court concluded that the “differences between bilateral and class-action arbitration are too great for arbitrators to presume… that the parties’ mere silence on the issue of class-action arbitration constitutes consent to resolve their disputes in class proceedings.”

However, for some it seems that the U.S. Supreme Court strayed from the proper interpretation of the grounds for vacature of arbitral awards.

The parties themselves empowered the arbitrators to render their clause construction award.

Justice Ginsburg in her dissenting opinion rightly noted that “the panel did just what it was commissioned to do.”

If the arbitral tribunal had jurisdiction (provided by parties’ agreement to arbitrate), the award was final and binding on the parties, subject to limited grounds for vacature of the award. It is not for the state court to agree or disagree with the award. Judicial review is statutorily limited, and it is undeniable that disagreement with the tribunal’s award is not one of the limited grounds for annulment under any law.

Another question is what is wrong with an arbitrator’s attempt to develop what was viewed as the best rule to be applied in such a situation and to find the best solution to be applied to a specific case before them. Is this not what ‘l’esprit de l’arbitrage’ actually represents?

Indian jurist Fali Nariman wrote that the task of a good arbitrator is to ask him/her-self in every single arbitral proceeding as to what justice demands in the factual situation presented, and then to inquire whether there is anything in the applicable law which would militate against the tribunal arriving at a just decision. The arbitrators in Stolt-Nielsen did exactly that. They have construed the arbitration agreement as they deemed best considering the circumstances of the case.

The Stolt-Nielsen decision is contrary to the limited judicial control power of the state courts over the arbitration awards.

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20 See Champ v. Siegel Trading Co., 55 F.3d 269, 275 (7th Cir. 1995) (cautioning court’s judgment should not deprive one party of benefit of bargain).

21 AnimalFeeds outlined three arguments in support of imposing class arbitration: (1) that class arbitration is permitted under Bazzle, absent an express provision to the contrary; (2) the arbitration clause should be construed to allow class arbitration for public policy reasons; and (3) the arbitration clause would be unconscionable and unenforceable otherwise. However, the arbitrators rejected the first argument and did not consider the third, suggesting that public policy considerations had an overwhelming impact on the decision to impose class arbitration.

22 Federal Arbitration Act, 9 U.S.C. § 10(a) (2006) (providing grounds for reversing arbitration awards). Section 10(a)(4) provides that an award may be vacated “where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.” Id. In Stolt-Nielsen, the Court noted that the rationale behind this section was that arbitrators are charged with contract interpretation, and not formulating public policy. Stolt-Nielsen III, 130 S. Ct. 1758, 1767 (2010) (quoting 9 U.S.C. § 10(a)(4) (2006)) (identifying Court’s authority for vacating arbitrator’s decision). However, in her dissent, Justice Ginsburg emphatically stated that the Supreme Court prematurely adjudicated the issue on appeal. Stolt-Nielsen III, 130 S. Ct. at 1777 (Ginsburg, J., dissenting). She explained that the arbitration panel’s resolution was a partial award and the case was still at a very early stage. As such, the award was an interlocutory decision, and the Court should not have intervened so early in the process, particularly because the panel did not render a final judgment. See generally Catlin v. United States, 324 U.S. 229, 233 (1945) (explaining final judgment rule). The final judgment rule essentially states that a decision should not be reviewed until a “final decision” has been rendered. The Court in Catlin describes a “final decision” as “one which ends the litigation on the merits and leaves nothing for the court to do but execute the judgment.” The rule is supported by a number of public policy considerations such as preventing piecemeal litigation and avoiding undue delays from appeals of interlocutory decisions. This rule is one that is firmly embedded in the federal courts.

The U.S. Supreme Court disregarded advantages of class action arbitration compared to class action litigation and concentrated only on the obvious differences between bilateral and multi party arbitration.

9. Conclusion

It is doubtless that the problems related to the participation of multiple subjects with party capacity in the arbitration proceedings are so complex, that the solutions thereto must be looked for at the borderlines of arbitration as we know it.

As the awareness level of participants in international transactions is usually very high, in most cases it may be supposed that the parties, with the main features of arbitration in mind, have critically analyzed their positions and agreed on the dispute resolution mechanisms that suited best their interest perceptions.

Therefore, neither arbitral tribunals, nor state courts, should protect the parties from being insufficiently informed or incapable of predicting future events, nor should they have the authority to apply procedural rules inherent to state court litigation contrary to the expressed consent of the parties in order to achieve procedural economy and efficiency or to avoid inconsistent results.

On the other hand, the differences between legal traditions and legislations are still factors that should be taken into account when discussing problems related to participation of multiple subjects with party capacity in arbitration proceedings.

Hence, it is necessary to adopt additional universal arbitration principles, the application of which should be felt as duty by arbitrators, and which would be deemed known and recognized by all participants in international transactions, no matter where they come from.

In Stolt-Nielsen, the U.S. Supreme Court had an opportunity to take a step further from its previous decision in Green Tree,24 where it refused to interpret the arbitration clause because “arbitrators were well situated to interpret agreement”.25 Additionally, in PacifiCare Health Systems, Inc. v. Book,26 the Supreme Court held that arbitrators should determine issues pertaining to the enforceability of certain provisions within an arbitration agreement, rather than courts.27

Bearing in mind the global infl uence of the American arbitration legal development, taking such a step would have meant further advancement of the international arbitration regime.

Instead, the U.S. Supreme Court, in many scholars’ opinion, took a big step back.

25 In Bazzle, the plaintiffs signed a contract to secure a home loan from the defendant, Green Tree Financial Corporation. The contract contained a mandatory arbitration clause, but was apparently silent on whether class arbitration was permissible. The case began in the South Carolina trial court and proceeded to the South Carolina Supreme Court. “The Supreme Court of South Carolina held (1) that the arbitration clauses are silent as to whether arbitration might take the form of class arbitration, and (2) that, in that circumstance, South Carolina law interprets the contracts as permitting class arbitration.” The United States Supreme Court granted certiorari to “determine whether the holding was consistent with the Federal Arbitration Act.” A threshold question for the Court involved whether the contract is silent on class arbitration, or if it actually forbids class arbitration. Exercising its discretion, a plurality of the Court remanded the case to the arbitration panel to interpret the contracts governing the dispute. See also Buckner, supra note 1, at 302-03 (noting Bazzle significantly expanded arbitrators authority and scope of arbitration).
27 In Book, a group of doctors brought claims against a number of HMOs under the Racketeer Influenced and Corrupt Organization Act (“RICO”). The HMOs sought to compel arbitration, but the doctors resisted because the arbitration agreement prohibited the recovery of punitive damages. Some circuits, however, allow treble damages for the RICO claim. The Court in Book held that because this was not an issue of whether the parties had agreed to arbitration or even whether a particular issue was subject to arbitration, it was for the arbitrator to decide the enforceability of the provision.
PART TWO

PROPERTY LAW
UNDERREGULATION, OVERREGULATION, AND MISREGULATION OF SECURITY INTERESTS IN CROATIAN LAW

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Abstract
This chapter sketches the development of the Croatian law of personal property security, and critically assesses its often erratic, uncoordinated and policy-inconsistent reforms. Although most post-communist countries struggled with secured credit regulation, Croatian developments proved somewhat specific in opting for several piecemeal reforms. The initial reform of personal property security was packed into the general overhaul of property law, but it was also accompanied by a parallel system of security devices offered within the civil enforcement regime. Thus, traditionally regulated areas remained traditional, but supplemented and supplanted by other regulation, in particular with respect to fiduciary transfers. Only in the mid-aughts has the legislator decided on a registration-based system of priority, however without clearly addressing or revising existing regulation. Still later reforms concentrated on industry-specific issues by dismantling parts of the system, as in the case of financial collateral, or by adding experimental-like features to it, as was the case with grain warehouse receipts. On the other hand, some devices, particularly those involved in acquisition financing such as retention of title and financial leases, as well as certain receivables financing instruments, were left mostly neglected and outside of the scheme, ignoring the functional veil of Article 297 of the Law of Property Act. The resulting interrelationships, complexities and deficiencies demonstrate that the state of current law is very much shaped by underregulation, overregulation and misregulation, which if left unidentified will slow the pace of moving the Croatian financial market out of transition and into a world of financial sophistication and legal clarity.

Key words: secured credit, transition, legislation, reform, Croatia.

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UNDERREGULATION, OVERREGULATION, AND MISREGULATION OF SECURITY INTERESTS IN CROATIAN LAW

I. Introduction

Although it has been more than twenty years since the beginning of the process we refer to as “transition,” and even though many CEE countries have joined the EU, or—like Croatia—are in the midst of accession, their statuses as transitional legal systems have not changed. Reasons for this are multifaceted and dependent on the particular political and socioeconomic environment. However, in all countries, transforming property law has been one of the greater challenges. In particular, the law of personal property security (PPS), on which this paper focuses, has often been the holdout, although its centrality for the development of a modern credit market has been clearly established.1 Croatia has walked down the long and winding road of reform, and is something of a latecomer to modern financing patterns. This paper identifies three distinct features that have persistently plagued Croatian PPS and stymied progress, namely underregulation, overregulation, and misregulation. Underregulation has made it difficult to find the law, or to accurately predict legal outcomes, thus making issuing secured credit riskier than it should be. Overregulation, on the other hand, has made the law sometimes inconsistent, and at other times superfluous, making it costly to compare, contrast and assess an actor’s legal position. Finally, misregulation has simply invoked perplexing questions, contradictions, vicious circles and dead ends, deterring and dissuading both creditors and debtors.

Croatian law handles security disparately across several sectors, but generally agrees on property law being its natural environment. In this broad area it was only in late 1996 that Croatia passed a reformed Law of Property Act.2 It was rudimentarily based on the superseded Basic Proprietary Relations Act of 1980,3 while heavily drawing on the Austrian and, in some respects, the German civil codifications. The idea championed by commentators was one of “reintegration into the continental European legal circle.”4 This isn’t surprising. Even though Yugoslav private law was marginalized as bourgeois in favor of a new social order, there was also a presence of legal continuity, both formal and informal. Formally, there was a link to the entirety of pre-war law in cases of lacunae.5 Informally, members of the Austrian-trained and path-dependent legal profession kept to

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1 See generally Frederique Dahan, and John Simpson, eds., Secured Transactions Reform and Access to Credit (Cheltenham: Edward Elgar, 2009).
2 Zakon o vlasništvu i drugim stvarnim pravima [ZV] [Law of Property Act], Narodne novine [NN] [Official gazette] 91/96, 73/00, 129/00, 114/01, 79/06, 141/06, 146/08, 38/09.
3 Zakon o osnovnim vlasničkopravnim odnosima [Basic Proprietary Relations Act], Službeni list SFRJ [S.l. SFRJ] [Official gazette of the SFRY] 6/80, 36/90 and NN 53/91, 91/96.
5 See article 4 of the Zakon o nevažnosti pravnih propisa donesenih prije 6. travnja 1941. godine i za vrijeme neprijateljske okupacije [Act on the Invalidation of Regulation passed before April 6, 1941 and during enemy occupation], Službeni list FNRJ [Official gazette of the FPRY] 86/46 (enacted in 1946 and allowing the application of pre-war rules, unless contrary to the principles of the constitutional order of the federation or its republics).
their habits, thus reproducing existing legal mannerisms. Due to the relative brevity of the socialist period, incorporating barely two generations, the behavioral patterns didn't fully dissolve but were rather corrupted by ideology on the one hand, and a perpetually frozen set of rules, applied at one's discretion, on the other.6

In the drafting of new laws, and in designing PPS, however, the traditional models from Austria, Germany, Switzerland and France were difficult to grasp because of the relatively convoluted state of PPS law, and its absence from civil codifications. Although there is evidence that there was a degree of awareness of these models,7 further developments in Croatia took a double track, clustered within the rules of property and enforcement law, thus creating an initially compartmentalized picture. In the mid-aughts, two additional changes followed: the introduction of a system of registration, and the introduction of EU-harmonized financial collateral regulation.

Today, Croatian PPS law recognizes the possessory pledge,8 as well as several types of non-possessory security. First, there are two types of registered fixed pledges: one over registered assets i.e. assets that cannot be used or conveyed without registration,9 and the other over non-registered assets, and drafted either by a notary public or, in rare instances, by a judge. The former covers vessels and aircraft, and is similar to the traditional mortgage over land.10 The latter is relatively novel, and involves registration in a register designed specifically for that purpose.11 The creditor has no right of possession,12 while the debtor can continue to use the asset but cannot dispose of it.13 Second, there is the registered floating pledge, “floating” over a collection of assets located in a designated storage facility.14 This type of security also requires a notarized document or a court record. The debtor is allowed to dispose of the goods,15 but, unless agreed otherwise, is obligated to regularly “substitute the collateral sold or removed, depending on the nature of her business.”16 The interest lapses when the collateral is delivered to a third party or otherwise removed from the designated location.17

Finally, it seems possible (yet empirically untested) to create a non-possessory unregistered fixed pledge, based on the recognition of constructive possession in general property law.18 The pledge is of limited value, as it lacks third-party effects unless the third party knows of the interest or was notified of it.19

The second large group of security interests encompasses title-based devices. Here, Croatian law recognizes retention of title clauses (ROT) on the one hand, and fiduciary transfers on the other.

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6 Article 5 of the 1946 Invalidation Act explicitly banned the application of old case law or opinions of other pre-war state authorities in interpreting such rules. It also explicitly banned using these rules as sources for drafting new legislation. These bans were, however, not obeyed.
7 See e.g. Edita Čulinović-Herc, “Zalaganje pokretnih stvari bez gubitka posjeda” [Pledging movables without losing possession], in Zaštita vjerovnika [Creditor protection], ed. Petar Simonetti (Zagreb: Informator, 1994).
8 ZV art. 308.
9 ZV art. 304(3).
10 ZV arts. 298(7), 304(4).
11 It was introduced by the Zakon o upisniku sudskih i javnobilježničkih osiguranja tražbina vjerovnika na pokretnim stvarima i pravima [ZU] [Act on the Register of Creditors’ Judicial and Notarial Security Interests in Tangibles and Intangibles], NN 121/05.
12 ZV art. 321(4).
13 The misbehaving debtor faces criminal charges. See article 228(1) of the Kazneni zakon [KZ] [Criminal Code] NN 110/97, 27/98, 50/00, 129/00, 51/01, 111/03, 190/03, 105/04, 84/05, 71/06, 110/07, 152/08, 57/11.
14 ZU art. 38(1).
15 ZU art. 38(4).
16 ZU art. 38(5).
17 Ibid.
19 See ZV art. 15(3).
Today, the former are regulated principally in the Law of Obligations Act of 2005,\(^\text{20}\) while the latter in the Enforcement Act of 1996.\(^\text{21}\) Rudimentary provisions on both can also be found in the ZV.\(^\text{22}\) The ZV, however, set out a recharacterization policy that mandates all security devices be treated alike, the default rules being the ones on the pledge contained in the ZV.\(^\text{23}\)

Finally, there are three other specialty security devices, two of which were introduced only recently. The first is security over financial collateral, introduced by legislation\(^\text{24}\) implementing the Financial Collateral Directive,\(^\text{25}\) and creating hybrid security interests designed with particular financing patterns in mind. The second is the more obscure pledge of grain warehouse receipts, created in 2009 by the Grain and Industrial Crops Warehousing and Warehouse Receipt Act.\(^\text{26}\) The third is the ordinary pledge of warehouse receipts, which has a long history but is of little practical value.

The rest of the paper is organized as follows. In part II, I discuss the causes of underregulation of PPS in Croatian law, and show that the transitional character of the Croatian society in the nineties, coupled with inadequate models and a political system absorbed with fundamental institutional issues, made it difficult to immediately handle a new PPS system. This was accompanied by difficulties in proper assessment of regulatory demand and accurate predictions of the application of the rules in the new environment.

In part III, I analyze the genesis of the Croatian multiplicity of security devices and point to inconsistencies in policy between different statutes, as well as policy shifts within a relatively short time span, as the principle causes of overregulation. Further to that, the implementation of EU law, on the one hand, mandated accommodating additional, specialty devices humoring the financial industry, while on the other hand, the desuetude of existing law coupled with a legislator forbearing from changing such law, and instead taking supplemental legislative action, also reinforced overregulation.

Although overregulation may seem at odds with underregulation, the two can, in fact, be mutually supportive. Underregulation naturally causes legislative opacity, which generates an appearance of regulatory demand. Overregulation, on the other hand, if inconsistent or contradictory, creates an additional meta-level of problems which are seldom addressed, thus causing underregulation of crucial issues.

Part IV critically comments on particular features of Croatian reformed PPS law. First, it deals with key financing patterns, namely retention of title and floating security, important for equipment financing and inventory financing, respectively, both of which have in their own way been weakened by conflicting or omissive statutory language. Second, it analyzes the defining features of the recently introduced registration system, underscoring the ill-advised mimicking of the land registration system, especially with respect to third party effects. Third, it touches upon the problems of an ineffective enforcement regime, singling out repossession and strict foreclosure as the usual suspects. Finally, Part IV takes exception to the solutions, or rather lack thereof, to the various priority conflicts that can emerge as a consequence of the elaborate legislation. Part V concludes.

\(^{20}\) Zakon o obveznim odnosima \{ZOO\} \{Law of Obligations Act\}, NN 35/05, 41/08

\(^{21}\) Ovrsni zakon \{OZ\} \{Enforcement Act\}, NN 57/96, 29/99, 42/00, 173/03, 194/03, 151/04, 88/05, 121/05, 67/08.

\(^{22}\) See Art. 34 ZV.

\(^{23}\) Art. 297(2) ZV.

\(^{24}\) See Zakon o financijskom osiguranju \{Financial Collateral Act\}, NN 76/07, 59/12.


\(^{26}\) Zakon o uskladjenju i skladišnici za žitarice i industrijsko bilje \{ZUIB\} \{Grain and Industrial Warehousing and Warehouse Receipt Act\}, NN 79/09, 124/11.
II. Underregulation

A. Prioritizing reform agendas

One of the major features of Croatian law, as compared to other CEE countries, is the very slow, gradual and ultimately delayed development of reformed rules on PPS. In order to appreciate this feature, it is necessary to put law reform into the broader transitional context. The political and economic conditions in the early nineties were—similar to other countries in the region—turbulent and inflation-ridden. Unlike many other countries, there was also the element of chaos and violence caused by armed conflict, which for some time occupied a large part of the restructuring agenda. It is not entirely clear why security interests remained unnoticed, but it seems they were delayed until transitioning from a system of social ownership to a system of private ownership, which was considered paramount for jump-starting the economy. This process unfolded both on the level of socially owned companies, and on the level of socially owned land.

Certainly, privatization was essential for market development, but the formative role of effective PPS law in financial deepening has been routinely reiterated. This is one of the reasons the EBRD decided to push secured transactions reform from its inception, particularly by drafting a Model law, which was finalized in 1994. The Bank’s goal was neither harmonization of PPS in CEE countries, nor a simple graft of the Model law, but rather supplying a reference point for national drafters when designing or revising PPS regulation. It was quite unique at the time, as it took into account features of both civil and common-law traditions. However, although EBRD’s work in this field is to be commended, particularly because of the very early intervention and far-sightedness in targeting PPS law, the Model law has not been without its critics, who took issue with particular policy choices (or lack thereof). Unlike some CEE countries, Croatia opted out of the Model law, all but ignoring EBRD’s subsequent efforts. It remains unclear whether this was a conscious decision, and, if so, to what extent it was determined by actual opposition to substantive issues. One of the reasons probably has to do with the generalist drafting style, which made implementation more difficult. Another reason might be the sheer novelty of the ideas, which deviated from the traditional civil law with which the new legal system was determined to fuse. The authority of the EBRD, which was of recent origin, was sometimes unjustly perceived as biased at worst, and well-meaning at best, but still lacking the prestige and patina of the Western codifications, making it difficult to properly engage the interest of the government.

B. Resisting codification

During the socialist era, many CEE countries were eager to codify their private law, as it seemed in line with grandiose social engineering, as well as making law more accessible to ordinary people. Yugoslavia was not among those countries, the major reason being its federalist structure,

27 In 2005, even among the countries of the former Yugoslavia, Croatia was late in the introduction of a comprehensive system of registration of security interests.
32 This is the case of e.g. Hungary, Moldova, and Slovakia. See Röver, Secured Lending, 37.
and the heterogeneous legal backgrounds of the federal states. In the codification-conditioned countries, the trend has not dwindled after the dismantling of the iron curtain. In fact, a short survey points to codification resurgence in the region. Croatia, however, has been hesitant toward the idea of codification, as have other former Yugoslav states (with the exception of Serbia), and serious discussions of the matter are rare.

Instead, Croatia chose a segmented path to law reform. It is unclear whether this was a matter of deliberate policy, or simply of prioritizing reform, as discussed above. At any rate, certain bodies of law were given preference over others, due to their both objective and perceived significance in institutional support for market development. That said, even disregarding the preferences, the earlier lack of codification has generally not been perceived as a serious systematic deficiency, making such a project seem not only as an unfamiliar and laborious experience, but also as an unnecessary one.

At the end of the day, the previous lack of codification also meant that Croatia could not turn to reforming existing codified law, but had to review its older legal heritage. Although this might have been an efficient choice for an anxious legislator, it overlooked the fact that the Austrian legal system has been and remained hostile toward PPS. On a broader level, this is due to the fact that the main thrust of developments in PPS occurred only after the Second World War. Looking at the civil codes at the time, as far as PPS is concerned, revealed a rather distorted picture of questionable validity, because in all of the major systems PPS invariably developed outside of codified law. At


39 It is well known that in Germany the Mobiliarsicherheiten are for all practical purposes a product of commercial and judicial ingenuity. See Sibylle Kessal-Wulf, “Recht der Kreditsicherung,” in J. Von Staudingers Kommentar zum Bürgerlichen Gesetzbuch mit Einführungsgesetzen und Nebengesetzen, ed. Michael Martinek and Andreas Pittrich (Berlin: Sellier / De Gruyter, 2012), 22-34. In France, the pre-reformed system of security interests was hardly a system at all, but rather an amalgamation of specialty legislation based on financing patterns accommodated at a certain historical junction. See Jean Devez, Alain Couret, and Gérard Hirigoyen, Lamy Droit du financement (Paris: Lamy, 2004), 1905-62.
the same time, Croatian socialist law distanced itself from the theory and practice of modern business transactions, making it so much harder for the post-socialist legislator to understand or identify crucial weaknesses and modes of their improvement.

Finally, recall that Croatian law, unlike its Western neighbors, maintained monism in the regulation of contracts, carried over from and with the ZOO of 1978.40 PPS is a crosscutting body of law, applicable to merchants inasmuch as or even more than to consumers, and historically developed in order to accommodate commercial transactions. This meant that the civil codes of dualistic systems were never designed but for the more paternalistic consumer regulation. Having such models and not their commercially-oriented siblings serve as blueprints can also partially account for the segmented development of PPS in Croatian law.

Although it cannot be argued that the lack of codification efforts caused serious harm to the system, it might have, however, buttressed isolated and uncoordinated law making, which inevitably led to regulatory gaps and insufficiencies. Even if early reforms were sequestered, codification would probably have provided a platform for discussion and reevaluation, and ultimately forced an analysis of the links and disconnects between existing concepts.

C. Forecasting and regulatory demand assessment

A part of underregulation might be explained by the optimism of the legislator with respect to the actual practical deployment of novel doctrines. A good example is the treatment of fiduciary transfers in the ZV. As previously mentioned, the ZV managed to pack the entirety of the provisions into a single article. The complexity of the theory behind these provisions can be readily observed by glancing at current textbook commentary.41 In hindsight, it could be argued that the belief in the trickle-down diffusion of the theoretical underpinnings was partially tarnished with naïveté or even overconfidence. That said, however, it is quite difficult to conjecture the extent of creditor resourcefulness in a state of the world without the additional, more salient, regulation contained in the 1996 Enforcement Act. On the other hand, the succinctness of the ZV provisions might also have been a purposive suppressor of fiduciary transfers, given their restrictive nature. However, this course of action, coupled with a general recharacterization rule, as opposed to a simple bar on title-based security, also required significant intellectual effort.

A similar type of bias might have been present with respect to interpreting existing law. As was the case in the early history of the Western systems, a key issue was the sanctioning of non-possessory security. The 1978 ZOO was silent on the matter, while the major codifications clearly installed the Faustpfandprinzip, rejecting the doctrine of constructive possession.42 Older commentators followed this traditional line of reasoning based on the doctrine of publicity, thus denying constructive possession43 (although not without dispute).44 This problem persisted into the early nineties, with the position becoming more relaxed.45 The lack of case law on such a fundamental

40 This was consistent with the Russian tradition. See Hiroshi Oda, *Russian commercial law*, 2nd ed. (Leiden: Martinus Nijhoff, 2007), 68.
42 See § 451 Allgemeines bürgerliches Gesetzbuch (Aus.); § 1205 Bürgerliches Gesetzbuch (Ger.); Zivilgesetzbuch art. 884 (Switz.); Code civil art. 2076 (repealed 2006) (Fr.).
point of commercial value clearly demonstrates the skepticism and marginalized role of PPS in the socialist era. Today, there is less doubt on the validity of constructive possession, as this matter is handled by the ZV, which recognizes constructive possession, but restricts its third-party effects to cases where third parties had actual or constructive knowledge of the change in possession. The new rule changed the interpretational landscape, but was too well packed within the system to be able to draw the attention of a secured creditor accustomed to older rules.

Sometimes, current underregulation can also be attributed to earlier underregulation. An example can be found in the context of warehouse receipts, discussed below, where earlier underregulation of licensing coupled with socioeconomic conditions led to a gradual disuse of the law. This further reinforced the underregulation of licensing by lowering the perception of regulatory demand, and by slimming the chances of the rules being tested, analyzed, and enhanced.

III. Overregulation

A. Inconsistencies in policy

A large part of overregulation in Croatian PPS law can be attributed to inconsistencies in policy. This was particularly noticeable in the ZV-OZ divide. On a general level, the regulation of security interests in the ZV was curious in its deference to the OZ. Both were drafted parallel to each other: the former was passed in October, and the latter in June of 1996. It is not clear why this choice was made, but it seems the deference was a consequence of an earlier reform of enforcement law. Namely, in 1990 an amendment to the Enforcement Act introduced a new Title XXII, which allowed the parties to petition a court hearing where they would draft and record their security agreement. The upside of such a maneuver was a complete circumvention of litigation, as the contract included in the court record was given the effect of an in-court settlement, a type of enforcement title, thus allowing the creditor to directly proceed with a judicial sale of the collateral. This efficiency gain was an explicit target of the reform.

This model effectively linked the system of enforcement with the security interest by pushing the formative phase of the security agreement into the courtroom, and then managing the enforcement phase by application of the standard rules on judicial liens. In order to fully appreciate this peculiar development, recall that, at the time, the socialist system had long forgone a system of notaries, and it will take four more years for their rebirth. Further to that, the ensuing court collection

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46 See Meliha Povlakić, Moderne tendencije u razvoju sredstava obezbjeđenja potraživanja s posebnim osvrtom na bezposjedovnu (registriranu) zalogu [Modern tendencies in the development of security devices with a special consideration of non-possessory (registered) pledges] (PhD dissertation, Sarajevo: Univerzitet u Sarajevu, Pravni fakultet, 2001), 33 (noting that secured credit was contrary to the principles of the socialist society).

47 ZV arts. 15 (3), 116(2).

48 See e.g. ZV art. 312(2)-(3).

49 See Zakon o izvršnom postupku [ZIP] [Enforcement Procedure Act], S.l. SFRJ 20/78, 6/82, 74/87, 57/89, 20/90, 27/90, 35/91, and NN 26/91, 3/91, 91/92, arts. 251a-251f (1990).

50 ZIP art. 251c(2) (1990).


52 ZIP art. 251f (1990).


54 The Notaries Public Act (Zakon o javnom bilježništvu), NN 78/93, 29/94, 162/98, 16/07, 75/09 came into force in October 1994.

55 See ZIP art. 16 (1990) (listing only three enforcement titles, all of which are judgments or equivalent final decisions).
process exhibited the same features, which effectively made the entire model often prohibitively expensive. In this context, sidestepping litigation made sense as an interim cure until a strategic reconstruction of the judiciary could be tackled.

Additionally, there were unintended side effects of this regulation. The chosen legislative avenue—amending the rules of enforcement—dictated that the new rules fit into the existing system both by subject matter and by method. The natural consequences of such a choice were adherence to judicial enforcement, on the one hand, and the idea of state control over verification of the security agreement, on the other. Neither was questioned at the time, albeit both are very formal features. Neither was subsequently eliminated from the Croatian PPS system. Arguably, the original 1990 OZ amendments were the critical event that, coupled with systemic nonergodicity, defined the current state of the law. Even the 2012 Enforcement Bill does not do away with the judicial or notarial formalities in the creation of security interests.56

Another unintentional consequence was a perceived position on the earlier law regarding non-possessory security. As previously mentioned, pre-reform literature has debated possible extensions of article 966 of the 1978 ZOO so as to include non-possessory security via constructive possession.57 However, non-possessory security was championed as one of the innovative enhancements of the 1990 OZ amendments,58 thus indirectly conceding a bar on constructive possession. This is also an example of how overregulation can be stimulated by underregulation. Had the previous system been clearer on the rule, allowing constructive possession, the appearance of regulatory demand would have been different, suppressing overregulation.

Oftentimes the inconsistencies in policy were exacerbated by uncoordinated drafting. A major example of the deleterious consequences can be found in the regulation of fiduciary transfers. In the mid-nineties when the new OZ was drafted, it introduced a novel and unprecedented type of title-based security, the fiduciary transfer.59 These are also conceptualized in the ZV in a part of a single section,60 but the majority of the provisions remain in the OZ. ZV article 34 contains general rules on limitations on ownership, including conditional and fiduciary clauses. Fiduciary transfers are thus viewed as special instances of conditional transfers, where the conditions are linked to default or payment of the obligation secured. Further to that, the ZV institutes as principle the recharacterization of all security devices, at least in terms of the application of its rules on pledges.61 On the other hand, the OZ contains a detailed set of provisions that introduce the fiduciary transfer as an independent security device, designed to allow nonjudicial enforcement by way of strict foreclosure.62

This bifurcation in legislative choice might be explained by diverging policies regarding the general role of title-based security. The underregulation of fiduciary transfers in the ZV seems to have been a deliberate attempt to curtail it. Aside from the general rule on recharacterization, ZV article 34 allows third-party effects of a fiduciary relationship only when it is recorded in a title reg-

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56 See e.g. Vlada Republike Hrvatske, Prijedlog Ovršnog zakona [Enforcement bill], P.Z. 128, arts. 301, 308, 313, 330 (2012).
57 See Povlakić, Moderne tendencije, 156.
59 See OZ arts. 273-279.
60 ZV art. 34(5).
61 Article 297(2) of the ZV reads: “All that is set forth for the pledge shall be applied accordingly to a transfer of ownership by way of security, as well as any other securing the satisfaction of an obligation by tangible or intangible assets of the debtor or third party, unless otherwise prescribed by law.”[“Što je određeno za založno pravo primjenjivat će se na odgovarajući način i na prijenos vlasništva radi osiguranja, kao i na svako drugo osiguravanje namirenja tražbine stvarima ili pravima dužnika ili treće osobe, ako zakonom nije što drugo određeno.”]
62 See OZ arts. 273-279.
This effectively confines fiduciary transfers to registrable big-ticket items. In contrast, the OZ upheld the fiduciary transfer as the flagship security device, disregarding registration. Ultimately, even though the ZV yielded to the OZ in the regulation of non-possessory pledges, it is clear that the latter went a step further by instituting a device that the former seems to have deliberately tried to suppress.

The problem was acknowledged in the literature, and eventually led to a much-criticized attempt in 2003 to compromise by tempering the rules of enforcement and reintroducing a mandatory execution sale, in lieu of the strict foreclosure. The attempt failed, and the older solutions were restored in 2005. These developments had a damaging effect on fiduciary transfers. In less than ten years, the government’s erratic cycle of reform and re-reform signaled to the business community that serious design issues remained unresolved, resulting in unpredictable vacillation and a generally unstable legal infrastructure. As the two reforms coincide, this was probably one of the reasons the government decided to push the introduction of a registration system, hoping to boost creditor confidence.

B. Policy shifts

The inconsistencies in policy were partly caused by a persistent belief that relatively wide regulatory shifts were needed to address existing inadequacies. For example, the literature has repeatedly stressed that fiduciary transfers were introduced in order to suppress the earlier regulation of pledges (both possessory and non-possessory). This demonstrates a very different path of development from other countries that instituted title-based security, e.g. Germany, because in Croatia such security wasn’t developed gradually, but was rather imposed by statute.

When in 2005 the legislator set out to reform Croatian PPS once again, the policy choices shifted. First, unlike previous efforts, the reform was not carried out through amendments to codified bodies of law, like the ZV or OZ, but rather by installing a separate piece of legislation focused around the new system of registration. It seemed as though it was a mini-reform project, which would not touch the key elements of the system itself, but enhance it with a worthy add-on.

Second, this was a reform that targeted exclusively PPS. While previous reforms took an integral approach, covering both interests in land and in other assets, this one took interest only in personal property. A closer analysis of past reforms shows that, in fact, despite the integral approach, the strength of credit secured by real property was the primary goal. As noted earlier, this was in line with the general historical trend of securing property rights in real estate as paramount.

63 See Gavella et al., Stvarno pravo 2, 488.
64 See ZV arts. 312-313.
65 See Gavella et al., Stvarno pravo 2, 457-58.
66 Ibid., 498.
68 See Zakon o izmjenama i dopunama Ovršnog zakona [Act on Amending the Enforcement Act], NN 173/03.
70 See Zakon o izmjenama i dopunama Ovršnog zakona [Act on Amending the Enforcement act], NN 88/05.
71 The OZ amendments were passed in early July 2005 and the ZU in late June 2009.
72 Mihajlo Dika, “Fiduciarno osiguranje” [Fiduciary security], in Ovrha i stečaj—radni materijali [Enforcement and bankruptcy—working materials], ed. Nevenka Marković and Jasnica Garašić (Zagreb: Narodne novine, 2009), 35 (noting that the goal of introducing fiduciary transfers was to enable the secured creditor to get a substantively stronger security by sanctioning nonjudicial enforcement).
Third, the reform took stock of existing developments and opted to include almost all security devices. However, because the ZU was not supplemented by changes in other law, it did not close off the possibilities that such law offered for creating unregistered interests. These avenues were heretofore unexamined in practice, but might still complicate matters in cases where the parties eschew registration, or it is denied, or for some reason invalid. Because the general rules in the ZV are designed with no ZU-type registration in mind, they rely on more tricky criteria such as knowledge and notification.

Fourth, the reform isolated the problem of a lack of effective inventory security, and tried addressing it through a type of floating security. This was a valuable addition however, as will be discussed below, far from the more sophisticated devices developed elsewhere.

C. Implementation of EU law

A part of multiplicity was caused by the implementation of EU law, namely, the Financial Collateral Directive. This development happened in all EU countries, and deliberately compartmentalized security interests of the financial community. It is debatable whether such isolation, which clearly preferred the secured creditor over other creditors was justified on grounds of controlling systemic risk, but given its accession status, in Croatia there was naturally no room for discussion.

Implementation was via special legislation (the Financial collateral act), and not by revising the relevant statutes. This was done to facilitate the legislative process, although it made the extent of derogation—and the seriousness of its consequences, especially in bankruptcy—opaque to all but the industry.

An additional problem with financial collateral regulation was that it instituted a hybrid security device, which included both a customized version of the pledge, and a title transfer collateral arrangement. This was completely consistent with the Directive, which, in fact, precisely targeted systems that had trouble validating some or both types of collateral arrangements.

The FCA also opened up the possibility to use unblocked deposit accounts as financial collateral, under a favorable and careful reading of article 1(1)(10) of the Financial Collateral Act, which, unlike article 2(2) of the Directive, only requires the collateral arrangement be noted (i.e. registered) with the account provider. This remains, however, both a contested point of interpretation and a weak point of implementation in Croatian law.

D. Disused law and legislative forbearance

Due to the political constraints of the socialist regime, and the lack of economic activity, some features of existing law haven’t been fully explored, yet remained good law. A good example is that of warehouse receipts. It is well known that these instruments served as one of the dominant security devices in pre-reform systems like those of the United States or France, making them potentially attractive. The 1978 ZOO fairly extensively regulated warehouse receipts as documents issued by public warehousemen. The receipt consisted of two parts: one, which is a negotiable

document of title,76 and another, which gives its holder a pledge over the warehoused goods,77 thus creating a type of de facto non-possessor security.

This traditional security device has been carried over into the ZOO 2005,78 but remains neglected. Reasons for this concern are not only the sluggish economy, but also the complete lack of regulation of public warehousing services,79 including licensing for issuing warehouse receipts. Although such a license is not an issuance precondition, only licensed warehousemen have an issuing duty, which can partially account for the virtual absence of warehouse receipts.80

In 2009 the government proposed a bill on warehousing grain and industrial crops, which was eventually passed as the ZUIB. Under this act, licensed and registered warehousemen81 issue single-document warehouse receipts, which can be used as collateral by noting the interest on the document82 and recording it on their records.83

The Government was not only aware but also critical of existing regulation in the ZOO, as well as of its disuse. This clearly follows from the legislative history, which characterized the existing system as “risky,” albeit without further elaboration.84 The remedy chosen to tackle the specific sector was, however, specialty legislation, and not a comprehensive overhaul of warehousing legislation. Such legislative self-restraint over existing law even when it is marginalized is typically motivated by an avoidance of addressing bigger issues, and ultimately causes unnecessary regulation, which further compartmentalizes existing law.85 In the case of warehouse receipts, note that the reformed ZOO was passed only in 2005, with no substantial changes with respect to warehouse receipts compared to earlier law. Less than four years later the same rules fell under legislative scrutiny, but still remain on the books.

IV. Misregulation

A. Essential financing patterns

1. Retention of title

Retention of title is an example of impetuous reforms. Originally, this device was recognized in the ZOO of 1978, but never gained momentum due to the politico-economic constraints at the time.86 The ZOO designed the ROT clause in very simple terms, but for third-party effects required it be drafted in a document notarized no later than at the time of bankruptcy filing or seizure of

76 ZOO art. 745 (1978).
77 ZOO art. 746 (1978).
78 See ZOO arts. 755, 759-760.
80 Ibid., 846.
81 ZUIB art. 4.
82 ZUIB art. 13(2).
83 ZUIB arts. 10, 13(4).
85 The biggest upside of the new regulation was the indemnity fund, insuring the potential claims of both owners and creditors against the loss of the warehoused goods. See ZUIB art. 17.
86 Meliha Povlakić, “Zadržanje prava vlasništva kao efektano sredstvo osiguranja vjerovnika u zemljama nastalim disolucijom SFRJ (Republica Hrvatska, Republika Slovenija, BiH)” [Retention of title as an efficient security device for creditors in the countries created by the dissolution of the SFRY (Republic of Croatia, Republic of Slovenia, Bosnia and Herzegovina)], Zbornik Pravnog fakulteta Sveučilišta u Rijeci 2003, no. 3 (2003): 390.
assets. It made no mention of a conditional transfer. However, the ZV mentioned ROT in article 34, framing it in terms of a conditional transfer, where the seller and buyer are treated as owner precedent and owner subsequent, respectively. The application of article 34 of the ZV to ROT clauses meant they were ineffective unless registered in a register of title, which was available only for a limited number of assets. This is because the ZV took great care in instituting publicity as a general principle, including a policy against secret interests. The 1978 ZOO was less concerned with publicity, and more concerned with fraud, implementing formal requirements thwarting it.

Further to that, article 34 of the ZV made mandatory the application of the rules on pledges with respect to the sale of collateral, albeit with the concession of a non-judicial (but still public) sale. Such a rule fundamentally alters the priority position of a purchase money creditor, because it contradicts the reclamation rights established in the Bankruptcy code, as well as the OZ.

Another twist was added when some ROT clauses became registrable under the ZU. It included in its scheme ROT clauses with a duration over a year. The registration of ROT clauses is, however, fundamentally different from the registration of other interests because there is no encumbrance or conveyance involved—but rather a lack thereof—in spite of the change in possession. This distinction was not reflected in the law, which makes the record confusing. Additionally, ZOO article 462(3) remained unchanged, granting third-party effects against lien creditors and in bankruptcy if the clause is in notarized form, yet remaining unregistered—thus completely missing the point of effective registration.

In 2005, Croatia passed the Leasing Act, which regulated leasing services including the finance lease. Due to the fact that ownership remains with the lessor during the length of the transaction, which regularly coincides with the economic life of the leased asset, this device is similar to ROT clauses, and remains notorious for its strained relationship with security. The Leasing Act defined the finance lease as a type of lease where the fee paid by the lessee “takes into account the whole value of the leased asset,” the lessee “incurs the cost of its depreciation, and has the option to purchase and acquire ownership of the asset at a price that is at the time of the exercise of the option lower than the actual value of the asset.” The Leasing Act seemed comfortable enough with such definitional boundaries and made no additional attempts to deflect possible recharacterization issues. These are present in the context of ZV article 297, but no more than with ROT clauses, so the risk remains relatively low. However, neither the ZU, nor the Bankruptcy Act, mentions leasing.

2. Floating security

It is well known that historically the development of floating security represents a key turning point in the rise of a modern PPS system. In Croatian law, this is one of the rare instances where

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87 See ZOO art. 540 (1978), mentioning effectiveness against the buyer’s creditors.
88 See Stećajni zakon [Bankruptcy Act], NN 44/96, 29/99, 129/00, 123/03, 82/06, 116/10, 25/12
89 See OZ art. 55.
90 ZU art. 6(1)(7), art. 79.
91 The registration rules instruct the buyer be recorded in section “A” and the seller in section “C6” of the record, with the description of the collateral in section “B6”, the latter two sections being specifically designed for ROT. See Pravilnik o obliku i sadržaju upisnika te unutarnjem ustrojstvu i radu Službe upisa [Bylaw on the form and content of the register and the organization and operation of the Registrar], NN 77/06, arts. 14(3), 17. The confusing fact is that it is the seller’s ownership which is recorded, although ownership is not registrable per se.
92 Zakon o leasingu [Leasing Act], NN 135/06, art. 5(3).
the incentive for reform can be directly traced to the demands of the business community. A case\(^{93}\) in the early aughts, which caught academic attention, involved the court dealing with a pledge over fungible warehoused goods, and failing to recognize it because they were not separately stored and marked. The case is interesting, because it shortly discussed inventory financing on a general level, and noted obiter that Croatian law does not accept security over inventory.\(^{94}\)

The lawmakers took note, and introduced the “floating pledge” via a single provision of the ZU (article 38). This type of interest can be granted over assets (including a class thereof) located at a designated site, such as a warehouse, distribution center, silo, plant or other business premises. To a degree, this intervention solved the problem of collateralizing inventory, because it sanctioned a class of assets as an independent concept,\(^{95}\) although it could be argued that this was always possible through careful drafting.\(^{96}\) Because the security was designed as floating, it naturally included future property. This clearly follows from the relation back of the priority to the date of registration\(^{97}\) (as opposed to the date of actual storage), regardless of the fact that the collateral found at the time of seizure may not have existed at the time of registration. However, the rule covered only localized inventory. The plain reading of the statute requires the location of the premises be identified, which would preclude umbrella clauses such as “all of the debtor’s premises,” although such an extensive interpretation may very well hold up.

The article 38-type floating security is thus far removed from the English floating charge or the American floating lien. First, it is restricted to inventory, excluding all intangibles, and any notion of an enterprise charge. Second, the scope of the inventory covered is exclusively determined by its location. If, and only if, the goods have left the designated facility, the security interest lapses.\(^{98}\) Third, it does not automatically extend to proceeds, and contractual extensions are theoretically possible, although the position is far from settled because of the complex interpretation of the rules on accounts receivables financing.

A difficult situation arises when a pledged asset is moved into a location covered by floating security that predates the pledge. Because priority relates back to the time of registration, a subsequent creditor can be hurt by a misbehaving debtor. Thus, there is an incentive for potential secured creditors to eschew unencumbered collateral that matches the registered description of the collateral encumbered by floating security, regardless of its location, thus making the system less efficient.

As far as accounts are concerned, the reforms have failed to take an integrated approach. Accounts receivables financing has been particularly difficult under the 1996 OZ because the interest attached by issuing and serving the order of attachment, instructing the account debtor to withhold payment to the secured party.\(^{99}\) This made sense in a model that drowned the security interest in the enforcement system,\(^{100}\) but was less useful from a practical point of view. In the new system, which introduces registration, there should be no reason to further exclude non-notification accounts re-

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94 Ibid., 120.

95 This is contrary to the general principle of specificity enshrined in article 5(1) of the ZV, and reinstated the concept of universitas rerum, which was previously recognized in section 302 of the Austrian civil code.

96 This depended on the interpretation of the requirement of specificity, namely, whether the goods themselves needed to be individually itemized. See Dika, “Generički određene pokretnie stvari,” 121.

97 ZU art. 38(6).

98 ZU art. 38(4).

99 OZ art. 263(4).

100 Mihajlo Dika, Građansko ovršno pravo: Opće građansko ovršno pravo [Civil enforcement law: General civil enforcement law] (Zagreb: Narodne novine, 2007), 772.
ceivables financing, including deposit accounts, or hinder the development of a mature floating lien for that matter. This, however, remains a grey area, as there is some evidence that no floating security over intangibles was ever intended.101

B. Registration

The introduction of an electronic system of registration was effective in supplanting the less efficient methods of publicizing priority such as announcements in the Official Gazette.102 Its wide scope incorporates fixed104 and floating105 security, fiduciary transfers106 and selected ROT clauses,107 as well as liens108 and subsequent (i.e. post-registration) conveyances of collateral.109 It is, however, supplementary in nature because it does not accept registration of interests if the collateral itself is registered elsewhere.110

A frequently misguided take on the role of the PPS register is its identification with the traditional land register, which differs in several crucial points of comparison. The land register is a comprehensive system of publicizing interests in land, occupying a central position in private law. It protects the reliance of good faith searchers, and the accuracy of its data is backed up with the authority of the State. The PPS registration system is clearly different: its comprehensiveness is impossible, being technically too demanding, costly and inefficient. This means that the secured creditor cannot rely on the register to supply her with all the necessary data; she must investigate herself, inspecting the debtor’s financial records and the state of the collateral. The ZU did not fully recognize this. The register it introduced has a structure111 and uses terminology112 that resonates with the land register, and even the remedies echo the uniqueness of those pertinent to the procedural peculiarities of land registration.113

A most inappropriate imitation concerns the attachment effects of registration.114 The ZU register is not a notice-filing system. Registration is only possible after the drafting of a notarized or a judicially certified security agreement, submitted to the Registrar,115 and it is the formally issued decision of the Registrar, and not the will of the parties, which creates the interest.116 Such requirements make little sense in a system that lacks the shielding effects of the original model, and have severe consequences with respect to costs of operation and efficiency. Regardless of the system being electronic, the parties are forced to submit an original document, and the Register needs

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101 See ibid. See also OZ art. 274(2), NN 139/10, 125/11, 150/11, 154/11, 12/12, 70/22 (2010) (not in force), instructing the notary to notify the account debtor of attachment).
102 ZU art. 2(3).
103 OZ art. 266(1).
104 ZU art 6(1).
105 ZU art. 6(2).
106 ZU art. 6(3)-(4).
107 ZU art. 6(7).
108 ZU art. 6(1), (5).
109 ZU art. 6(6).
110 ZU art 6(1).
111 See e.g. ZU arts. 11-12.
112 See e.g. ZU art. 7.
113 See e.g. ZU art. 34 (naming the cancellation of a record as a specific cause of action).
114 Art. ZU arts. 17-18.
115 ZU art. 24(1).
116 ZU art. 17(1).
to somehow verify ownership of the collateral, which is particularly difficult by way of submitted documentation.117

The most serious issue faced by the registration system is the unrealistic belief in the diligent and omniscient third party. All third parties have a search duty and cannot invoke their own ignorance.118 This means that even when faced with an asset in possession of a seller, the buyer is—irrespective of his status as merchant or consumer, or the orthodoxy of the transaction—automatically put on notice of any registered interest. In cases of a registered floating security, the security interest lapses when the asset is removed from the designated site, which is in line with this business pattern, but it is the form of the transaction (including registration type) that defines the floating structure. It does not take into account the free dispositions of the debtor as the defining, but a defined feature, which seems incidental to the chosen form.

The Enforcement Act 2010, which never came into force, made another faux pas. By simply copying the provisions of the former Act, the new Act disregarded the changes introduced by the ZU, which referenced particular provisions of the old Act,119 making the future state of the law highly muddled. The Croatian parliament has recently discussed a new Enforcement bill. In June 2012, the application of the 2010 Act was once again suspended until mid-October 2012, indicating that it will probably never come into force. The Enforcement bill, however, repeats the mistakes of its predecessor.120 These drafting errors demonstrate a disturbing level of confusion, but at the same time signal that the reforms have become redundant and fatiguing.

C. Enforcement methods

1. Repossession

Repossession remains a most troubling area of the enforcement scheme. The literature has easily dismissed nonjudicial enforcement122 except in cases of possessory security,123 probably because the secured creditor could not repossess the collateral without court involvement, due to the general rule against trespass.124 Additionally, the early involvement of the court or notary made it highly implausible for the subsequent absence of any state official, and even created an expectation of their prompt response.

At the same time it should be noted, however, that there are no express prohibitions of creditor repossession, and further analysis is still needed for proper assessment. The better route would definitely be to take an unambiguous position on the matter, particularly in light of the fact that the ZV currently sanctions wrongful self-help repossession in trespass cases through damages, giving the creditor a de facto option to proceed, provided she causes no harm. It should be noted, however, that such a route suggests a more active and responsible role of the secured creditor, with

117 ZU art. 24(3).
118 ZU art. 21(4).
120 See OZ arts. 266(2), 269(1) (2010); OZ art. 262(2).
123 See ZV art. 337 (allowing, under certain conditions, the creditor in possession to conduct a nonjudicial public sale).
124 See KZ arts. 329-330.
less reliance on the judiciary, which might be perceived as uncanny in the current Croatian sociolegal culture.  

Another example of the unsettled state of repossession regulation is the ZUIB, discussed above. The original ZUIB contained messy wording and lacked enforcement provisions, which created a situation where it was not clear whether it confused the idea of pledging and mortgaging (allowing the creditor to repossess the goods directly from the warehousemen), or it gave way to the ZOO (which called for protest and a public sale). In the two years of its application, ZUIB generated just 25 issued receipts (only a small number of which were used as collateral), signaling obvious creditor apprehension. This issue was alleviated in 2011 by amendments to the ZUIB, which granted the secured creditor a right of nonjudicial enforcement by way of sale via licensed merchants. The ZUIB did not address any further details, but instructed the Ministry to draft a bylaw, which has yet to be completed.

The problem of creditor authority for self-help repossession is exacerbated by the fact that in the current state of regulation, the debtor is not incentivized in any way to refrain from contesting or hindering enforcement. In fact, when pressured and left with no alternatives to forfeiting the collateral, the debtor is, on average, probably better off resisting enforcement. Such outcomes adversely feed back to the cost of credit, thus offsetting the initial benefits of security.

2. Strict foreclosure

The ZV enacted a traditional policy against strict foreclosure, making any clause stipulating the debtor’s irreversible loss of ownership void. This is grounded in the fear of exploiting an unwary debtor, and does not extend to post-default bargaining. It is unclear whether it extends to cases where there is no evidence of an unfair outcome. On the other hand, the OZ precisely opted for this enforcement option, though through a relatively complex set of provisions. The creditor must first notify the debtor, via a notary, of its intent, giving her the option to demand a sale and set the lowest acceptable sales price. If the debtor demands the sale, a notary, authorized by the creditor, must initiate the sale. If she is unable to do so in the three months following authorization, or if the debtor fails to exercise her option, the law institutes a presumptive waiver of the right to demand a sale, and the presumptive acceptance of the collateral in full satisfaction of the obligation it secures.

The possible weakness here is the fact that the debtor must demonstrate vigilance and strategy in exercising her option, because the sales option is an inefficient choice only if the market value of the collateral is lower than the value of outstanding debt. From the creditor’s point of view, strict foreclosure is beneficial because of its nonjudicial nature, but is generally a poor substitute for payment, particularly because of the no-deficiency rule. Additionally, it might sometimes prove awk-

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125 The problem is also present in cases of fiduciary transfers. Even though the secured creditor has the right to strictly foreclose, and the right to demand possession of the chattel (for purposes of sale), she does not seem to be entitled to self-help repossession. See OZ arts. 274(5), 279(5), 274h.
127 ZUIB art. 13(7).
128 See ZV art. 307(4) (creditor receives ownership in case of default; debtor has no right of redemption), and ZV art 307(5) (creditor receives ownership for a set price).
129 OZ art. 277(1).
130 This price could not be set lower than the amount of the secured obligation, including interest and taxes. See OZ art 277(2)-(3).
131 OZ art. 277(4).
132 OZ art. 277(6).
133 This includes interest and taxes. See OZ art. 277(7).
ward for the creditor to have to engage in further sales of the collateral, especially where financial institutions face regulatory pressures with respect to portfolio structure.

**D. Priority conflicts**

The current PPS regulatory environment has enticed competition between the various security devices. Registration data have shown a clear preference for fiduciary transfers (as opposed to non-possessorial pledges). This is not surprising. First, fiduciary transfers are regulated more extensively and more explicitly than pledges, particularly because this regulation was, unlike the more abstract, complex and scattered regulation of pledges, isolated into a single heading of the OZ. Second, fiduciary transfers offered a route, although not an ideal one, to nonjudicial enforcement, which at least initially seemed attractive and promising to creditors. Third, due to doctrinal reasons, fiduciary transfers offer a position shielded from subsequent creditors, both secured and unsecured. The fiduciary creditor is clearly at an advantage because she is treated as owner of the collateral and can, even if unregistered, successfully block a lien creditor. By eliminating its title, the transferee has managed to immobilize the debtor’s further dealings with potential secured creditors, and remove the collateral from the purview of the unsecureds. Consequently, once identified as an attractive financing model, the fiduciary transfer became a common, well-known business pattern, which the financial institutions did not care to easily substitute due to the obvious cost increase.

Despite the vast array of devices, there is no coherent set of provisions in any of the statutes which would cover the perplexing priority conflicts that might easily ensue. Registered or unregistered; pledged, conveyed, or retained; bought or seized—all of these features directly influence priority, be it grossly or only slightly. Yet the lack of statutory interconnections means that unsecured creditors, buyers as well as secured creditors are all forced to assemble the scattered statutory breadcrumbs into a pattern allowing them to navigate the priority maze. At the end of the day, the fact that Croatian law has such unbalanced regulation where certain security devices are designed extremely formally, while others completely informally, and where some devices are overtly given preference over others, leaves one with an impression of confusion and befuddlement.

**V. Conclusion**

The current regulatory environment of PPS still suffers from uncertainties, which can hinder secured credit. The provided examples of underregulation, overregulation, and misregulation show that even though the system of secured credit is operational, it is ultimately difficult to get a fairly accurate account of the law. Because financial institutions, particularly in the aftermath of the last credit crisis, are increasingly risk-averse, legislative splinters, even if minor, can easily adversely affect the structure of the credit market.

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134 Zlatko Mičetić, “Izkuštvo i problemi u radu službe upisa u primjeni Zakona o upisniku sudskih i javnobilježničkih osiguranja tražbina vjerovnika na pokretnim stvarima i pravima” [Experience and problems in the work of the Registrar in applying the ZU], in Registar sudskih i javnobilježničkih osiguranja: iskustva i problemi [Register of judicial and notarial security: experiences and problems], ed. Vesna Grubić (Zagreb: Narodne novine, 2007), 79; Zlatko Mičetić, “Upisnik sudskih i javnobilježničkih osiguranja tražbina na pokretnima i pravima” [Register of judicial and notarial security interests over tangibles and intangibles], in Registar sudskih i javnobilježničkih osiguranja: aktualna pitanja u vezi s pretpostavkama i pravnim učincima upisa u javnu knjigu te namirenjem osigurane tražbine [Register of judicial and notarial security: current issues with respect to conditions for and effects of public registration and the enforcement of a secured claim], ed. Olga Jelčić (Zagreb: Narodne novine, 2008), 3.

135 OZ art. 55.

136 E.g. OZ arts. 135(1), 152(3).
Although on the broadest of levels, it can very well be argued that all of the reforms were directed at facilitating the operation of secured credit, the resulting structural complexity shows just how important it is to be mindful of the sensitive dynamics of the reforms and the interdependencies they create. Knowing when and how to take legislative action in a transitional legal system is, to be sure, dismaying. In this context, this paper pinpointed the three traps that hurt the Croatian PPS in its formative years. Arguably, this is why learning from experience becomes pivotal in offering strategies for overcoming the hurdles, by staying watchful and carefully modifying practices. In particular, this concerns taking special account of the place of proposals within the current legislative scheme. Previous examples have demonstrated that extensive focusing on immediate problem solving might leave the seemingly peripheral, but in fact crucial residual issues unresolved, resulting in inadequate regulation. It can thus be argued that this time is as good as any to take stock of both the reforms that have and haven’t been carried out throughout the turbulent period of transition. Otherwise, when combined, the three forces will continue to quietly thwart progress, spelling nothing but double, double, toil and trouble.
CLAIM SECURED BY HYPOTHEC

by dr. sc. Miloš Živković, Assistant Professor at the University of Belgrade, Faculty of Law

Abstract

The paper attempts to go a bit further than is usual in legal analysis of the secured claim within the framework of civil law systems, explaining the pitfalls of accessory hypothec and practical consequences of doctrinal positions and concepts adopted by the legislators and the courts. Its starting point is the analysis of the relationship between the hypothec and the claim it secures and the concept of accessoriness, which impregnates that relationship in most civil law systems. After that the paper presents the ‘ordinary’ analysis of the secured claim, often found in textbooks, which seems to show that there are no problems related to secured claim and no unsolved issues in that respect. Then it takes a different approach, applying the usual doctrinal positions to hypothetical(s) derived from real life use of hypothec, and reveals that underneath the apparent lack of any doubts and problems lays a full number of issues that need to be tackled. Naturally, some answers to these issues are offered at the end.

Key words: accessoriness – security interest – flexibility of security – applicability of hypothec.

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CLAIM SECURED BY HYPOTHEC

1. Introduction

1. Within civil law systems, hypothec\textsuperscript{1} is usually defined as a security right in real property. Its purpose, therefore, is to secure a claim (German: \textit{Sicherungszweck}, Serbian: обезбеђујућа сврха), and it is therefore dependent (an accessory) to that claim.\textsuperscript{2} This gives the hypothec a position of secondary right in comparison to the secured claim, which is primary. Hypothec has no purpose of its own; its sole purpose is to secure the performance of the secured claim and it therefore “shares the legal destiny of the secured claim,” as is usually said when illustrating the effects of accessoriness. While it may have an underdog position from a legal point of view, it has long been noticed that, in real life, hypothec is not only the security for a credit, but also a means to obtain the credit in the first place,\textsuperscript{3} because without the proper security, banks will not grant credit.

2. The structure of hypothec is more or less the same in all civil law systems, at least from a very general point of view. It is an \textit{in rem} (property) right providing its bearer, the secured creditor, priority in settlement of his claim from the value of the subject matter of hypothec.\textsuperscript{4} As an \textit{in rem} right it is supplied with opposability towards any person (so-called “right of trail” or “right to follow”, German: “Folgerecht”, French: “droit de suite”, Serbian: “право следовања”). The main power contained in the hypothec is the power to convert the subject matter of the hypothec into money, regardless of the identity of its owner or possessor, and thus enable the prior settlement of the secured claim from the sum obtained through the conversion.\textsuperscript{5} Hypothec is, as a rule, acquired (or obtains \textit{in rem} effect, in Romanic systems) by registration, and the time the registration is requested determines the rank of each hypothec.\textsuperscript{6}

3. Due to the effects of accessoriness (statutory accessoriness), which may be defined as direct and statutory unilateral dependence of one right, called accessory, from another right, called

\textsuperscript{1} The term ‘hypothec’ is used deliberately instead of the term ‘mortgage’, even though mortgage is the functional equivalent of hypothec in common law systems (and in the English language, for that matter). The main reason for its use is the fundamentally different legal construction of the two rights, which could cause confusion for a common law lawyer if the term ‘mortgage’ would be used.

\textsuperscript{2} This is the prevailing opinion in the literature; for different opinions, deriving the accessoriness from other sources, see Mincke, Wolfgang. Akzessorietät des Pfandrechts. Berlin: Duncker & Humblot, 1987. Also, there have been theories that, while acknowledging the common purpose as a determining aspect of the relationship between the hypothec and the receivable it secures, denounced the concept of accessoriness as determination of such a relationship. See, e.g. Heck, Philipp. Grundriß des Sachenrechts. Tübingen, 1930 for the so-called “common purpose” (German: Zweckgemeinschaft) theory or von Lübtow, Ulrich. “Die Struktur der Pfandrechte und Reallasten – Zugleich ein Beitrag zum Problem der Subjektlosen Rechte.” In Das deutsche Privatrecht in der Mitte des 20. Jahrhunderts, Festschrift für Heinrich Lehmann zum 80. Geburtstag, Band I. Berlin-Tübingen-Frankfurt a.M.: Walter de Gruyter-Mohr Siebeck-Schweitzer-Verlag Franz Vahlen, 1956, 328ff for the so-called 'on-right' (Anrecht) as an object that both the receivable and the hypothec secure.

\textsuperscript{3} The change in the point of view was underlined by Dernburg, Heinrich. Das Preußische Hypothekenrecht, zweite Abtheilung. Leipzig: Breitkopf und Härtel, 1891, VI. Also Mincke, 145.


\textsuperscript{5} This is the prevailing view of the Germanic doctrine, but also in Serbia, Lazić, Miroslav. Prava realnog obezbeđenja. Niš: Punta, 2009, 56.

the principal, where the purpose of accessory right is the realization of the purpose of principle right, and where the contents of the principle right is automatically and directly included in the content of the accessory right, the secured claim is of vital importance for the accessory hypothec. Following the publishing of an article by German scholar Dieter Medicus, it has become common to differentiate five aspects of accessoriness: accessoriness in establishment (origin), scope, right-bearer (competency, belonging), realization (enforcement) and extinction (extinguishment). The number and reach of exceptions to these various effects of accessoriness differentiates various legal systems within the civil law family. One thing remains common – the determination of secured claim is condition sine qua non of the statutory accessory hypothec, because the bond between that claim and the in rem right is established directly by the law itself, and therefore the principle right must be determined from the outset.

4. In some civil law systems, however, the development of law during the Middle Ages and in the 19th century led to abandoning of the concept of (statutory) accessoriness. The right to convert the subject matter of hypothec into money has been detached from any secured claim, which thus liberated that right from a security purpose – it could have any purpose that the grantor of such right attributed to it. Land charge (German: “Grundschuld”, Serbian: "земљишни дуг") of German law and a letter of indebtedness (German: "Schuldbrief", French: “cédule hypothécaire”, Serbian: "писмо о дугу") are examples of such rights. However, in practice they are almost exclusively used for the purpose of securing some claims, which resembles the accessory hypothec. The difference between these falsely called non-accessory security rights in real property in comparison to accessory hypothec is the fact that the bond between the secured claim and the in rem right of conversion of the subject matter into money and collecting the amount of this claim therefrom is not direct, and not established by the law itself, but rather through a contract between the creditor and the owner of the encumbered real property ("security agreement"). These rights that might be called quasi-accessory or contractually accessory, are by definition more flexible than the accessory right (hypothec), because it is up to the parties of the security agreement to modify the effects of accessoriness to their interests. Naturally, quasi-accessoriness contains a few murky areas itself, for it is inherently more dangerous for the debtor than the accessoriness, which protects the debtor from double collection and some other risks. Therefore, the most recent development within the civil law systems when it comes to security rights in real property is the so called “gradual accessoriness”, a mix between statutory and contractual accessoriness, where in some of the (five mentioned) aspects of accessoriness it would be direct and ex lege, and in some others it would remain contractual. Accordingly, the level of legal security for the debtor is maintained while making the security right itself much more flexible.

5. As it stands, accessory hypothec requires that a principle right, which is the secured claim, is determined. We shall now analyze the rules applicable to the secured claim in civil law jurisdictions, primarily in Serbia but also beyond.

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7 Definition taken from Živković, 338.
10 Živković, 337ff.
2. Secured Claim

6. There are generally two ways to describe the claim that can be secured by the hypothec: one is to simply say ‘monetary claim’, that is a claim aimed towards a sum of money, and the other is to say ‘any claim the value of which can be expressed in money’. This is self-understood from the fact that hypothec aims at transforming its subject matter (real property) into money, so that only monetary claims can be satisfied from it. The first of the above solutions is therefore simpler and better, for it does not leave any room for doubt – the secured claim is a claim for an amount of money, so that amount, along with interest and expenses of enforcement, is covered by the hypothec. The other solution is a bit more complicated. Say, one wants to secure an obligation to construct and operate a power plant. The claim in this case is a non-pecuniary one, to construct and operate a power plant. This claim can be expressed in monetary terms – the consideration paid by the other contractual party is substantially the amount, and the ‘monetary expression’ of the said claim would be in the vicinity of that consideration. However, in practice it would be impossible to secure a claim of this kind by a hypothec, for the precise value determination is essential for registration, which is essential for the hypothec. This is why the practice uses different techniques to achieve security by hypothec – it provides a contractual penalty (or in common law terms, liquidated damages, which is the functional equivalent) in case the non-pecuniary obligation is duly fulfilled, and then secures the amount of such contractual penalty with a hypothec. The contractual penalty claim is, though, a monetary claim with a determined amount, so at the end it is a monetary claim that is secured by the hypothec. Therefore, saying that ‘the value can be expressed in money’ is in fact false, for only monetary claims can be secured by the hypothec.11 Practically, if one wants to secure a non-monetary claim by a hypothec, one needs to find a way to transform that claim into a monetary one (e.g. by providing a facultative monetary obligation, contractual penalty or performance bond), and then secure that monetary obligation by hypothec. The Serbian Law on Hypothec of 2005 does not explicitly require that the secured claim is a monetary one, but it is clear from the context (it mentions currency and interest) that it has such claims in mind.12

7. The next commonly discussed issue is that of currency of the secured claim. The question is very old, and has been discussed since the 19th century doctrine.13 In most of the legal systems of transition countries the secured claim may be in any currency,14 and in case it is not the domestic currency there is the inherent risk of exchange rate fluctuation, which makes foreign currency mortgages less specific than domestic currency ones.15 In Serbia, for example, trading in real property with foreign currency is allowed,16 such that such risks are minimized.

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11 Some reputable ex-Yugoslav authors have advocated this ‘broader’ notion of the secured receivable with reference to Art. 794 of the Swiss Civil Code (ZGB). However, the reference is false, for that Article of ZGB only provides for a maximum amount hypothec when the exact amount of an otherwise monetary receivable cannot be determined in advance, and not to a non-monetary secured receivable – see Gams, Andrija. Osnovi stvarnog prava, V izdanje. Beograd: Naučna knjiga, 1968, 195. A better way to put it would be one that speaks about a monetary obligation being facultative to a non-monetary one – see Gavella, Nikola. Stvarno pravo, svezak 2. Zagreb: Narodne novine, 2007, 130, fn. 45.

12 Art. 7 Serbian Law on Hypothec. It speaks of “any claim”, including future or conditional claims as well as the claims expressed in foreign currency, which leads to the conclusion that the claim is monetary.

13 Dernburg, Heinrich. Das Preußische Hypothekenrecht, Zweite Abtheilung. Leipzig: Breitkopf und Härtel, 1891, 188ff. In those times information on exchange rates was not ‘a click away’, so the problem with reliability and specialty was far bigger for some currencies.


15 This is said in the sense that the same amount of foreign currency may be a significantly different amount in local currency at the moment of enforcement, compared to the moment of establishment of hypothec. In countries in which the sale of real property may be performed only in local currency, one does not always know the amount that should be required to satisfy a foreign currency debt.

16 Art. 34 Para. 2 Item 5) of the 2006 Law on Foreign Exchange Operations of Serbia (Закон о девизном пословању).
8. As for further issues related to the claim secured by the hypothec, it goes without saying that it has to be valid, i.e. not void, and if it is voidable, the avoidance would simultaneously mean the avoidance of the hypothec. Another issue is the enforceability of a secured claim, in other words whether it has to be enforceable or not at the time the hypothec is established. The general answer would have to be in the negative, because in principle enforceability cannot be achieved by providing security. This issue was also discussed as far back as the 19th century, and today it seems that the only type of unenforceable claim that can be validly secured by hypothec is one limited by statute, and only in cases where security is provided by the debtor, not the third party. In such cases, there is an express provision of the ex-Yugoslav Code of Obligations (hereinafter: ZOO) that, should the debtor provide security for the debt limited by statute, it shall be considered as waiver of the statute of limitation. Therefore, providing hypothec in this case cures the unenforceability, and not only security right, but also the secured claim becomes enforceable again.

9. One of the intriguing issues related to a secured claim has been whether it must exist at the moment of establishment of the mortgage, or it can be under conditional precedent, or be a future claim. Even though strict accessoriness would seem to require that the secured claim validly exist at the time hypothec is established, even Roman law allowed conditional and future claims to be secured by hypothec. Today it seems that accessoriness is nowhere understood so strictly so as to require an existing secured claim for the establishment of hypothec. The fact that hypothec is accessory merely requires that a secured claim is determinable at the time of establishment of the hypothec. In other words, accessory hypothec may secure a determined, but not just any claim between a creditor and a debtor. This should be self-understood, because it is not possible to have a ‘dependent’ right when one does not know which right is the principle one, i.e. upon which right the ‘dependent’ one is associated. Most national doctrines of civil law countries connect the requirement of determination of secured claim to the principle of ‘specialty’ of hypothec, which is often considered to have a twofold meaning – on the one hand, that the subject-matter of hypothec must be precisely determined, and on the other, that the secured claim must be precisely determined. However, it seems that the requirement of determination of a secured claim stems from the principle of accessoriness, for it is not conceivable to have an accessory right when the principle right is not determined, or at least determinable. As we shall see later, this is not just a doctrinal dispute, but has some practical implications as well.

10. This inevitably leads to the next question – what is required for determination of a claim? It is quite rare that the statute itself contains the answer as, for example, is the case in Montenegro: ‘The claim is considered sufficiently determined if creditor, debtor, legal grounds and the amount,
respectively the highest amount of coverage by hypothec, are determined. However, this provision of the Montenegrin statute agrees with the positions of doctrine in civil law countries which base their security rights over real property upon the principle of accessoriness – this is the position in Austria and France, and also in many countries that follow their respective laws as a role model. Exceptionally, it is allowed to secure a bundle of claims by hypothec provided, however, that all of the claims originate from the same legal ground (say, a framework credit agreement). This is the so called maximum or highest amount hypothec, which is recognized in many jurisdictions. In that case, hypothec is actually accessory to the legal relation out of which the individual claims are stemming, and not to any of the particular claims individually – the framework credit agreement, and not any of the individual tranches, is the principal right. The determination of legal ground for a secured claim or a bundle thereof is essential, which is also evident from the fact that obligations cease to exist once the ground of an existing obligation is altered – this is one of the cases of novatio (novation), which, due to accessoriness, also leads to extinguishment of the hypothec that used to secure the claim before the novation. The most recent developments and reforms in countries that base their security rights on real property upon accessoriness seem to reflect a tendency to allow claims from multiple legal grounds to be secured by one highest amount hypothec. The provisions of Croatian Enforcement Law, French ‘rechargeable hypothec’, Montenegrin ‘continued (extended) hypothec’ and recent developments in Austrian doctrine seem to push in the direction that any claim between two persons may be included under cover of hypothec (by allowing claims from different legal grounds, of the same or even different kinds, to be covered by the highest amount). That is, however, definitely too far from accessoriness and would not mean only an exception from the principle, but rather abandoning the principle as such. Without at least a determined legal ground (legal relation), as in the case of highest amount hypothec, it would not be possible to determine which is the principle right for a hypothec, in other words to which right the hypothec is accessory. What would the scope of hypothec be (to which of the claims/legal relations it would align to), and what would happen if just some of the covered claims/legal relations are assigned (would the ‘accessory’ hypothec accompany the assignment or not) or cease to exist (would it lead to extinguishment of hypothec, complete or partial or not)? Accessoriness could not survive such development and it is therefore unlikely that the courts will allow it, and where the statute seems to have allowed it, the courts (and also notaries, for that matter) are bound to encounter problems with its implementation.

26 Art. 315 Para. 5 of Montenegrin Law on Ownership Relations of 2009. Almost the same provision is contained in Art. 301 Para. 1 of the Croatian Law on Ownership and other Property Rights of 1996, which was probably the role model for the Montenegrin provision.

27 This position dates as far back as Exner, Adolf. Das Oesterreichische Hypothekenrecht, (Erste Abteilung). Leipzig, 1876, 132. It is undisputed since, see in newer doctrine Hinteregger, Monika. “Kommentar zu § 449 ABGB.” In Schwimman, Michael (Hrsg.). ABGB Praxiskommentar, Band 2, 3 Aufl. Wien: Lexis-Nexis ARD Orac, 2005, 288.

28 Art. 2421 of the revised Code Civil (CC). Also Farge, Michel. Les sûretés. Grenoble: Presses universitaires de Grenoble, 2007, 291. Farge adds that Art. 2421 of the revised CC requires determination of creditor, debtor and legal ground of the receivable, and Art. 2423 of the revised CC the amount or highest amount.

29 For Croatia see Gavella, 137-138. The enforcement procedure regulations are, seemingly, even less strict than the substantive law – see Art. 263a of Croatian Law on Enforcement (OZ). It is not clear why Gavella is restricting this provision to movables, while the statutory text clearly includes real property as well.

30 Stojanović, Dragoljub, and Dimitar Pop-Georgijev. Kometar Zakona o osnovnim svojinsko-pravnim odnosima, treće izdanje. Beograd: Službeni list, 1986, 225. Also Živković, 82ff. The highest amount hypothec exists in some form in Croatia, Bosnia and Herzegovina, Montenegro and Serbia; presumably it exists in Macedonia as well, while the position in Albania is not clear – see Civil forum for South East Europe, Collection of studies and analyses, First Regional Conference, Cavtat 2010, Volume II. Beograd: GTZ, 2010.


32 Art. 263a OZ.


34 Art. 317 Para. 2 Montenegrin Law on Ownership Relations.

35 Kurzbauer, 33ff.
It would be much fairer to allow the quasi-accessory security rights in real property, than to stretch the statutory accessoriness of hypothec to the level of extinction.

3. Practical Pitfalls

11. The material presented in the previous section was a typical, perhaps detailed, analysis of the secured claim. This is something one might find in textbooks on property law or on real security rights (if they are of any worth, that is) and it mostly covers the basics. However, one simple characteristic of the accessory hypothec is usually failed to be mentioned. That characteristic is that hypothec, as a rule, secures one claim, and while it is possible that a hypothec for securing one claim exists on several real properties (the ‘common’ or ‘simultaneous’ hypothec), the opposite, that several claims are secured by a hypothec on one real property should not be possible. Why not? Well, this is due to the accessoriness. Having several claims secured by one and the same hypothec is not a problem from the point of view of the principle of specialty of hypothec – it merely requires all of the claims to be determined. It seems quite simple – the parties to the agreement on hypothec merely agree that several of their mutual claims are to be covered by hypothec. However, what will happen if the creditor assigns one of those claims to a third party, or if one of these claims turn out to be null and void? Will the amount of the hypothec be reduced after some of the claims are settled? What happens with the other claims if the real property is sold to satisfy one of them? The highest amount hypothec rescues the day if all of the claims stem from one legal ground (one framework credit agreement, for instance), for the hypothec is then accessory to it and not to individual claims. But outside that exception, having several claims secured by one hypothec leaves nothing of accessoriness. Further, given the fact that accessoriness is based upon mandatory legal provisions (ius co-gens) and that it works by operation of law, such arrangements should not be allowed for a security right which is, in principle, accessory.

12. It is true, though, that in the case where several claims from different grounds are secured by a single hypothec, one might consider them all as one secured claim for the sake of accessoriness. The important limit is the highest amount that is registered as the ceiling for the coverage. The argument would be that even if one single claim is secured, it could be partially assigned, or it could be partially null or partially cease, and the problems that would come up in respect of accessoriness would be the same as in the case where several different claims, deemed as one, are secured. There are some differences between the two situations, but in essence the problems would be the same. If we put aside the doctrinal argument that several different claims cannot be deemed as one, and that therefore there would be no principle right for the hypothec and thus no accessoriness, from the practical point of view ‘accessoriness’ to the fictive ‘claim’ which in fact consists of several claims would cause enormous legal complexity, while its designated purpose is, amongst others, simplification of a legal situation. Additionally, this fiction would not remove the only remaining restriction: that all of the secured claims must be determined (or made determinable) at the time hypothec is established. Allowing the parties to subsequently add or remove some claim from the coverage by hypothec cannot be reconciled with accessoriness even through a fiction that all secured claims are deemed as one. My argument is that even though some legal acrobatics could be used to, up to a certain extent, ‘save’ the accessoriness in cases where more than one (different) claims are to be secured by a single hypothec, both the practical and doctrinal price for doing so would be pro-

36 Co-holding of mortgage by several different creditors (having the same rank towards the third parties but different ranks amongst themselves) who would have to be registered as such; partial transformation of highest amount hypothec into fixed amount with simultaneous reduction of highest amount; reduction of highest amount for the case some of the claims is settled; complex enforcement in case only some of the secured claims are due, to name just a few of those complexities.

37 Medicus, 498ff.
hibitive. This is especially the case with alternatives to be found in quasi-accessoriness (contractual accessoriness) and, even more, gradual accessoriness, which would enable the parties to achieve the same goals regularly and simply, with no need for fictions or legal acrobatics.

13. Therefore, my position remains: with accessory hypothec, one hypothec can secure only one claim or, exceptionally, a bundle of claims coming from the same legal ground. The claim, respectively the legal ground, must be determined at the time the hypothec is established. This is the requirement of accessoriness.

14. The problem is that the credit praxis of banks and other financial institutions requires more flexibility: they want to be able to secure claims from different grounds by a single hypothec; and they need the possibility to change the number of secured claims during the existence of hypothec. In the conflict between the needs of commercial and civil life and the doctrinal restrictions of commercial and civil law, the outcome is known in advance – life shall prevail. The current situation in Serbia is such that its legislator is still deliberating on whether to include gradual accessory security rights in its future property legislation. Many esteemed law professors of age and experience fear this prospect, and it is very difficult to explain to them that we practically have it already, but at the cost of deviating our doctrine and principles, especially the accessoriness. Here is a typical example from the credit practice of Serbian commercial banks: the bank grants a credit to a customer, and secures its claim by a hypothec. However, in case of default, the credit agreement foresees that the debt shall be transferred to the customer’s current account, and if there is not enough means to cover it on that account, it shall be considered as overdraft, naturally having a very high agreed interest rate far exceeding the default interest rate or interest rate of the original credit. The hypothec, which was supposed to secure the original debt, is then used to recover the overdraft, together with interest. In case of extra-judicial enforcement, there is actually no remedy left for the customer. The fact that the claim was satisfied from the proceeds of sale of hypothecated real property that was not the one originally secured is simply overlooked and neglected. So, the secured claim is being effectively replaced prior to extinguishment of the original claim and without establishing a new security right, something that should not be possible with accessory hypothec.

15. Croatian substantive legislation does not recognize quasi-accessory security rights. However its OZ, in Article 263a, allows claims from different grounds to be secured by a single hypothec, which practically means that accessoriness is given up. Moreover, OZ does this for the practically most utilized form of hypothec (notarial). The same seems to be true with Montenegrin practice, where notaries regularly provide several different secured claims for one hypothec.


39 This was feedback I received personally after giving a lecture in law of hypothec to Montenegrin notaries in July 2012.

40 This Art. 317 is as murky as it gets, and even the author of the statute did not explain it with any precision in his commentary – Rašović, Zoran. Komentar Zakona o svojinsko-pravnim odnosima, knjiga II. Podgorica, 2009.

seems more adequate that if in that case the grantor of credit was in good faith in respect of nullity, the hypothec could secure the claim based upon unjust enrichment of the user of credit. This could be explained by the reasons of equity, because it would not be fair to leave the grantor of credit without any security in that case. However, even though this solution might seem logical and right, it is clearly contrary to the effects of accessoriness, for a null and void secured claim should lead to a null and void hypothec. The exception is not explicitly provided in legal texts and is therefore, at least formally, difficult if not impossible to defend. Furthermore, the situation in cases of a quasi-accessory security right in real property is quite the opposite. The courts tend to extend the meaning of security agreement by broad interpretation, and in case the parties provided a claim from a credit agreement to be covered by a hypothec, and that agreement turns out to be void, the hypothec covers the unjust enrichment claim.\footnote{Eickmann, Dieter. „Commentary to § 1191.” In Münchener Kommentar zum Bürgerlichen Gesetzbuch, 5. Auflage. München: Beck, 2009, Rn 41. See also decisions of German Bundesgerichtshof (BGH) cited there.}

4. Conclusion

16. The issue of a secured claim in respect of hypothec, at first glance, seems to be a technical one. Yes, there must be a secured claim, for without it the hypothec would have nothing to secure and its security purpose is guaranteed by statute through the accessoriness principle. It must be a monetary claim (or at least it must be suitable to be expressed in monetary terms), valid and enforceable. The secured claim is determined satisfactorily if creditor, debtor, legal ground and amount, or at least the highest amount, are determined. However, if one goes a step further and examines the requirements of the practice, the inevitable conclusion is that accessoriness as a statutory bond between the secured claim and hypothec is too stiff and must be relaxed, sometimes beyond recognition, in order to meet the needs of commercial practice. If that is the case (and it has been shown that in many ‘accessoriness’ countries it is), would it not be better and fairer to allow quasi-, respectively gradual accessory security rights in real property? Gradual accessoriness means that the parties to the security agreement (usually creditor and debtor/owner of real property) may agree on which claims should be secured by security right; they can provide for more than one secured claim, or even all claims between the two persons, existing and to come; they can alter, reduce or increase the number of claims, change some for others, or simply use their party autonomy as they see fit. The rules on consumer protection in financial services, general consumer protection law and rules of general law of obligations on protection of the weaker party should work to prevent creditors from misusing their position and creating extremely imbalanced security agreements. That risk being covered, the advantages of gradual accessory security rights in real property are indisputable. Moreover, accessoriness as a principle would remain undistorted for all cases in which hypothec is used, and there would be no need to twist and bend it in order to meet the practical needs – if the creditor wants flexibility, it can go for gradual accessory rights; if it went for hypothec, the flexibility shall be limited by the effects of accessoriness.
THE CONCEPT OF PROPERTY RIGHT UNDER THE EUROPEAN CONVENTION ON HUMAN RIGHTS AND ITS IMPORTANCE IN THE ALBANIAN LEGAL FRAMEWORK

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Abstract

Whether the right to property is a human right has been historically controversial, depending on the political ideology of the society. To some it has been one of the crucial rights, to some others it has been the main enemy of freedom and equality. Thus, it has been quite difficult to reach consensus in a politically divided world as to whether the property right is a human right. However, the European Convention on Human Rights offered a guarantee for the protection of property in Article 1 of its First Protocol. The purpose of this paper is to take a closer examination of the property right as a human right protected by international instruments, namely the European Convention on Human Rights, analysing the autonomous concept of property given by the jurisprudence of the European Court of Human Rights. Such an examination might help to understand the material influence of human rights in property law. Originally, private law was considered to be immune from the effect of human rights, but the last decades' developments make it possible to speak about the tendency towards the constitutionalisation of private law, including constitutional property.

Key words: property interests, enjoyment of possession, restitution after the fall of communism, state duty doctrine, horizontal application of human rights.

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THE CONCEPT OF PROPERTY RIGHT UNDER THE EUROPEAN CONVENTION ON HUMAN RIGHTS AND ITS IMPORTANCE IN THE ALBANIAN LEGAL FRAMEWORK

1. Introduction

The word ‘property’, being widely used in philosophical, economical and legal discourses, has been attributed vague meaning. Even its repeated use within legal debates is highly ambiguous. All classical thinkers from Plato and Aristotle, to Grotious and Locke, Rousseau and Kant, and Hegel and Marx, assigned property a central place in their stipulations and theories regarding human values and proper organization of societies. Defining ‘property’ seems a very challenging task and some argue that the concept of property defies definition. Comparative scholarship has not proved to have been of great help until lately, as property law has been continually considered as being of local character, generally regarded as a set of national, fairly rigid, and technical legal rules, thus hindering the comparative study of property law. However, recent development in the constitutionalization of private law and direct impact human rights may have in property law, as can be seen in case law developed either by the European Court of Human Rights (ECtHR/Court) concerning the protection of property as provided by Article 1 of the First Protocol (P1-1) to the European Convention on Human Rights (ECHR/Convention), or by the Court of Justice of European Union (CJEU), has led to a growing interest in comparative property law. This might contribute to the need for harmonization or unification of certain aspects of property law, which is especially crucial for business activity in the EU. The rapid growth of European private law and, more particularly, European property law has led scholars to reflect upon a less fragmented and more coherent development of this field. Ratification of the

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1 See (Gambaro 2011, 205-7).
2 See (Munzer 2001): 2.
3 See (Alexander and Peñalver 2012).
4 (Erp, Comparative Property Law 2006).
5 In the last decade a growing amount of legal literature has been dedicated to the horizontal human rights effects in many areas of private law, inter alia, (Fundamental Rights and Private Law in the European Union: A Comparative Overview 2010) (Cherednychenko 2007) (Weinrib and Weinrib 2001) (Loof 2000) Loof, (Mak 2008).
6 See for example the case of J.A. Pye (Oxford) Ltd v. the United Kingdom, no. 44302/02, 15 November 2005 in which the Court discussed core rules of private law such as acquisitive prescription and found violation of property rights, but then in J.A. Pye (Oxford) Ltd and J.A. Pye (Oxford) Land Ltd v. the United Kingdom (GC), no. 44302/02, ECHR 2007-III, the Grand Chamber just followed a practical solution not to find violation of P1-1, otherwise the Court findings would have required radical changes in domestic private law of states party to the ECHR.
8 On the increasing importance of property law as a new field of European private law see (Shulze 2011, 24), (Erp, European property law: A methodology for the future 2011). The growing interest in the concept and content of property led to the newest publication of ius commune casebooks, the first ever casebook on comparative and European property law: (Erp and Akkermans, Cases, Materials and Text on National, Supranational and International Property Law 2012).
9 (Erp, European property law: A methodology for the future 2011, 228)
ECHR\(^\text{10}\) has demonstrated a significant impact on the protection of human rights by Albanian legislation and had a special impact on the protection of property rights. Whether the property right is a human right has been historically controversial, depending on the political structures of the society. For some it has been one of the fundamental rights, the most important, while for others it has been the primary enemy of equality and freedom. For this reason it was very difficult to reach a consensus in a politically divided world as to whether the right of ownership was a human right. Consequently, the United Nations Covenants have not included the protection of property rights.\(^\text{11}\) However, the ECHR provided a guarantee for the protection of property in P1-1.\(^\text{12}\) P1-1 of ECHR is similarly formulated by Art. 41 of the Albanian Constitution in 1998.\(^\text{13}\) An identical guarantee is provided by the Civil Code in Articles 153\(^\text{14}\) and 190.\(^\text{15}\) The legislator aimed to imply the human right dimension of property at the core of private law, thus creating a multi-layered protection of property rights. Aiming to understand the meaning of property law through the lenses of human rights and constitutional principles, this paper tries to analyze the property right from a different perspective compared to traditional private law, by considering it as a human right, protected by international instruments such as the ECHR, which is the most important binding international instrument of human rights imposing amendments to, and requiring conformity of, domestic constitutional and private law.\(^\text{16}\) From this point of view, this work provides a new approach towards understanding the meaning and concept of property, which for the sake of legal certainty must be acknowledged in order to rightly interpret and apply domestic provisions, as far as ECHR has given an autonomous meaning to P1-1. The right of individual direct claims for violation of the ECHR and the jurisdiction of the European Court of Human Rights are binding on each State Party to the Convention. Considering that ratification of ECHR by the former socialist countries has significantly increased the number of property issues before the ECHR, an examination of judicial practice in this regard would help to understand the concept of property protected by the ECHR, which is often considered as a living instrument.\(^\text{17}\)


\(^{11}\) (Çoban 2004, 1).

\(^{12}\) Additional Protocol No. 1 to the ECHR, Paris, 20 March 1952. Article 1 reads: “Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law. The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.”

\(^{13}\) ... 3. The law may provide for expropriations or limitations in the exercise of a property right only in the public interest. 4. Expropriations or limitations of a property right that amount to expropriation are permitted only against fair compensation. 5. In the case of disagreements related to the amount of compensation, a complaint may be filed in court. In Albanian legal doctrine, it is generally accepted that constitutional human rights are modelled after ECHR, see, (Traja 2002, 60), (Omari and Anastasi 2010, 72-3) Pursuant to Art. 41 (4), just compensation is provided.

\(^{14}\) After the fall of communism in the 1990s, the Albanian legislator, recognizing the communist regime’s atrocities against human rights and with regard to private law against particularly property rights, in the adoption of the new Civil Code of 1994 provided a stronger guarantee, a provision very similar to Napoleon Code Civil Article 545. Initially the Civil Code, adopted by Law No. 7850 of 29.07.1994, Official Journal No. 11/94 provided: “No one shall be deprived totally or partially of the ownership over his things, except in legal public interests and always against a full and previous compensation.” This provision was amended by Law No. 8781 of 3.5.2001, Official Journal No. 24/01 aiming to bring it in line with constitutional stipulation. At present, Art 153 of the Civil Code is modelled after the first paragraph of Art. 834 of the Italian Civil Code and reads “No one shall be expropriated, or be limited in exercising of property rights amounting to expropriation, except in public interests and always against a fair compensation.” Similarly this article was amended in 2001 and at present reads: “Things shall be expropriated only in public interests recognised by law and always against a fair compensation. Such things become property of the state or property of other public agencies, in whose favour the expropriation takes place.”

\(^{15}\) See Herrmann v. Germany [GC], no. 9300/07, § 36, 26 June 2012.

\(^{16}\) Inze v. Austria, 28 October 1987, § 41, Series A no. 126.
Although the ECHR as a legal document is directed to State parties and not to individuals, the ECtHR during its practice has continually reiterated the State duties to take all necessary and possible measures with respect to human rights protected by the ECHR. Such obligations are imposed not only on the governmental bodies, but also on legislative and judicial organs. Concerning the state positive obligation doctrine and the issue of horizontal application of human rights, though a controversial issue in western legal doctrine and not very clear in Albanian legal practice, a close look will be taken on it in the third part of this paper. Nevertheless, the presence of a public law guarantee in the Civil Code and the recent amendment in the Civil Procedural Code, which consider an ECtHR judgment as one of the causes for revision of domestic final court decisions, are worth researching for the meaning of property in the human rights field of law.

Another need for understanding the protection and guarantees of property rights comes from the fact that since the collapse of communism, Albania has been part of the international community and opened up to globalization process of the entire world. One of the principles of globalization is the free movement of international capital and the international market. The security of property rights is an important prerequisite for an international investor to make an investment in a foreign country. So in addition to domestic regulation of property by private law, we can say that international law of human rights directly applicable in Albania can serve as a tool for guaranteeing property rights, which could serve to attract foreign investment that is essential for the development of the country.

A better understanding of property rights might also help to correct past injustices by the communist regime and could serve as a basis for the proper restitution of property, especially in the very critical recent situation after the pilot-judgment procedure adopted by ECtHR against Albania, as a result of structural and systematic breaches of inter alia P1-1. This paper aims to provide an analysis of Article 1 of Protocol 1 with a keen eye on the judicial practice of the European Convention organs, mainly the ECtHR, thus assisting in a better implementation and application of the Convention principles in domestic law.

2. Concept of property under ECHR

The European Convention on Human Rights in its Article 1 of Protocol 1 guarantees the right of property. The wording of P1-1 shows that it was formulated with little concern for precision. Some of the defects are probably due to the constraint of time, others probably the result of weak compromises to reach an agreement. P1-1 in the English version refers to ‘possession’ in the first and second sentences, while to ‘property’ in the third. The French version uses ‘biens’ in the first sentence and ‘propriété’ in the second, and then ‘biens’ again in the third sentence. Moreover, the English term ‘possession’ is not consistent and clear as an adequate legal term to properly indicate the prop-

18 Art. 494 (ë) of the Albanian Civil Procedural Code provides that an interested party may claim revision of a final court decision when the ECtHR has found violation of the European Convention on Human Rights and its Protocols.
20 See (Allen, Property and The Human Rights Act 1998 2005, 37-40). Inability to reach an agreement results also from the fact that the State Parties to the Convention did not include the right to property in the text of the ECHR, but such right was included only in the Additional Protocol which was adopted more than one year later.
21 Protection de la propriété: “Toute personne physique ou morale a droit au respect de ses biens. Nul ne peut être privé de sa propriété que pour cause d’utilépublique et dans les conditions prévues par la loi et les principesgénéraux du droit international. Les dispositions précédentes ne portent pas atteinte au droit que possèdent les Etats de mettre en vigueur les lois qu’ils jugent nécessaires pour réglementer l’usage des biens conformément à l’intérêt goénéral ou pour assurer le paiement des impôts ou d’autres contributions ou des amandes.” See English version at fn. supra.
erty, which is more comprehensive and used by legal acts, texts and documents. Additionally, the English legal terminology intimately connected with English law might have offered no help, given the differences existing between civil and common law traditions and the tremendous difficulty to describe civil property law concepts in the English language. Other States parties to ECHR in the translation of P1-1 have mistakenly confused possession with individual ownership of tangible movable or immovable property. But while P1-1 does not prescribe the content of the concept of property, it has been the duty of the ECHR bodies to determine which rights are guaranteed. Earlier in its case law the ECtHR has pointed out that P1-1 is in substance guaranteeing the right of property, which is the clear impression left by the words ‘possessions’ and ‘use of property’, and unequivocally confirmed by the travaux préparatoires, which show that the drafters continually spoke of ‘right of property’ or ‘right to property’ to describe the subject matter of the successive drafts which were the forerunners of the present P1-1. As result, the right to dispose of one’s property constitutes a traditional and fundamental aspect of the right of property. Although this position seems fairly restrictive, a glance at later ECtHR case law indicates that possession is ‘independent from the formal classifications in domestic law’. Case law also illustrates that ‘possessions’ has a very broad and autonomous meaning. There is not a common concept of ownership in Europe on which the Convention bodies could set the limits of protection provided by Article 1 of Protocol 1. For this reason it was necessary to interpret the concept of property in an autonomous way and the ECtHR has adopted a broad definition which is not limited to the traditional concept of rights in rem, but includes all vested pecuniary interests arising from both private and public law relations. The autonomous concept of ownership includes all rights in rem over tangible things. The concept of property also includes legitimate expectations that create enforceable claims on domestic law. To give just a few examples the ECtHR has found violations in respect of: failure to recognize a void “contract”; the failure to protect a minority shareholder; refusal to renew a lease of a tenant who had no contractual or statutory right of renewal; refusal to return royal estates to the Former King of Greece; the failure to prevent and warn of risk of an illegally-occupied dwelling; the failure to execute court

22 See (Allen, The right to property in Commonwealth Constitutions 2000, 119-61) ‘the meaning of property’; on difficulties defining ‘possession’ see also (Hill 2001, 24-6) and the dissenting opinion of Sir Gerald Fitzmaurice at § 18, fn. 8, in Marckx v. Belgium, 13 June 1979, Series A no. 31.

23 On differences in technical terminology and on difficulty to commonly define property see (Erp and Akkermans, Cases, Materials and Text on National, Supranational and International Property Law 2012, 46-8, 362).

24 Some Contracting Parties to ECHR and its Additional Protocol have translated P1-1 uniformly throughout all sentences as ‘ownership’, i.e. German version - Eigentum; Norwegian - Eiendom; Swedish - Egendom; Finish - Omnaisuus; Croatian - Vlasništvo. While Latin language-speaking countries have referred to the French version, i.e. Italy, Spain, Portugal and Romania, Albania has also referred to the French version but the word ‘biens’ is translated as the general concept of ‘wealth’. ECHR texts available at: (European Court of Human Rights n.d.).


26 Marckx v. Belgium, 13 June 1979, § 63, Series A no. 31. In Handyside v. the United Kingdom, 7 December 1976, § 62, Series A no. 24, the ECtHR had stated: “the expression ‘deprived of his possessions’, in the English text applies only to someone who is ‘deprived of ownership’ (“privé de sa propriété”).”

27 Marckx v. Belgium, § 63.

28 Beyeler v. Italy [GC], no. 33202/96, § 100, ECHR 2000-I.

29 (Orebech 2009, 61).


31 Beyeler v. Italy, ECHR 2000-I.

32 Sovtransavto Holding v. Ukraine, no. 48553/99, ECHR 2002-VII.

33 Stretch v. the United Kingdom, no. 44277/98, 24 June 2003.

34 Former King of Greece and Others v. Greece [GC], no. 25701/94, ECHR 2000-XII.

35 Öneryıldız v. Turkey [GC], no. 48939/99, ECHR 2004-XII.
orders issued in private disputes;\(^{36}\) the failure to honour a promise made in 1944 to provide land;\(^{37}\) etc. In its case law the ECtHR has also discussed intellectual property rights,\(^{38}\) goodwill,\(^{39}\) licenses,\(^{40}\) the right to pension and social security benefits,\(^{41}\) etc. In many cases the ECtHR seems to regard the P1-1 as a general protection for wealth, as it often limits the interpretation of ‘enjoyment of possession’ to the economical affectation of the individual. However, it is also clear that the P1-1 can play a role in protecting individual autonomy and identity. The consolidated case law has indicated that legislation which forced the applicants to allow hunting on their property, although not causing them any economic harm, still undermines their ethical objection to hunting, thus imposing a heavy burden on applicants’ rights of property amounting to violation of P1-1.\(^{42}\) *Chassagnou and Others v. France, Schneider v. Luxembourg,* and very recently *Herrmann v. Germany* show that property as a human right fulfils a function in realizing personal beliefs and affirming identity, dignity and autonomy. Indeed, the emphasis on dignity and freedom is compatible with Hegel’s argument that property is essential to the development of personality, where a person gains existence in the world by projecting its will into material objects including its body and mind.\(^{43}\) This paper will try to present a loose categorization with regard to types of rights consisting in property or possession as defined by the ECtHR case law.\(^{44}\)

### 2.1 *Ius in rem*

The rights *in rem* in tangible movable and immovable things constitute property for the purposes of P1-1. The Court ruled in *Gasus Dosier* that ‘possessions’ (‘biens’) in P1-1 has an autonomous meaning which is certainly not limited to ownership of physical goods: certain other rights and interests constituting assets can also be regarded as ‘property rights’; and thus as ‘possessions’, for the purposes of P1-1. In the context of the case it was immaterial whether *Gasus’s* right to the concrete mixer was to be considered as a right of ownership or as a security right *in rem*. In any event, the seizure and sale of the concrete mixer constituted an ‘interference’ with the applicant company’s right ‘to the peaceful enjoyment’ of a ‘possession’ within the meaning of P1-1.\(^{45}\) The exclusively contractual origin of a right *in rem*, i.e. a right determined only by the parties to the contract or a right determined by statute law, is no obstacle to its being termed a possession.\(^{46}\) For example, in the case of *James and Others v. U.K*, the possession was a leasehold and the ECtHR recognized that state interference by legislation to force the applicants to sell their rights against their will at prices far below market value constituted a ‘deprivation of possession’ as defined in second sentence of

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\(^{36}\) Allard v. Sweden, no. 35179/97, ECHR 2003-VII.

\(^{37}\) Broniowski v. Poland [GC], no. 31443/96, ECHR 2004-V.

\(^{38}\) Anheuser-Busch Inc. v. Portugal [GC], no. 73049/01, ECHR 2007-I.

\(^{39}\) Van Marle and Others v. the Netherlands, 26 June 1986, Series A no. 101.

\(^{40}\) Tre Traktörer AB v. Sweden, 7 July 1989, Series A no. 159.

\(^{41}\) Gaygusuz v. Austria, 16 September 1996, Reports of Judgments and Decisions 1996-IV; Grudić v. Serbia, no. 31925/08, 17 April 2012 - Request for referral to the Grand Chamber pending.

\(^{42}\) Chassagnou and Others v. France [GC], nos. 25088/94, 28331/95 and 28443/95, ECHR 1999-III; Schneider v. Luxembourg, no. 2113/04, 10 July 2007; Herrmann v. Germany [GC], no. 9300/07, 26 June 2012.


\(^{44}\) For the categorization different authors are taken into consideration, mainly the work of (Çoban 2004, 144-61); as well as (Allen, Property and The Human Rights Act 1998 2005), (Orebech 2009), etc.

\(^{45}\) Gasus Dosier- und Fördertechnik GmbH v. the Netherlands, 23 February 1995, § 53, Series A no. 306-B. Nevertheless, it was decided that such interference was justified as the control on use of property under second paragraph.

\(^{46}\) See (Sermet 1998, 11-2).
P1-1,

although such interference did not amount to violation as it was justified under P1-1, second paragraph. At times the ECtHR tried to accept the position of rights within the limits of national law. In Marckx the court noted that Article P1-1 applies only to a person’s existing possessions and that it does not guarantee the right to acquire possessions whether on intestacy or through voluntary dispositions. This formal approach on distinguishing between vested rights and mere hopes were confirmed in Inze v. Austria where the ECtHR noted that in distinction from Marckx, here the applicant had already acquired by inheritance a right to a share of his deceased mother’s estate, including the farm, subject to a distribution of the assets in accordance with domestic law. Nevertheless, the autonomous meaning doctrine employed in Gasus has allowed the court not to restrict itself to domestic legislations but to develop its own perception and standards of the protections under ECHR. In later cases the ECtHR did not limit its appreciation to the nature of rights under domestic law.

In Beyeler v. Italy, the Court held that the meaning of possession under P1-1 does not depend on the formal classification created by domestic law. Consequently, it found possession under P1-1, even in a null and void sale contract under domestic law. In Öneryildiz v Turkey, it was found that a squatter held sufficient substantive interests amounting to P1-1 possession in respect of a dwelling he had constructed, although against the domestic law. However, the interference with P1-1 was found because the authorities had taken no steps to evict the applicant, furthermore the taxes were levied and public services were supplied.

2.2 Intellectual property

There is no doubt that intellectual property rights constitute possession in the meaning of P1-1, notwithstanding that the Convention institutions have been called upon to rule on questions of intellectual property only very rarely. In previous case law, namely in Smith Kline and French Laboratories Ltd, the Commission had noted that under Dutch law the holder of a patent is referred to as the proprietor of a patent, and that patents are deemed to be personal property which is transferable and assignable. Accordingly, a patent falls within the scope of the term ‘possessions’ in P1-1. In Anheuser, it was not only reinforced that P1-1 is applicable to property rights, but it was found that the applicant company’s legal position as an applicant for the registration of a trade mark came within P1-1, as it gave rise to interests of a proprietary nature. Similarly, even with regard to the right

47 James and Others v. the United Kingdom, 21 February 1986, § 34-38, Series A no. 98.
49 Inze v. Austria, 28 October 1987, § 38, Series A no. 126.
51 Beyeler v. Italy [GC], no. 33202/96, § 100-106, ECHR 2000-I. Here the ECtHR analyzed the domestic legislation with regard to the sale contracts and rights of pre-emption, and regardless that the sale contract of the painting was null and void the applicant occasionally was considered by authorities to have some kind of de facto proprietary interests. Consequently, unjustified interference with P1-1 was found.
52 Öneryıldız v. Turkey [GC], no. 48939/99, ECHR 2004-XII. Nevertheless, no property rights on occupied land were found.
53 Anheuser-Busch Inc. v. Portugal [GC], no. 73049/01, § 67, ECHR 2007-I.
54 Smith Kline and French Laboratories Ltd v. the Netherlands, no. 12633/87, Commission decision of 4 October 1990, Decisions and Reports 66, p. 70. In British-American Tobacco Company Ltd v. the Netherlands, 20 November 1995, opinion of the Commission, §§ 71-72, Series A no. 331, the Commission expressed the opinion that the company was denied a protected intellectual property right but was not deprived of its existing property. More recently, in Melnychuk v. Ukraine, which concerned an alleged violation of the applicant’s copyright, the Court reiterated that Article 1 of Protocol No. 1 was applicable to intellectual property, although it did not find unreasonable interference of domestic courts with such right, see Melnychuk v. Ukraine (dec.), no. 28743/03, ECHR 2005-IX, see also, Breierova and Others v. the Czech Republic (dec.), no. 57521/00, 8 October 2002.
55 Anheuser-Busch Inc. v. Portugal [GC], no. 73049/01, § 78, ECHR 2007-I.
to domain names on the Internet, the ECtHR has recalled its previous principles that the concept of ‘possessions’ referred to in P1-1 has an autonomous meaning. Certain other rights and interests constituting assets can also be regarded as ‘property rights’, and thus as ‘possessions’ for the purposes of P1-1. In the case of non-physical assets, particularly important is whether the legal position in question gave rise to financial rights and interests and thus had an economic value. Thus intellectual property, such as trademarks and copyrights or licences to use property in a particular way such as licences to serve alcoholic beverages,56 fishing rights,57 the granting of a commercial operating licence by the authorities,58 or building permits in a plot of land,59 as well as use or dispose of Internet domains, constitute possessions.60 Conclusively, deriving from the ECtHR case law one may conclude that intellectual property is considered as a human right regardless if it belongs to any individual or to any multinational commercial company.61 The recognition of domain names as possessions under P1-1 has given rise to further dynamic analysis concerning new objects of property.62

2.3 Ius in personam

In many States party to the ECHR ius in personam are not accepted as property law. In many domestic private laws exists the summa divisio between the obligation law and property law.63 Nevertheless, civil law rights in personam are considered as property in the constitutional meaning.64 With regard to P1-1, the Convention organs have continually accepted that a range of economic interests, including tangible or intangible interests, fall within the scope of the right to property,65 a fortiori not only claims arising from private law relationships, but also those arising from public law relationships.

2.3.1 Claims in private law

The case law of ECtHR has accepted that private law assets such as pecuniary claims based on contract, tort, unjustified enrichment as well as shares are clearly included in the concept of possession.66

Shares: In connection to shares in a company, it is observed that a ‘company share’ is a complex thing. It certifies that the holder possesses a share in the company together with corresponding rights. That is not only an indirect claim on company assets, but other rights, especially voting rights and the right to influence the company, which may stem from the share. As a consequence it

56 Tre Traktörer AB v. Sweden, 7 July 1989, Series A no. 159.
58 Pine Valley Developments Ltd and Others v. Ireland, 29 November 1991, Series A no. 222.
60 Paeffgen GMbH v. Germany, (dec.) nos. 25379/04, 21688/05, 21722/05 and 21770/05, 18 September 2007.
61 On some discussion whether intellectual property should be considered and protected as human rights and how should this be done see (Helfer 2008).
63 See (Zweigert and Kötz 1977, 177-89), (Cashin Ritaine 2008), (Faber and Lurger, National Reports on the Transfer of Movables in Europe 2008), (Faber and Lurger, National Reports on the Transfer of Movables in Europe 2009), (Faber and Lurger, National Reports on the Transfer of Movables in Europe 2011), (Bar and Drobnig 2004).
65 (Carss-Frisk 2001).
66 (Gomien 1996, 313).
is found that the shares held by the applicant undoubtedly had an economic value and constituted 'possessions' within the meaning of P1-1.\footnote{Marini v. Albania, no. 3738/02, § 164, 165, 18 December 2007. In this case the ECtHR confirmed the previous findings of the Commission, such as Branelid and Malmström v. Sweden, nos. 8588/79 and 8589/79, Commission decision of 12 October 1982, Decisions and Reports, p. 81 and Company S. and T. v. Sweden, no. 11189/84, Commission decision of 11 December 1986, Decisions and Reports 50, p. 138. With regard to shares in public companies see also Lithgow and Others v. the United Kingdom, 8 July 1986, Series A no. 102, although the ECtHR found no violation of P1-1.} Furthermore, State failure to protect the value of shares in a company is considered as unjustified interference.\footnote{Sovtransavto Holding v. Ukraine, no. 48533/99, § 92-98, ECHR 2002-VII.}

**Unjust enrichment**: In connection to the unjust enrichment in \textit{O.N v Bulgaria}, the ECtHR observed that the applicant's complaints concerned his claim for restitution and compensation, as generated in accordance with the rules of unjust enrichment under the applicable general law of obligations. His claim was recognised by the domestic courts as having arisen in 1986. A claim of this nature constitutes an asset and therefore amounts to 'a possession' within the meaning of the first sentence of P1-1.\footnote{O.N v. Bulgaria, (dec.) no. 35221/97, 6 April 2000, although the application was declared inadmissible as the Court found that P1-1 'does not give rise to any positive obligation for the State to maintain the value not only of deposits, but also of claims or any other asset. It does not require from States to apply an inflation-rate-compatible' default interest rate to private claims. The Convention cannot be seen as posing on States obligations concerning their economic policy in dealing with the effects of inflation and other economic phenomena.'}

**Tort**: Regarding Torts the ECtHR in \textit{Pressos Compania Naviera S.A. and Others v. Belgium} found that the rules in question were rules of tort, under which claims for compensation come into existence as soon as the damage occurs. A claim of this nature 'constituted an asset' and therefore amounted to a possession within the meaning of the first sentence of P1-1.\footnote{Pressos Compania Naviera S.A. and Others v. Belgium, 20 November 1995, § 33, 34, Series A no. 332. The ECtHR found a violation of P1-1, regarding that the legal act adopted by Belgian authorities with retroactive effect and distinguishing previous claims amounted to an unjustifiable violation of right to property protected by P1-1.}

**Debts**: In connection to debts and arbitral awards the ECtHR in \textit{Stran Greek Refineries} deemed necessary to ascertain whether an arbitration award had given rise to a debt sufficiently established to be enforceable, and found that such right constituted possession within the meaning of P1-1.\footnote{Stran Greek Refineries and Stratis Andreadis v. Greece, 9 December 1994, § 59, 62, Series A no. 301-B.}

**Good will and clientele**: In connection to such right, in \textit{Van Marle}, although the Netherlands argued that under domestic law there was no such right which could be regarded as property, the ECtHR declared the P1-1 applicable, finding that the right relied upon by the applicants may be likened to the right of property embodied in P1-1: by dint of their own work, the applicants had built up a clientèle; this had in many respects the nature of a private right and constituted an asset and, hence, a possession within the meaning of the first sentence of P1-1. The refusal to register the applicants as certified accountants radically affected the conditions of their professional activities and the scope of those activities was reduced. Their income fell, as did the value of their clientèle and, more generally, their business. Consequently, there was interference with their right to the peaceful enjoyment of their possessions.\footnote{Van Marle and Others v. the Netherlands, 26 June 1986, § 41,42, Series A no. 101. Nevertheless, the ECtHR declared such interference justifiable under P1-1.}

### 2.3.2 Claims in public law

**Claims against public authorities, legitimate expectations and licenses**: As a matter of administrative law, the decisions and licenses given by public authorities may create legitimate expectation with regard to the exercise of the rights of property. That means that the withdrawal of a permission...
to use property in a particular way would normally be regarded as an interference with the enjoyment of possession under P1-1. However, under domestic law these principles are subject to significant limitations, especially when administrative authorities act behind given legal competences then such acts do not create legitimate expectations. But ECtHR has found that failure to honour legitimate expectations which are created even by *ultra vires* public authority acts constitutes interference with the enjoyment of possession. In *Stretch v. UK* the Court recalled that according to the established case law of the ECHR organs, ‘possessions’ can be ‘existing possessions’ or assets, including claims, in respect of which the applicant can argue that he has at least a ‘legitimate expectation’ of obtaining effective enjoyment of a property right. Although it was recognized that under English *ultra vires* doctrine, the renewal of the lease agreement was invalid, the ECtHR considered that the applicant must be regarded as having at least a legitimate expectation of exercising the option to renew and this may be regarded, for the purposes of Article 1 of Protocol No. 1, as attached to the property rights granted to him under the lease. Similarly, in *Mullai v. Albania* the ECtHR found interference with P1-1 rights, although the building permit in that case was declared null and void by the Albanian Supreme Court. Here, it was considered that a simple application for a building permit does not give rise to any proprietary interest as such, but in the concrete case, the applicant was granted a building permit by the Municipality of Tirana. Consequently, the building permit constituted ‘possessions’ for the applicant company. In itself, the building permit also gave rise to the benefits of the contract negotiated between the applicant company and the individual applicants for the construction of the tower block. It therefore generated a capital asset and had a definite economic value for the individual applicants sufficient to consider such rights under P1-1 possession. Similarly, the ECtHR has found that the annulment of a final court decision, although resulting by failure to respect the standards set by Art 6 §1 of ECHR, constitutes an unjustified interference with possession under P1-1.

**Pensions and other social benefits:** In *Grudić v. Serbia*, the ECtHR assessed that the principles which apply generally in cases under P1-1 are equally relevant when it comes to pensions. Thus, that provision does not guarantee the right to acquire property. Nor does it guarantee, as such, any right to a pension of a particular amount. However, where a Contracting State has in force legislation providing for the payment of a pension - whether or not conditional on the prior payment of contributions - that legislation has to be regarded as generating a proprietary interest falling within

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74 *Stretch v. the United Kingdom*, no. 44277/98, § 32-34, 24 June 2003 where unjustified violation of P1-1 was found.
76 Mullai and Others v. Albania, no. 9074/07, § 98-100, 23 March 2010.
77 Vrioni and Others v. Albania, no. 2141/03, § 74-75, 24 March 2009.
78 *Grudić v. Serbia*, no. 31925/08, § 72, 17 April 2012 - Request for referral to the Grand Chamber pending. Here the ECtHR regarded the discontinuance of pensions to the applicant resident in north Kosovo (Mitrovica) as an unjustified violation of P1-1.
79 Andrejeva v. Latvia [GC], no. 55707/00, § 77, 18 February 2009, and, more recently, Stummer v. Austria [GC], no. 37452/02, § 82, 7 July 2011.
80 See, among other authorities, Van der Mussele v. Belgium, 23 November 1983, § 48, Series A no. 70; Silvenko v. Latvia (dec.) [GC], no. 48321/99, § 121, ECHR 2002-IX; and Köpec̆ v. Slovakia [GC], no. 44912/98, § 35 (b), ECHR 2004-IX.
the ambit of P1-1 for persons satisfying its requirements. The reduction or the discontinuance of a pension may therefore constitute an interference with peaceful enjoyment of possessions that needs to be justified.

2.4 Claims based on restitution and compensation in eastern Europe

In the latest pilot judgment Manushaqe Puto and Others v. Albania,84 the ECtHR compiled once again all the principles developed so far with regard to the restitutions claims. It reiterated that an applicant can allege a violation of P1-1 only in so far as the impugned decisions related to his possessions' within the meaning of this provision. ‘Possessions’ can be a ‘legitimate expectation’.85 Where the proprietary interest is in the nature of a claim it may be regarded as an ‘asset’ only where it has a sufficient basis in national law, for example where there is settled case law of the domestic courts confirming it.86 P1-1 cannot be interpreted as imposing any general obligation on the Contracting States to return property which was transferred to them before they ratified the Convention.87 Just as P1-1 does not guarantee the right to acquire property, it does not impose any restrictions on the states' freedom to determine the scope of property restitution and to choose the conditions under which they agree to restore property rights of former owners.88 On the other hand, once a state, having ratified the Convention including P1-1, enacts legislation providing for the full or partial restoration of property confiscated under a previous regime, such legislation may be regarded as generating a new property right protected by P1-1 for persons satisfying the requirements for entitlement.89 Deprivation of ownership or of another right in rem is in principle an instantaneous act and does not produce a continuing situation of deprivation of a right.90 It is true that the court does not consider as deprivation of property the confiscation and nationalisation of past regimes, arguing that those cases fall outside ratióne temporis of the ECHR, but in cases against Albania, the Court stated that if non-enforcement of the final decisions persisted subsequent to the Convention’s entry into force, the case falls within ratióne temporis.91

However, the right of property is not an unlimited right and Article 1 of Protocol 1 allows states to intervene for legitimate purposes. By some it is considered as one of the weakest rights protected by the Convention, in as far as it leaves states a broad margin of appreciation.92 In order to provide an effective guarantee for the right of property, it is necessary to define the boundaries

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82 Carson and Others v. the United Kingdom [GC], no. 42184/05, § 64, ECHR 2010.
84 Manushaqe Puto and Others v. Albania (Applications nos. 604/07, 43628/07, 46684/07 and 34770/09), 31 July 2012, not yet final. The ECtHR made reference to case of Maria and Dorel-Dănuţ Barbu v. Romania, no. 14332/03, 23 March 2010. Other cases against Albania representing the same principles: Beshiri and Others v. Albania, no. 7352/03, 22 August 2006; Ramadhi and Others v. Albania, no. 38222/02, 13 November 2007; Driza v. Albania, no. 33771/02, ECHR 2007-V (extracts); Hamzaraj v. Albania (no.1), no. 45264/04, 3 February 2009; Nuri v. Albania, no. 12306/04, 3 February 2009; Delvina v. Albania, no. 49106/08, 8 March 2011.
85 Gratzing and Gratzingrova v. the Czech Republic (dec.) [GC], no. 39794/98, § 69, ECHR 2002-VII.
86 Kopecký v. Slovakia [GC], no. 44912/98, § 52, ECHR 2004-IX.
89 Kopecký v. Slovakia [GC], no. 44912/98, § 35, ECHR 2004-IX.
90 Malhous v. the Czech Republic (dec.) [GC], no. 33071/96, ECHR 2000-XII, although in Loizidou v. Turkey (merits), 18 December 1996, Reports of Judgments and Decisions 1996-VI the continual denial of access to land was a deprivation of property, thus Turkey was held responsible. Such statement was held also in Ali Telhai v. Albania, (dec. No. 2) no. 58918/08, 17 November 2009; unpublished, available at http://hudoc.echr.coe.int.
91 Manushaqe v. Albania § 95, Vrioni v. Albania § 54.
92 (Greer 2006, 274-6).
of legitimate interferences. With regard to the interference, the ECHR has built a system of three rules. Furthermore, in assessing the interference with property rights the principles of lawfulness, legitimate aim and public interest, where the states enjoy a certain margin of appreciation, fair balance, proportionality, and legal security should be regarded, but the analysis of such case law principles falls outside the scope of this paper. Albanian Constitutional Law on several occasions had to evaluate whether the laws on restitution and compensation of property, the law on legalization and the law on verification of property titles in agriculture land were in conformity with the Constitution. The Court had refrained itself from declaring the laws unconstitutional by justifying through public interest arguments, the fair balance. Only on one occasion did the Constitutional Court declare the law as unconstitutional, reasoning that the law on restitution and compensation must not create new injustices for leaseholders of premises restored to ex owners. But the Constitutional Court decisions are still not tested in Strasbourg, in as far as individuals do not have a standing before the Constitutional Court, apart from the due process of law.

3. State positive obligation doctrine in protection of property and the horizontal effect of human rights in the Albanian legal system

The first sentence of Article 1 of Protocol 1 presents a proprietary right with a broad content. However, this provision only protects existing property and does not guarantee the right to acquire ownership. Consequently, we can say that this is essentially a negative right and does not give to an individual the right to seek property or social assistance benefits. However, the concept of ownership is interpreted broadly to such an extent as to include all rights with a patrimonial character or all pecuniary rights deriving from civil and public law, and even legitimate expectation. In this context it is important to understand what kind of duty the right of property imposes on the contracting states. Do the states have only a negative duty not to interfere with property rights, or do they also have positive obligations to ensure the proper exercise of such rights by every person? Are the states responsible only when they interfere through their public agents in property rights, or are they to be held responsible also for private parties’ interferences? In other words, what is the horizontal effect or third-party applicability of P1-1? Continually the ECtHR has expanded and built up new standards to evaluate state duties arising from the Convention rights. In Öneryildiz v. Turkey the court considered that genuine, effective exercise of property right does not depend merely on the State’s duty not to interfere and could require positive measures of protection. In the concrete case, failing to take all the measures necessary to avoid the risk of a methane explosion, and hence the ensuing landslide, also ran counter to the requirement of “practical and effective” protection of the right guaranteed by Article 1 of Protocol No. 1. Therefore, an unjustified interference, in this case committed by omission, was found. In the Court’s words, the infringement amounted not to ‘interference’ but to the breach of a positive obligation. These positive measures arise particularly where there is a direct link between the measures an applicant may legitimately expect from the authorities and his effective enjoyment

93 In Sporrong and Lönroth v. Sweden, 23 September 1982, § 61, Series A no. 52, it was found that P1-1 comprises three distinct rules. The first rule, which is of a general nature, enunciates the principle of peaceful enjoyment of property; it is set out in the first sentence of the first paragraph. The second rule covers deprivation of possessions and subjects it to certain conditions. The third rule recognises that the States are entitled, amongst other things, to control the use of property in accordance with the general interest, by enforcing such laws as they deem necessary for the purpose. The three rules are not, however, ‘distinct’ in the sense of being unconnected. The second and third rules are concerned with particular instances of interference with the right to peaceful enjoyment of property and should therefore be construed in the light of the general principle enunciated in the first rule.

94 Constitutional Judgement V-30/05; V-35/07; V-29/10 available at www.gjk.gov.al; see also (Zaganjori, Vorpsi and Biba 2012).

95 Constitutional Judgement V-26/05 available at www.gjk.gov.al.

96 See (Mowbray Oxford-Portland Oregon, 127-87).

97 Önerylidiz v. Turkey [GC], no. 48939/99, § 130, ECHR 2004-XII.
of his possessions.\textsuperscript{98} In cases concerning property rights against Albania, the ECtHR has ascertained several principles on state duty to act, which were reiterated in \textit{Bushati v. Albania}\textsuperscript{99}. Firstly, pursuant to Article 1 of the Convention, each Contracting Party shall secure to everyone within its jurisdiction the rights and freedoms defined in the Convention;\textsuperscript{100} The obligation to secure the effective exercise of the rights defined in that instrument may result in positive obligations for the State. In such circumstances, the State cannot simply remain passive and ‘there is no room to distinguish between acts and omissions’\textsuperscript{101} Secondly, as regards the right guaranteed by P1-1, those positive obligations may entail certain measures necessary to protect the right to property\textsuperscript{102} even in cases involving litigation between private individuals or companies,\textsuperscript{103} particularly with regard to the enforcement of final judgments.\textsuperscript{104} Thirdly, the Court considered that the failure of domestic courts to exercise appropriate control over the enforcement of final judgements creates a permanent uncertainty which disturbs the ‘fair balance’ required to justify interference with P1-1.\textsuperscript{105} Finally, it means that in such situations, the Court finds State failure to comply with its obligation to secure to the individuals the effective enjoyment of his right of property, as guaranteed by P 1-1, as interference, thus holding the State responsible under the Convention. In the \textit{Bushati v. Albania} case the court found that the bailiff’s failure to take adequate and sufficient measures for securing enforcement of the final court decision left the applicants in a situation of uncertainty, unable to fully enjoy their possessions. While in \textit{Vrioni v Albania}, the Court observed that the quashing of an enforceable judgment by the Albanian Supreme Court frustrated the applicants’ reliance on a binding judicial decision and deprived them of an opportunity to enforce their title to their property.\textsuperscript{106} It clearly results from ECtHR case law that the right of property under P1-1 imposes a positive obligation on the state to safeguard that right, regardless of whether the state is represented by legislative, executive or judicial organs.

The given situation implies that domestic courts should observe the respect for human rights even in disputes between private parties, a phenomenon known as the horizontal effect of human rights or \textit{Drittwirkung}. This theory labelled as ‘constitutionalisation of private law’ is hotly debated in western legal doctrine and raises some concerns in private law theory, which is traditionally regarded as immune from human rights and public law in general.\textsuperscript{107} However, the purpose of this paper is limited only to an overview on the Albanian legal situation with regard to the horizontal application of human rights, especially the right of property. In order to observe the impact of ECtHR findings after the continuous condemnation of Albania, a closer look must be taken of the constitutional and legal regulation in general and of the Constitutional and Supreme Court case law in particular. Before such analysis, it is important to note that some studies have shown that “as far as the constitution of the post-communist countries are concerned, they have mostly failed to make

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\textsuperscript{98} Ibid. § 134. \\
\textsuperscript{99} Bushati and Others v. Albania, no. 6397/04, § 93-94, 8 December 2009. \\
\textsuperscript{100} X and Y v. Netherlands, judgment of 26 March 1985, Series A no. 91, p. 11, §§ 22-23. \\
\textsuperscript{101} Mutatis mutandis, Airey v. Ireland, judgment of 9 October 1979, Series A no. 32, p. 14, § 25. \\
\textsuperscript{102} Mutatis mutandis, López Ostra v. Spain, judgment of 9 December 1994, Series A no. 303-C, p. 55, § 55. \\
\textsuperscript{103} Sovtransavto Holding v. Ukraine, no. 48553/99, § 96, ECHR 2002-VII. \\
\textsuperscript{104} Fuklev v. Ukraine, no. 71186/01, § 91, 7 June 2005. \\
\textsuperscript{105} Ibid § 92, 93. \\
\textsuperscript{106} Vrioni and Others v. Albania, no. 2141/03, § 74, 24 March 2009. \\
\textsuperscript{107} Smits defines that “… the constitutionalisation of private law can be described as the increasing influence of fundamental rights in relationships between private parties, fundamental rights being those rights that were originally developed to govern the relationships between the State and its citizens:” at (Smits 2006).
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distinctions between the horizontal or the vertical effect, concentrating mainly on placing positive duties on their relevant governments to promote social and economic rights.\footnote{108}

**Normative regulation:** In Albania, the legal situation is rather controversial and unclear. Furthermore, the horizontal effect of human rights is hardly discussed in legal doctrine. Nevertheless, the importance of ECHR and ECTHR case law is strongly observed and overemphasized by academics and courts. With regard to international law, Albanian law follows a ‘monist approach’; consequently the international agreements are placed under the constitution and above the laws,\footnote{109} but ECHR holds a special place compared to other international Conventions.\footnote{110} The Albanian Constitution invokes directly the ECHR and gives it a constitutional status, although only with regard to limitations of rights, which gives the Albanian constitutional system a unique feature, found in no other legal system.\footnote{111} Both the Constitution and International Agreements are directly applicable.\footnote{112} In contrast to the given legal situation appears the individual *locus standi* before the Constitutional Court. Individuals’ complaints are restricted only to the right of due process of law, thus not for other constitutional rights.\footnote{113} However, again in support of horizontal application and to the importance of ECHR is the provision of the Civil Procedure Code, which allows a review of a final court decision (*res judicata*), when the ECHHR finds violation of the ECHR rights.\footnote{114} The effects of this provision are still unknown. It remains to be seen how courts will react when a party requires a revision of *res judicata*, based on a decision of ECHHR.

**Case Law:** Although the individual limited *locus standi* is rather confusing and could raise some doubts regarding horizontal application of the constitution, the Constitutional Court has accepted that individuals could seek protection of their human rights with the common courts. In a case related to the constitutional right of private property, it observed that the right of access to court is a constitutional right, and as far as the constitution is directly applicable, although the related disputed law did not provide for an effective remedy before the court, such law, according to the Constitutional Court view, did not deny the right of the individual to complain before the common courts on every aspect of the law, which might raise conflict between interested parties.\footnote{115}

Another principle affirmed in Constitutional case law, but underlying another pathway, is the interpretation of laws in compliance with the constitution, the so-called “compatible interpretation”.

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\footnote{108}{See (Lytvynyuk 2009, 204) with references to (Gardbaum 2003, 393) and to (Sunstein 1996) Cass R. Cass Sustain observes that the post-communist constitutions pervasively fail to make this distinction [between the constitutional duties of government and the constitutional duties of the private sphere], and impose their duties on everyone, and create rights which are good against everyone. This step perpetuates, if in a small way, the failure of communist societies to create and protect a civil sphere.…. A constitution that purports to guarantee all rights ... may guarantee nothing at all.”

\footnote{109}{Art. 116 of the Constitution.

\footnote{110}{The Constitution in its Art 17(2) provides that “...limitations of constitutional rights may not infringe the essence of the rights and freedoms and in no case may exceed the limitations provided for in the European Convention on Human Rights”.

\footnote{111}{Art. 17 (2) of the Constitution: “... These limitations may not infringe the essence of the rights and freedoms and in no case may exceed the limitations provided for in the European Convention on Human Rights.”; (Omari and Anastasi 2010, 84) with further references to (Traja 2002).

\footnote{112}{Art. 4 (3) of the Constitution: “The provisions of the Constitution are directly applicable, except when the Constitution provides otherwise.” Pursuant to Art 122 (1) of the Constitution, an international agreement ratified by the Parliament is part of the domestic legal system and directly applicable except when it is not self-executing and its application requires the adoption of a law.

\footnote{113}{Art 131 (i) of the Constitution: “The Constitutional Court decides ...i) final adjudication of the individual complaints for the violation of their constitutional rights to due process of law, after all legal means for the protection of those rights have been exhausted.” Although theoretically the individuals can use such complaints to arrive indirectly to the protection of other constitutional rights, this becomes far more complicated.

\footnote{114}{Art. 494 (e) of Civil Procedure Code. Such amendment was adopted by Law no. 10 052, of 29.12.2008, Official Journal No. 205/08.

\footnote{115}{Judgement of Constitutional Court V - 35/07 available at www.gjk.gov.al. I am not certain if the Constitution could be directly applicable in common courts as far as Art. 145(2), of the Constitution provides: “If judges find that a law comes into conflict with the Constitution, they do not apply it. In this case, they suspend the proceedings and send the issue to the Constitutional Court. Decisions of the Constitutional Court are obligatory for all courts.”}
In this way the Constitutional principles could reflect and have effect on the whole legal system including private law. On several occasions the Constitutional Court has decided that the constitutionally compatible interpretation of law should be applied. Such interpretation is possible when a legal provision may be interpreted in several ways, one of which is in conformity with the Constitution. Such an interpretative method seeks the constitutional effect of different results and selects the result that respects constitutional values, taking in consideration the fundamental rights of the individuals. Thus if a legal provision could be interpreted in more than one way, or apparently may violate the constitutional values, only the interpretation in compliance with the Constitution is valid. Furthermore, in constitutional case law one may see numerous references to ECtHR jurisprudence. Such a situation is supported and urged by the legal doctrine, as long as it is often argued that the Albanian Constitution provides a symmetrical catalogue of human rights to those of the ECHR, and it is the intention of the legislator to fully comply with international agreements and standards.

Similar situations have appeared recently in the Supreme Court jurisprudence. The Supreme Court on several occasions has directly referred to the Constitutional provisions as well as to the ECHR in order to find solutions to the concrete cases brought to the courts by private parties in their purely private conflicts. In an emblematic judgment, the Supreme Court referred directly to human rights and as a result constructed different and new figures of civil damage: concretely it divided the category of non-pecuniary damages into further categories such as ‘moral damage’, ‘existential damage’, ‘biological damage’, etc. Similarly, the Supreme Court referred to P1-1 and the homologue Art. 41 of the Constitution in a property law case, as well as to ECtHR case law in tax cases. However, is hard to say whether common courts refer directly to the Constitution or ECHR in private law disputes as far as, in case of doubt of unconstitutionality of a legal provision, they are obliged to stay the proceedings and refer the case to the Constitutional Court. The present situation may lead to the opinion that the Albanian constitutional legal system accepts the doctrine of horizontal application of human rights. It is hard to strictly define whether the influence of human rights is direct or indirect or through conformity of domestic legislation with ECHR and Constitution standards, but it is clear that the constitutional values underlie and influence the application of private law, i.e. the Civil Code provides the same guarantee of property as the Constitution. Some authors observe that the indirect effect does not necessarily result in fundamental rights having ‘less bearing’ than the direct effect and different forms of application may well co-exist, and that human rights - even when strictly speaking their application is not required - may contribute to the articulation of parties’ interests and an adequate weighing of these interests.

Doctrine: The Albanian doctrine is unanimous in the importance and status of ECHR. However, it is very deficient in studying the perplexities the direct horizontal effect of human rights might create, i.e. when conflicting human rights are in dispute, which right should prevail? Still such problems are not brought into light, and consistent solutions are yet to be found. It remains to be seen how courts will react in practice. This situation presents a challenge to the Albanian courts and

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116 Judgments of the Constitutional Court V 33-10; V-29/10. In an earlier case regarding torture and inhuman treatment, (V-3/04), the Constitutional Court found that the obligation of state resulting from international agreement with respect to the prohibition of torture and inhuman consist not only on the obligation to protect its citizens from public officials, but also in the obligation to take measures to protect them from other private individuals. This case showed the Constitutional Court’s willingness to accept the doctrine of direct horizontal effect of human rights, but later the legislator by Law No. 9686/2007 amended the respective provision of Criminal Code by limiting the criminal liability for torture only to public officials.

117 Unification Judgement of the Albanian Supreme Court, No. 12, of 14.09.2007.

118 Unification Judgment of Albanian Supreme Court, No. 1 of 06.01.2009.

119 Unification Judgment of Albanian Supreme Court, No. 4 of 30.05.2011.

120 (Barkhuysen and Emmerik 2006, 47) with further references. See also (Allen, The Autonomous Meaning of ‘Possessions’ under the European Convention on Human Rights 2003).

121 See (Sadushi 2012), (Zaganjori, Vorpshi and Biba 2012), (Omari and Anastasi 2010), (Traja 2002).
doctrine to elaborate durable standards in balancing conflicting human rights, because different concerns and perplexities arise when both parties to a horizontal conflict invoke a human right to protect their interests.

According to Western scholars in such situations, where two human rights conflict with one another, the principle of the indivisibility of human rights requires that both rights carry equal weight. Neither right should prevail over the other, thus alternative means must be employed to resolve the conflict. When a conflict between human rights reaches a court, the matter necessarily involves a claim that the plaintiff's rights have been violated. The defendant's human rights will normally come before the court in an indirect manner, i.e. as part of defence. The court will consequently be inclined to address the issue from the perspective of the directly invoked right. This is particularly true at the ECtHR, since the counter-party to a claim at the Court is always the respective government. This is also the case when the original conflict in domestic proceedings was one between two private parties or individuals. At the international level, a formerly horizontal conflict is transformed into a vertical one between the applicant and the State. The other individual - the domestic defendant whose human rights are also at stake - disappears in the background. The result is that the Court addresses only the right invoked by the applicant and disregards to a lesser or greater extent the other right(s) involved.122

Much more awkward appears to be the situation concerning the right of property, which is labelled as the 'constitutionalisation paradox'. The property right of P1-1, in particular, protects also contractual and testamentary freedom. Thus it can be regarded as a shield against the application of public law standards in legal relations between private individuals and thus against the constitutionalisation of private law. On the one hand, the standards of the ECHR and P1-1 may be applied in private legal relations through the concept of State positive obligations. On the other hand, such an application can be prevented by reliance, in particular, on Article 1 of the First Protocol.123 For example, a claim by a defaulting mortgagor for protection under P1-1 can immediately be countered by a claim from the mortgagee under the same article. Indeed, a counter claim will often be possible where there is an attempt to use the Convention in private matters, thus claims may effectively cancel each other out.124 In this context, some authors have pointed out that the courts would presumably be exercising their inherent equitable jurisdiction to do justice in a particular case, an approach which may be thought acceptable: appeal to the Human Rights legislation can be seen as a new weapon for the weak parties against the power of big corporations.125 However, not only individuals can invoke P1-1 - the rights of every natural or legal person are protected. Although one's sympathies may not be aroused by the claim of a large bank or building society that its possessions have been interfered with, the principles of the Convention must be applied by the courts regardless of the status of the applicant.126 An illustrative example of the above situation is the case of Vrioni v. Albania where the domestic conflict was between a bona fide purchaser, who had bought the immovable property from the State in 1957, and an ex-owner who, according to a domestic final judi-

122 See (Smet 2010) with further references. Here the author offers a model for resolution of conflict in opposing human rights. Studies in elaborating some steady standards and a doctrine of balancing are still in progress, as far as similar problems arise with European Union Acquis and the Charter of Fundamental Rights of the European Union.
123 (Barkhuysen and Emmerik 2006, 56).
124 See (Howell 2001, 157).
125 Ibid, 159. Common law and English authors query whether adoption of the Human Right Act of 1998 creates new causes of action. They argue that common law, being more traditional with a great emphasis on party autonomy and self determination, stressing that private law balances parties' interests by being equally applicable to each conflicting interest, is more resistant to the phenomenon of the horizontal effect of human rights. Nevertheless, a weak horizontal effect is inevitable. See (Allen, Property and The Human Rights Act 1998 2005, 225-56), (Weinrib and Weinrib 2001), (Beale and Pittam 2001), (Wright 2001, 183-94) More recently see (Cherednychenko 2007), (Mak 2008).
126 (Howell 2001, 159)
cial decision, had acquired the same property due to an ultra vires administrative act on restitution in 1992, thus the ex-owner’s title was null and void. Naturally before ECtHR the conflict transformed between the ex-owner and the Albanian State. Despite the third party (bona fide purchaser) being present in the court proceedings, the Court did not show any concern in their direction and did not consider the case from their point of view, even though that party definitively had a property right over the disputed object. Neither did the court show any concern for the difficult transition period Albania had been through. However, the Court recognised that the property was still occupied by a bona fide third party and that restitutio in integrum was impossible. Consequently, compensation was awarded in lieu. This compromise left both parties satisfied, only the State had to bear the enormous costs for violation of the property right. Had the situation with domestic judicial decisions been reversed, the bona fide purchaser, given the domestic legislation, the property interest, and particularly the situation that the property was a house and the fact that this party was in a similar legal position as the applicants in Pincová and Pinc v. the Czech Republic, his application before the ECtHR surely would have been successful. Consequently, the State would have been responsible again, this time not for the ex-owner, but for the bona fide purchaser. It appears that substantially the State was rather more responsible for the wrong application of law by public officials, than for the interference with a property right. Thus, in either course of action the State would have been held responsible. Does this imply that substantially the State has a duty to provide property to individuals?! Opposing ECtHR cases, on the one side Vrioni v. Albania, and on the other Pincová and Pinc v. the Czech Republic, indicate to the Albanian courts that the most essential issue in matters of property law is to achieve an appropriate fair balance between the parties in legal conflict, taking into consideration the Convention standards and manifold factors surrounding the parties’ positions in the given case. The case law of ECtHR is characterised by different underlining principles emerging in the enormous area of property case law, which is not always consistent.

Nevertheless, the most striking example, which caused a range of reaction among commentators and raised concerns on whether the domestic courts should test the domestic rules against P1-1 to achieve a fair balance in horizontal conflicts between private parties, was the willingness of the ECtHR to interfere in domestic law on pure private law regulations in acquisitive prescription. In the Pye v. UK case the Court decided, although by the smallest possible majority, that United Kingdom law on limitation and adverse possession was not in line with P1-1, because it did not offer Pye any compensation for the deprivation of his property right. Considering the fundamental character of the issue, the case was then brought before the Grand Chamber, which in 2007 ruled that the law on adverse possession was not in violation of P1-1, because the interference with Pye’s right should not be regarded as a deprivation of possession, in which case compensation is mandatory, but should rather be considered as a ‘control of use’ of the land. The Court found that the result of the control of use by the Land Registration Act (the loss of property by Pye) did not upset the fair balance between the aim of the interference and the means employed. Although violation of P1-1 was not

127 In cases against Albania, the Court has often stressed that the lack of funds or other resources as a reason for not honouring a judgment debt cannot relieve the State of its obligation under the Convention to ensure compliance with a final decision within a reasonable time. See Manushaqe Puto and Others v. Albania at § 96.
128 Vrioni and Others v. Albania, no. 2141/03, § 83 24 March 2009.
129 The position of the bona fide purchaser was very similar to the position of the applicants in Pincová and Pinc v. the Czech Republic, no. 36548/97, ECHR 2002-VIII, where the Court found that the applicants had to bear an individual and excessive burden which upset the fair balance required by P1-1, thus compensation was awarded.
130 On liberal and social democrat views influencing the ECtHR case law see (Allen, Liberalism, Social Democracy and the Value of Property under the European Convention on Human Rights 2010).
found, and the Court appeared in the end to be reluctant to interfere with domestic regulation of property of land, such a case showed that those rules as they stand in national laws might be scrutinised under the principles set by P1-1. This case stresses that this area of domestic law, which could be considered at the heart of private law, is not ‘safe’ from the influence of the ECtHR. It illustrates, therefore, that this area is not immune from the influence of fundamental rights.\textsuperscript{133}

Notwithstanding the difficulties the horizontal application of property rights might bear, the guarantee of P1-1 as well as its observance might serve a beneficial purpose in Albania. On the one side it raises the public belief in the security of property rights, which is an important prerequisite to attract international investors. So in addition to domestic regulation of the property by private law, we can say that international law of human rights directly applicable in Albania could serve as a tool for increasing potential foreign investment. On the other side, the horizontal application of human rights could impose on investors the respect for human rights, so it might achieve the protection of weak individuals from unfair behaviours of multinational commercial companies. It is noted that in today’s world, human rights violations often occur as a consequence of the behaviour of a variety of actors, including inter-governmental and private economic actors. It is proposed that one option is to construct human rights duties for every actor whose actions have an impact on human rights,\textsuperscript{134} i.e. the construction of human rights responsibilities of non-state actors.\textsuperscript{135} Thus, the striking of a fair balance would be essential in any situation concerning property rights.

4. Conclusion

The first sentence of Article 1 of Protocol 1 presents a proprietary right with a broad content. Although this provision only protects existing property and does not guarantee the right to acquire ownership, the concept of ownership is interpreted broadly to such an extent as to include all rights with a patrimonial character or all pecuniary rights deriving from civil and public law, and even legitimate expectations including social security benefits. Such an interpretation might be used to expand the concept of property to situate new types of property, namely intellectual property, domain rights, licenses, networks, radio waves, etc. Article 1 of Protocol 1 and its guarantees are applied equally to both natural and legal persons. While Article 1 of Protocol 1 protects a negative right of ownership, the primary responsibility of States arising from this provision is a negative obligation not to interfere with the right of ownership. It does not impose on States a positive obligation to ensure ownership to individuals,\textsuperscript{136} but the States have a positive obligation to ensure effective protection of property rights. A State must take all measures necessary to protect property from interference by third parties. Failure or omissions are equally considered as interference with a property right. States are not usually responsible for relations between private persons, as far as application to the ECtHR are accepted only against States. However, if public authorities are involved in one way or another in such a relationship, then such an involvement can bring liability on the State. Such involvement may be administrative, legislative or judicial. Thus, if the ownership of an individual is violated in a private legal dispute due to applicable law, then the state should be responsible because here the exercise of state authority by law, including laws which regulate private relations, are involved. The same applies to court decisions. In this way values established by the ECHR and

\textsuperscript{133} (Lindenbergh 2010, 373).

\textsuperscript{134} (Feyter 2007, 10).

\textsuperscript{135} See (Francioni 2007), (Marrella 2007).

\textsuperscript{136} Although there have been voices in favour that human rights should include claims to the basic goods needed to live a meaningful life, thus positive obligations to housing, education, health care, and the like. See (Allen, Liberalism, Social Democracy and the Value of Property under the European Convention on Human Rights 2010, 1058-65).
the Court might have direct effects over horizontal relationships. Strasbourg Court’s standard would probably need to be continually tested in Albanian court practice.

The methods of interpretation applied by the European Court of Human Rights are suitable for the development of protection of property rights in order to include developments in the social, economic and political Europe. Dynamic, autonomous and effective methods of interpretation give to the Court the means needed to set European standards for protection of property. Such standards have improved every day since the collapse of communism in Eastern Europe and after the Cold War, which is gradually being replaced by globalisation in the international political arena.

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THE CONTRACT MORTGAGE IN THE LEGAL SYSTEM
OF THE REPUBLIC OF MACEDONIA

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Abstract
This paper analyses the contract mortgage in the legal system of Republic of Macedonia. The introductory note contains the analyses of the laws that form the legal frame for regulating mortgage in Macedonian legal system.

Title one contains analysis of the legal nature of contract mortgage giving an insight on different theories concerning this issue.

Title two of the paper is dedicated to representing the manner in which contract mortgage is acquired in the Macedonian legal system.

Title three presents the manner in which contract mortgage can be terminated with special accent on the realization of the mortgage as a manner of termination.

Title four contains analyses of the issues emerging in the everyday legal practice concerning the contract mortgage.

Key words: collateral, mortgage contact, pledge, real rights, real securities, real-estate

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THE CONTRACT MORTGAGE IN THE LEGAL SYSTEM
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1. Introduction

Development of the real estate market can’t be imagined without the mortgage as an instrument for securing of claims. The reason is simple. There aren’t many people that can buy a home, or companies that can afford to invest in the real estate market, without some form of crediting (usually bank credits). The crediting of people and real estate investors carries a risk of whether they can pay back the money they have borrowed. Therefore, creditors are reluctant to enter into a credit contract if they are not given certain security that their claims will be paid out in full. The practice, not only in Macedonia but in other countries as well, shows that the most common way of securing the claims of creditors of such significant value is by acquiring mortgage. Thus the inevitable conclusion is that the right of mortgage has in a way become an integral part of the real estate market.

In Macedonia there was always a general awareness that in order for the real estate market to thrive (among other things) there must be solid regulation regarding all types of instruments for securing of claims, especially mortgages. Having this in mind during the drafting of the laws regulating mortgage, many modern legal solutions were adopted (for example the possibility of mortgaging buildings under construction – future things). However the ever-changing real estate market (its ups and downs) demand that these laws are constantly revised and changed when needed.

Mortgage in the legal system of the Republic of Macedonia is regulated by several laws. These laws regulate either the right of mortgage or certain aspects of protection and realization of the mortgage. The laws that form the legal frame for regulating mortgage are the: Law of Ownership and Other Real Rights; Law for Securing of Claims; Law of Contract Pledge; Law of Internal Sailing; Law of Obligations and Real Rights Relations in Air Traffic; Execution Proceedings Law; Notary Public Law and others.

The general law regulating mortgage (as one of the types of pledge) is the Law of Ownership and Other Real Rights. The Law of Ownership and Other Real Rights actually refers to all types of pledge (pledge on movable things, on immovable things, on rights, pledge acquired by contract, court decision or by law). This is so because in the Macedonian legal system pledge is considered to be a real right that can appear in several forms. However, regardless of the types of pledge, the nature of the pledge and its legal determination remain the same: “pledge is a real right on things belonging to others used for securing the claim of the pledge creditor who is authorized to dispose over the pledge object in order to ensure payment of his claim before other creditors, and before the creditors who acquired the right of pledge at a later time, regardless of who the owner of the pledged object is” (art. 1 “Official Gazette of Republic of Macedonia”, number 18/01.

2 “Official Gazette of Republic of Macedonia”, number 87/07.
3 “Official Gazette of Republic of Macedonia”, number 5/03.
4 “Official Gazette of Republic of Macedonia”, number 55/07.
5 “Official Gazette of Republic of Macedonia”, number 85/08.
6 “Official Gazette of Republic of Macedonia”, number 35/05.
7 “Official Gazette of Republic of Macedonia”, number 55/07.
There are some opinions of the view that separate regulation regarding pawn and mortgage is needed, but the opinion that the existing regulation is most adequate still prevails.

Regarding the types of pledge it is important to point out that the Law of Ownership and Other Real Rights recognizes two separate classifications of the right of pledge, one based on the pledged object and the other based on the manner in which pledge is acquired. According to the first classification (based on the pledged object) there are two types of pledge: mortgage (as pledge on immovable things) and pawn (pledge on movable things and rights) (art. 228). Based on the second classification (the manner in which pledge is acquired) there are three types of pledge: contract pledge acquired by contract, judicial pledge acquired by court decision and legal pledge acquired by law (art. 226).

The Law of Ownership and Other Real Rights contains only a few articles regarding the right of pledge. The precise regulation of the particular type of pledge is left to special laws such as the Law of Securing of Claims where judicial pledge is regulated, and the Law of Contract Pledge where the pledge acquired by contract is regulated. There are also many laws that regulate legal situations where the pledge is acquired by law, such as: the Law for Execution Proceedings; Obligations Law\(^8\), the Law for Protection of Cultural Heritage etc.

The Law for Securing of Claims is a special law that regulates many types of securities that can be acquired by the creditor in court proceedings, such as: pledge, temporary measures, transfer of ownership and rights as securities and other securities determined in other laws (art. 9). Regarding pledge we can say that this is the law that regulates judicial pledge. The Law regulates both types of pledge – pawn and mortgage, which in this case are acquired by court decision (art. 4). The mortgage is acquired by initiative of the creditor. In order to acquire the mortgage the creditor must submit to the court a document containing a claim expressed in monetary value viable for execution (art. 12). However, the court decision is only the basis for acquiring the right of mortgage. The Law clearly states that for the mortgage to be acquired “It must also be inscribed in public records”, meaning the real estate cadastre (art. 13 and 14).

The Law of Contract Pledge regulates the right of pledge acquired by contract. This law contains provisions regulating two types of pledge acquired by contract, namely pawn and mortgage. The law regulates the subject matter by articles that refer to all types of pledge, as well as by articles that only apply to one or the other type of pledge. This kind of approach in regulating the subject matter is due to the fact that the Law of Contract Pledge follows the concept of the Law of Ownership and Other Real Rights, according to which the pledge, as a real right, should be regulated in a relatively uniform way. However, the particularities of the pawn on the one side and the mortgage on the other make it impossible for them to be regulated in a completely uniform manner. Therefore, there are provisions that only refer to contract pawn and others that only refer to contract mortgage. Most of these provisions regulate the particular manner in which pawn and mortgage are acquired and realized.

The Law of Internal Sailing regulates the legal and safety issues regarding sailing in the waters of the Republic of Macedonia. An integral part of that law are provisions on ownership and other real rights on boats and other flotation devices. The Law of Internal Sailing inter alia regulates the manner in which mortgage is acquired on boats. Having in mind that the law is considered to be a special law in this area, the provisions on mortgage (acquired by contract or by law) to some extent derogate the Law of Contract Pledge (meaning those provisions of the Law of Contract Pledge which contradict provisions of the Law of Internal Sailing).

\(^8\) “Official Gazette of Republic of Macedonia”, number 18/01.
The Law of Obligations and Real Rights Relations in Air Traffic is a special law that regulates the obligations (contracts and torts) regarding aircraft and also regulates the manner in which ownership and other real rights are acquired on aircraft (art.1). Same as the previously mentioned Law of Internal Sailing, this law also contains special regulation (different from the Law of Contract Pledge) that refers to the contract mortgage on aircraft. The difference in regulation is mostly the manner in which contract mortgage on aircraft is acquired.

The Execution Proceedings Law regulates the forced execution of court decisions, decisions of government bodies (if involving payment of money) and other documents viable for execution (art. 12). The provisions of this law regulating the execution proceeding are also applicable when contract mortgage is realized by sale of the mortgaged object. Regarding the realization of the contract mortgage, the Law of Contract pledge clearly states that “when the realization of the pledge is performed by an authorized executor, the Law of Execution Proceedings is applied” (art. 59).

The Notary Public Law regulates the duties and obligations of notary public offices in the legal system of the Republic of Macedonia. The law also regulates the manner in which documents are drafted by the notary public offices. The notary public offices are also involved in the process of acquiring contract mortgage, and to some extent they are also involved in the proceedings for realization of contract pledge (pawn and mortgage). The role of the notary public in acquiring the mortgage is the drafting of the mortgage contract, which must be notarized according to the Law of Contract Pledge (art. 22). We note that the mortgage contract is viable for execution (realization) only if it has been previously notarized. According to the Law of Contract Pledge the notary public offices are also authorized to lead proceedings for realization of the contract mortgage if the pledge creditor and the pledge debtor have agreed to such a manner of realization of the mortgage (art. 23 and 59).

1. The nature of contract mortgage

The civil doctrine has different theories on what is the legal nature of contract mortgage. The different theories given by authors may be divided into three groups.

The first group of theories are those which consider mortgage, as all other types of pledge, a real right.

The assumption that contract mortgage is a real right is based mostly on the fact that mortgage is usually regulated by the same laws that regulate all real rights. In Macedonian civil doctrine the opinion that contract mortgage is a real right prevails because the Law of Ownership and Other Real Rights in article 225 clearly determines pledge (all types of pledge including mortgage) as a "real right on things belonging to others". This precise determination of pledge as a real right by the law leaves little room for debate in the Macedonian legal system regarding its legal nature. Therefore, it is easily concluded by authors that the principle of legal determination is applied regarding the contract mortgage, making the nature of contract mortgage as a real right to be undisputed.

Some authors even consider that it is not necessary for contract mortgage to be determined by law as real right. According to their opinion the affirmation of contract mortgage as real right comes from its characteristics of absolute effect, priority and the tracing effect.

10 Живковска, Родна. Стварно право [Property Law], 123-124.
Other authors point out that contract mortgage has most of the characteristics of real rights (legal determination, absolute effect, specialty etc.), but contract mortgage, as all other types of pledge, has some specific characteristics not present in other real rights. For example, the pledge creditor has no right to use the object of mortgage in any other way but to demand its sale in case his claim hasn’t been paid up in timely fashion. Another distinct characteristic of contract mortgage, not present in other real rights, is the accessory nature of mortgage which means that no mortgage can exist if there is no claim secured by that mortgage\(^\text{12}\).

There are also authors who offer a somewhat different opinion regarding the legal nature of contract mortgage. They state that “contract mortgage has characteristics of real rights and of obligations”. However, according to these authors the characteristics of real rights are those that prevail over the characteristics of obligations. For example, realization of the right of contract mortgage is left to the mortgage creditor in the sense that the mortgage creditor is free to decide whether he will realize the mortgage or renounce his right. Such free disposition is only possible in regard to real rights. In obligations the realization of the obligation and even the renunciation of the rights is possible only if both parties in the obligation agree. Another argument is based on the function of contract mortgage as real security. The function of mortgage, as is pointed out by the authors, is to provide a real (tangible) object as guarantee for payment of the claim of the mortgage creditor. If contract mortgage were considered to be an obligation, this would mean that one obligation is used for securing another obligation, which defeats the purpose of real securities. This argument and other observations lead the authors to the conclusion that overall contract mortgage should be considered to be a real right and not an obligation\(^\text{13}\).

**The second group of theories**, are those that determine contract mortgage as an obligation. These types of opinions are mostly present in Bulgarian civil doctrine. This is not surprising given the fact that the pledge in the Bulgarian legal system is regulated by the laws that regulate obligations and not by laws that regulate real rights. Therefore, the prevailing opinion is that contract mortgage is an obligation by its nature and as such is regulated by the law as an obligation\(^\text{14}\).

There are authors who consider that contract mortgage, even if by nature an obligation, has some characteristics of a real right as well\(^\text{15}\).

Other authors explain that contract mortgage is an obligation because unlike a real right it doesn’t provide the mortgage creditor with direct authority over the mortgaged object. The contract mortgage only provides the possibility of the pledge creditor to demand the sale of the mortgaged object so his claim would be paid off from the funds of the sale. According to the authors this fact is the strongest argument that contract mortgage is an obligation. Regarding the other important characteristic of real rights – the absolute effect, which is present in contract mortgage as well, the authors explain that this is only a secondary, and not a crucial element in determination of the legal nature of contract mortgage\(^\text{16}\).

**The third group of theories** support the stand that the right of pledge has a dual nature.

The authors that support such theory point out that pawn as pledge on movable things and rights is actually an obligation. The mortgage on the other hand, according to the authors, should be considered as a real right. According to the authors, the reason for mortgage to be considered as a real right is the absolute effect of the mortgage\(^\text{17}\).


\(^{13}\) Kovačević - Kuštrimović, Radmila, Lazić, Miroslav. Stvarno pravo [Property Law], 340-342.


The determination of pawn as an obligation and the mortgage as a real right is present in the French Civil Code (art. 2333 and 2393). In French civil doctrine the prevailing opinion is that the pledge in general is an obligation, but because of its importance in the legal system it receives a treatment of auxiliary right.

The author of this text considers that the right of contract mortgage is a real right, as it is stated in the Law of Ownership and Other Real Rights. The legal nature of contract mortgage as a real right is supported by the fact that most of the characteristics of real rights can be recognized in contract mortgage as well, with the exception of the characteristic of direct authority. Even if a mortgage creditor has no possession or direct authority over the mortgaged object, this has no influence on the nature of this right.

However, we must consider that contract mortgage has some specific characteristics not attributed to other real rights, such as: accessory nature, indivisibility and official nature. These specific characteristics are due to its complex nature as a real right.

2. Acquiring contract mortgage in the legal system of the Republic of Macedonia

The manner in which contract mortgage is acquired in the legal system of the Republic of Macedonia is regulated by the Law of Contract Pledge.

The analysis of the law leads to the conclusion that in the Macedonian legal system, for the acquisition of a contract mortgage certain constituent facts and conditions must be met. Constituent facts for acquiring contract mortgage are: the mortgage creditor and the mortgage debtor, the object of mortgage (the real estate) and a valid claim that must be monetary or expressible in monetary value. These constituent facts are general and refer to acquisition of all types of mortgage (mortgage acquired by contract, court decision or by law). Conditions for acquiring contract mortgage are the drafting of a valid contract for mortgage, and the inscription of the contract in public records. These conditions only apply to contract mortgage.

2.1. Constituent facts for acquiring contract mortgage

As has been previously mentioned, in the legal system of the Republic of Macedonia there are three constituent facts for acquiring contract mortgage: the mortgage creditor and the mortgage debtor, the object of mortgage and the claim.

The first constituent fact for acquiring contract mortgage is the mortgage creditor and the mortgage debtor. The Law of Contract Pledge contains a general provision concerning the persons that may appear in the role of pledge creditor and the pledge debtor (art. 13). This is one of the provisions that refers to all types of pledge, including the contract mortgage.

Analyzing article 13 of the Law of Contract Pledge we can conclude that a mortgage creditor may be any person (natural or juridical) who has a monetary claim or a claim expressed in monetary value emerging from some type of obligation or other legal relation. Since the law does not contain any other limitations or conditions regarding the pledge creditor, we can conclude that mortgage creditor and mortgage debtor may be foreign as well as domestic persons.

Mortgage debtor is a person (natural or juridical) who has certain debt towards the mortgage creditor, or a person who is not in obligation with the mortgage creditor but has consented for

the contract mortgage to be created on an object in his property. The Law of Contract Pledge has a very complex definition of the mortgage debtor that boils down to this – the mortgage debtor is the person who has consented for the mortgage to be created on a particular object in his property. This person may either be the same person that entered into certain obligations with the mortgage creditor, or a third party.

In the civil doctrine the relations between the mortgage creditor and the mortgage debtor have been closely analyzed. There is a general opinion that acquiring contract mortgage creates complex relations between all involved parties. First of all acquiring mortgage leads to creating a legal situation where two separate but intertwined relations exist. One is the relation between the mortgage creditor and the mortgage debtor regarding the right of mortgage, and the other is the relation between the mortgage creditor and the debtor regarding the obligation from which the claim secured by mortgage has emerged\textsuperscript{19}. Having a look at the parties in these two legal relations, we can conclude that the mortgage creditor in both relations must be the same person. However, the mortgage debtor and the debtor of the obligation can be two separate persons. For example: if two parties have entered into a credit contract and the claim is secured by contract mortgage, then the creditor from the credit contract must be the same person as the mortgage creditor in the mortgage contract. However, if the contract mortgage in this case is created on real estate belonging to a third person, then that third person, who is not a party to the credit contract, is a party to the mortgage contract.

Even if these two legal relations seem separate from each other, we must point out that the obligation has some direct effect on the right of contract mortgage. Namely, if the obligation is extinguished in some way (by payment, nullification of the contract, etc.) this will affect the right of contract mortgage as well. In this situation the mortgage debtor will be entitled to demand for the right of mortgage to be terminated. The basis for such a conclusion is the accessory nature of the right of contract mortgage determined by the Law of Contract Pledge (art.13). The Law of Contract Pledge in article 41 also states that one of the reasons for termination of the right of pledge is the payment of the debt (the claim secured by the pledge).

However, there are no provisions in the Law of Contract Pledge that regulate what will happen if there is a change to the parties in the obligation. Regarding this issue the civil doctrine considers two possible situations, namely a) changes on the side of the creditor and b) changes on the side of the debtor.

a) If the person of the creditor in the obligation changes, this means that the new creditor of the obligation must become the new mortgage creditor as well. If this doesn't happen the contract mortgage must be terminated\textsuperscript{20}.

b) If the person of the debtor of the obligation changes, the prevailing opinion is that this shouldn't directly affect the contract mortgage since it is not obligatory for the same person to be obligation debtor and mortgage debtor as well.

Regarding the issue of how changes of the parties in the obligation affect the contract mortgage we must point out that the legal solution can be found in the Law of Obligations. According to this law if the person who is the creditor in the obligation changes, this same person will become mortgage creditor as well (art. 425). On the other hand, if the person who is debtor in the obligation changes the contract mortgage it will be terminated unless the mortgage debtor expressly agrees for the security to remain (art. 437).


\textsuperscript{20} Gavella, Nikola. Stvarno pravo, svezak 2 [Property Law, Book 2], 134-135.
The object of contract mortgage is the second constituent fact for acquiring contract mortgage. According to the letter of the Law of Contract Pledge the objects of contract mortgage are immovable things (real estate and things treated as immovable such as boats and aircraft) (art. 4).

According to the Law of Contract Pledge, in order for a certain immovable thing to be the object of mortgage two conditions must be met: the mortgaged object must be owned by the mortgage debtor, and the right of ownership of the mortgaged object must be transferable (art. 10).

The first condition – the mortgaged object to be owned by the pledge creditor - is quite justified considering the fact that only the owner has the right to dispose with his/her ownership. The free disposition includes the right to put the real estate under mortgage. There is however an exception to this rule. The Law of Contract Pledge permits for the mortgage creditor to further mortgage the real estate on which he has the right of contract mortgage (art. 10).

The second condition – the ownership of the mortgaged object must be transferable - is logical as well since the mortgaged real estate needs to be sold in order for the claim of the mortgage creditor to be paid out. Considering this legal condition we note that immovable things such as those in public use, agricultural land and forests owned by the state can’t be mortgaged since laws prescribe that the right of ownership on such things can’t be transferred. We also note that certain real estate, even if the law doesn’t prohibit the transfer of ownership, still can’t be mortgaged. This is the case with construction grounds owned by the state. The right of ownership on construction grounds owned by the state may be transferred, but the Law of Construction Ground in article 45 states that only construction grounds in private ownership or ownership of municipalities may be mortgaged. This means that mortgaging construction grounds owned by the state is excluded.

As pointed out before, the object of mortgages are immovable things and things treated as immovables. According to article 13 of the Law of Ownership and Other Real Rights immovable things are: the real estate (land and buildings) and the installations tied to the real estate. Movable things treated as immovables are boats and aircraft.

Regarding mortgaging of real estate such as land and buildings, certain issues must be addressed. According to the principle superficies solo credit, determined by the Law of Construction Grounds, land is treated as the main (primary) thing and the object attached to it is considered to be secondary (art. 10). In such case when the real estate is being mortgaged, the mortgage involves the land and the building as a whole.

However, there are situations when the principle of superficies solo credit is excluded.

• The first situation is when the right of permanent use is acquired on a construction ground owned by the state. In this situation the person who has a right of permanent use on the construction ground owned by the state usually owns the building on that construction ground. In this particular case only the building could be mortgaged since the construction ground owned by the state may not be mortgaged, not only because of prohibition by law, but also because the mortgage debtor doesn't own it.

21 According to article 16 of the Law of Ownership and Other Real Rights things in public use are used by all natural and juridical persons but they are exclusively owned by the state. The Law for Agricultural Land (“Official Gazette of Republic of Macedonia”, number 135/07) in article 17 states that agricultural land owned by the state may not be sold. The Law for Forests (“Official Gazette of Republic of Macedonia” number 64/09) in article 89 states that forests owned by the state must not be sold.

22 The right of permanent use on construction ground owned by the state was acquired by natural and juridical persons in the time period when all construction grounds were first in social ownership and then ownership of the state. The tendency of the Macedonian legal system today is for the right of permanent use to be gradually extinguished by the process of privatization regulated with the Law of Privatization and Long-Term Lease on Construction Grounds Owned by the State (“Official Gazette of Republic of Macedonia” number 04/05).
• The second situation is when the right of long-term lease is acquired on the construction ground. According to the Law of Construction Grounds, the right of long-term lease authorizes its bearer to build on construction ground owned by another person and to acquire ownership on the building for the time period for which the right of long-term lease has been acquired (art. 23). In such cases if a contract mortgage is acquired, the object of mortgage includes the right of long-term lease and the object attached to that right. The same applies when the object has been built under a right of concession.

In the Macedonian legal system, boats and aircraft are treated as immovable things. According to the Law of Contract Pledge, mortgaging of boats and aircraft is performed in accordance with this law and other special laws (art. 35).

• The special law that regulates the acquisition of ownership and other real rights (including mortgage) on boats is the Law of Internal Sailing. According to this law, when boats are mortgaged by contract, the object of the mortgage includes the boat with all things incorporated into that boat (art. 123). The mortgaged object also includes claims relating to the boat such as claims for damages and insurance claims (art. 124 and 126). However, claims regarding transfer, lease, and water rescue are excluded unless the parties have reached an explicit agreement that those claims will be included as object of the contract mortgage (art. 125).

• The acquisition of ownership and other real rights on aircraft is regulated by the Law of Obligations and Real Rights Relations in Air-traffic. According to this law, the object of contract mortgage is the aircraft with all things incorporated in the aircraft unless third persons had acquired ownership on such things. The object of mortgage also includes insurance claims regarding the aircraft. Claims from transportation and other services, lease or rescue missions are not included in the mortgaged object unless the parties have agreed to it in the mortgage contract (art. 150).

According to the Law of Contract Pledge, objects of mortgage may also be future things (art. 7). Future immovable things are considered to be: buildings, boats, and aircraft under construction. The Law of Contract Pledge doesn’t contain any provisions that regulate specifically the mortgaging of future things, so the general rules apply. The Law of Obligations and Real Rights Relations in Air-traffic in article 157 states that mortgaging aircraft under construction is done according to the same rules and regulations as mortgaging aircraft. Similar regulations can be found in the Law of Internal Sailing (art. 130).

The Law of Contract Pledge prescribes that ideal parts of things may also be pledged or in this case, mortgaged. The basis of such a legal solution is to be found in the general Law of Ownership and Other Real Rights where ideal parts of things are treated as particular objects (art. 14). Regarding the mortgaging of ideal parts of immovable things, the Law of Contract Pledge states that they can be separate objects of mortgage when the immovable thing is in co-ownership (art. 11). In this situation, the object of mortgage involves only the ideal part of the immovable thing owned by the mortgage debtor.

The third constituent fact for acquiring contract mortgage is the claim of the mortgage creditor. The Law of Contract Pledge states that the claim must be monetary or expressed in monetary value (art. 13). Regarding the types of claims secured by mortgage, the law states that existing as well as future or conditional claims may be secured (art. 8). However, besides the condition that the claim must be monetary or expressed in monetary value, the law contains no other particular conditions concerning the claim. The civil doctrine on the other hand recognizes several conditions in order for the claim to be viable for this type of security. The conditions are the following: the claim
must be monetary or expressed in monetary value; the claim must be determined or determinable (principle of speciality); the claim must be valid and the claim must belong to the mortgage creditor.  

2.2. Conditions for acquiring contract mortgage

There are two conditions for acquiring contract mortgage in the legal system of the Republic of Macedonia – the mortgage contract and the inscription of the right of contract mortgage in public records.

The above-mentioned conditions are determined by article 17 of the Law of Contract Pledge. The article also prescribes that public records where the mortgage must be inscribed are: the public records where ownership and other real rights on real estate are inscribed, and the public records where ownership and other real rights of things treated as immovables (boats and aircraft) are inscribed.

The first condition for acquiring contract mortgage is the drafting of the mortgage contract. The mortgage contract is a formal legal act that must be concluded in written form and must be notarized. The Law of Contract Pledge states that a mortgage contract which is not concluded in the prescribed form has no legal value (art. 21). This means that if the form of the mortgage contract is not drafted as the law prescribes it can’t be used as a legal basis for acquiring the mortgage.

The formality of the contract extends to its content as well. The Law of Contract pledge in article 23 prescribes that the mortgage contract must contain certain elements such as:

- Information for the contract parties (the mortgage creditor and the mortgage debtor). The information that must be noted is the following: name of the contract parties, place of residence and unique identification number of citizens (for natural persons), name, headquarters and unique identification number of the subject (for juridical persons). If the pledge creditor or the pledge debtor are foreign nationals the necessary information includes: name, place of residence, passport number and the state that has issued the passport (for natural persons), name, headquarters and registration number in the foreign registry of juridical persons (for juridical persons). If the debtor and the mortgage debtor are not the same person the debtor of the claim must also be identified in the mortgage contract;
- Description of the mortgaged object with sufficient elements so it could be individualized, and also the value of the mortgage object;
- The legal basis for the claim secured by mortgage and the time line for voluntary payment of the claim. The maximal value of the claim secured by the contract mortgage must also be noted. If after the conclusion of the mortgage contract the parties agree to increase the maximal value of the claim secured by the contract mortgage, such action is considered as entering into a new mortgage contract;
- Time and place of conclusion of the mortgage contract;
- The expressed consent of the contract parties for the mortgage contract to be inscribed in public records (clausula intabulandi) and
- Other rights of the pledge creditor regarding the mortgaged object.

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24 The determination of the value of the mortgaged object in the legal system of R. Macedonia today is performed by authorized appraisers according to the Law for Appraisal (“Official Gazette of Republic of Macedonia” number 115/10) and the Methodology for Appraisal of Market Value on Real-Estate (“Official Gazette of Republic of Macedonia” number 54/12).
The Law of Contract Pledge also prescribes that the contract parties in the mortgage contract may agree on the manner of realization of the mortgage in case the debtor fails to pay out the claim of the mortgage creditor. This agreement refers to the authorized subject who may execute the proceedings regarding the realization of the mortgage. Subjects that are authorized by law to perform the realization of a mortgage are: notary public, executors and real estate agencies.

Contract parties according to the Law of Contract Pledge may give the mortgage contract an execution clause (art. 22). The execution clause means that the mortgage contract will become a document viable for immediate execution.

The second condition for acquiring contract mortgage is the inscription of the mortgage in public records.

The contract mortgage on real estate is inscribed in the real estate cadastre. According to the Law of Real Estate Cadastre, contract mortgage in the real estate cadastre is inscribed as a real right on real estate (art.127 paragraph 2). The inscription contains information regarding the mortgage creditor and the mortgage debtor and the legal basis and the value of the claim secured by the mortgage. Property deeds where mortgages are inscribed also contain notification that the transfer of ownership of the mortgaged real estate has no effect over the mortgage right.

The important novelty brought by the Law of Real Estate Cadastre is the sheet for pre-inscription of buildings under construction. This sheet contains information for the pre-inscribed right on real estate (mortgage included) on buildings under construction (art. 121). This novelty of the law was implemented as solution for the negative occurrences on the real estate market where many people were defrauded by investors in the construction business (further elaboration of the problem will follow in section 4 of this paper).

Contract mortgage on boats is inscribed in the Boat Registry. According to article 152 ownership and other real rights (including mortgage) are inscribed in the Boat Registry. The law states that the inscription of the contract mortgage in the Boat Registry is performed on the initiative of the interested party (art. 150). We stipulate that the interested party in this case is the mortgage creditor.

According to the Law for Air traffic the contract mortgage on aircraft is inscribed in the Aircraft Registry (article 97, paragraph 2). The Aircraft Registry contains information on ownership and other rights on aircraft. A mortgage in the Aircraft Registry is performed on the basis of a decision of the Agency for Air traffic Control.

25 It is considered that the mortgage contract contains an execution clause if there is a written statement of the contract parties to that effect which has been notarized by notary public.
26 The real-estate cadastre in the legal system of the Republic of Macedonia is an integrated part of the so-called Geodetic Cadastre Information System (GKIS) which contains all information concerning real estate. The Geodetic Cadastre Information System is constructed and regulated by the Law of Real-Estate Cadastre ("Official Gazette of Republic of Macedonia", number 40/08).
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<th>Value Limit</th>
<th>Time Limit (years)</th>
<th>Collateral Real Estate</th>
<th>Interest Rate</th>
<th>Costs</th>
<th>Cost for Estimation</th>
<th>Cost for Administration</th>
<th>Costs for Premature Repayment of Loan</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stopanska Banka</td>
<td>For Purchase of Apartments</td>
<td>33.000EUR - 150.000EUR</td>
<td>30</td>
<td>133%-200%</td>
<td>10% (6,2% fixed for first 3 years); 8,05% (6,2% fixed for first 3 years)</td>
<td>500MKD; 2500MKD-5000MKD; 1,25% (one time payment)</td>
<td>0%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Komercijalna Banka</td>
<td>Mortgage Loan</td>
<td>60.000EUR</td>
<td>18</td>
<td>140%</td>
<td>9,49%; 8,02%</td>
<td>300MKD; 2000MKD; 0,5% (for MKD) 1,5% (for EUR)</td>
<td>0%</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>For Purchase of Real Estate</td>
<td>N/A</td>
<td>N/A</td>
<td>120%-140%</td>
<td>8,39%-8,43%; 7,19% - 7,24%</td>
<td>300MKD; 2000MKD; 0,5% (for MKD) 1% (for EUR)</td>
<td>0%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>NLB Tutunska Banka</td>
<td>Mortgage for Purchasing Credit</td>
<td>1.800.000 MKD</td>
<td>7</td>
<td>300%</td>
<td>11,75%</td>
<td>N/A; 500MKD; 2000MKD; 1% (one time payment)</td>
<td>1% (one time payment)</td>
<td>2000MKD - 4000MKD</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Mortgage Cash Credit</td>
<td>50.000EUR</td>
<td>N/A</td>
<td>140%-300%</td>
<td>8,50%; 7,50%</td>
<td>500MKD; 2000MKD; 1,5% (one time payment)</td>
<td>0MKD - 4000MKD</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>For Real Estate</td>
<td>5.000 EUR - 150.000 EUR</td>
<td>30</td>
<td>140%-300%</td>
<td>7,5% (7,2% fixed for the first 3 years); 7,5% (6,5% fixed for the first 3 years)</td>
<td>500MKD; 2000MKD; 1,5% (one time payment)</td>
<td>2000MKD - 4000MKD</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Halkbank</td>
<td>Mortgage Loan</td>
<td>100.000EUR</td>
<td>10</td>
<td>150%</td>
<td>N/A; 8,30%</td>
<td>N/A; N/A; N/A; 1,75% (one time payment)</td>
<td>N/A</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sparkasse Bank</td>
<td>Mortgage Loan</td>
<td>N/A</td>
<td>15</td>
<td>300%</td>
<td>12%</td>
<td>N/A; N/A; N/A; 2% (one time payment)</td>
<td>N/A</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unicredit Bank</td>
<td>Mortgage Loan</td>
<td>100.000EUR/900.000 MKD</td>
<td>15</td>
<td>133%</td>
<td>9%; 8%</td>
<td>20EUR-50EUR; N/A; 2% (one time payment)</td>
<td>N/A</td>
<td>5%</td>
<td></td>
</tr>
</tbody>
</table>

27 Table one contains data concerning: value limit (the maximal amount of the loan), time limit of the loan, required collateral, interest rates and other costs for six banks in Macedonia.

28 Information not available.
Table 2 – Credit costs simulation

<table>
<thead>
<tr>
<th>Bank / Mortgage Loan</th>
<th>Value Limit</th>
<th>Time Period (years)</th>
<th>Collateral Real Estate</th>
<th>Interest Rate</th>
<th>Costs for Application</th>
<th>Cost for Estimation</th>
<th>Cost for Administration</th>
<th>Costs for Premature Repayment of Loan</th>
<th>Costs for TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stopanska Banka</td>
<td>For Purchase of Appartement</td>
<td>50,000 EUR / 300,000 MKD</td>
<td>10</td>
<td>66,500 EUR-100,000 EUR / 399,000 MKD-600,000 MKD</td>
<td>475,800 MKD</td>
<td>72,960 EUR</td>
<td>500 MKD</td>
<td>2500 MKD-5000 MKD</td>
<td>625 EUR / 3750 MKD</td>
</tr>
<tr>
<td>Komercijalna Banka</td>
<td>Mortgage Loan</td>
<td>50,000 EUR / 300,000 MKD</td>
<td>10</td>
<td>70,000 EUR / 420,000 MKD</td>
<td>465,600 MKD</td>
<td>72,840 EUR</td>
<td>300 MKD</td>
<td>2000 MKD</td>
<td>750 EUR / 1500 MKD</td>
</tr>
<tr>
<td></td>
<td>For Purchase of Real Estate</td>
<td>50,000 EUR / 300,000 MKD</td>
<td>10</td>
<td>60,000 EUR-70,000 EUR / 360,000 MKD-420,000 MKD</td>
<td>444,480 MKD</td>
<td>70,320 EUR</td>
<td>300 MKD</td>
<td>2000 MKD</td>
<td>500 EUR / 1500 MKD</td>
</tr>
<tr>
<td>NLB Tutsanska Banka</td>
<td>Mortgage for Purchasing Credit</td>
<td>50,000 EUR / 300,000 MKD</td>
<td>10</td>
<td>150,000 EUR / 900,000 MKD</td>
<td>511,200 MKD</td>
<td>N/A</td>
<td>500 MKD</td>
<td>2000 MKD</td>
<td>1000 EUR / 6000 MKD</td>
</tr>
<tr>
<td></td>
<td>Mortgage Cash Credit</td>
<td>50,000 EUR / 300,000 MKD</td>
<td>10</td>
<td>70,000 EUR-150,000 EUR / 420,000 MKD-900,000 MKD</td>
<td>446,400 MKD</td>
<td>71,160 EUR</td>
<td>500 MKD</td>
<td>2000 MKD</td>
<td>750 EUR / 4500 MKD</td>
</tr>
<tr>
<td></td>
<td>For Real Estate</td>
<td>50,000 EUR / 300,000 MKD</td>
<td>10</td>
<td>70,000 EUR-150,000 EUR / 420,000 MKD-900,000 MKD</td>
<td>427,320 MKD</td>
<td>71,160 EUR</td>
<td>500 MKD</td>
<td>2000 MKD</td>
<td>750 EUR / 4500 MKD</td>
</tr>
<tr>
<td>Halkbank</td>
<td>Mortgage Loan</td>
<td>50,000 EUR / 300,000 MKD</td>
<td>10</td>
<td>150,000 EUR / 900,000 MKD</td>
<td>N/A</td>
<td>73,680 EUR</td>
<td>N/A</td>
<td>N/A</td>
<td>875 EUR / 5250 MKD</td>
</tr>
<tr>
<td>Sparkasse Bank</td>
<td>Mortgage Loan</td>
<td>50,000 EUR / 300,000 MKD</td>
<td>10</td>
<td>150,000 EUR / 900,000 MKD</td>
<td>516,480 MKD</td>
<td>75,960 EUR</td>
<td>N/A</td>
<td>N/A</td>
<td>1000 EUR / 6000 MKD</td>
</tr>
<tr>
<td>Unicredit Bank</td>
<td>Mortgage Loan</td>
<td>50,000 EUR / 300,000 MKD</td>
<td>10</td>
<td>66,500 EUR / 399,000 MKD</td>
<td>456,000 MKD</td>
<td>72,720 EUR</td>
<td>N/A</td>
<td>N/A</td>
<td>1000 EUR / 6000 MKD</td>
</tr>
<tr>
<td>Average</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>73.228 EUR</td>
</tr>
</tbody>
</table>

Table two shows an example of the principle and the costs for credit of 50,000 EUR and 300,000 MKD with different interest rates with maturity of 10 years, considering the crediting conditions offered by different banks in Macedonia.
### Table 3 – Legal costs for crediting

<table>
<thead>
<tr>
<th>Value of Contract (MKD)</th>
<th>Fee</th>
<th>Fee (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 - 100.000</td>
<td>800</td>
<td>min. 0,8%</td>
</tr>
<tr>
<td>100.001 - 200.000</td>
<td>1.200</td>
<td>0,6% - 1,2%</td>
</tr>
<tr>
<td>200.001 - 300.000</td>
<td>2.000</td>
<td>0,6% - 1%</td>
</tr>
<tr>
<td>300.001 - 3.000.000</td>
<td>2.000 - 8.000</td>
<td>0,27% - 0,6%</td>
</tr>
<tr>
<td>3.000.001 - 5.000.000</td>
<td>10.000</td>
<td>0,2% - 0,3%</td>
</tr>
<tr>
<td>5.000.001 - 9.000.000</td>
<td>12.000</td>
<td>0,13% - 0,24%</td>
</tr>
</tbody>
</table>

### 3. Termination of the contract mortgage

The Law of Contract Pledge contains a general article referring to the manner in which the pledge can be terminated. According to article 41 of the Law of Contract Pledge the right of pledge can be terminated in several ways such as: payment of the debt (the claim secured by the pledge), realization of the pledge, renunciation of the pledge on the part of the pledge creditor, destruction of the pledged object (unless it was insured), dissolution of the pledge contract (unilateral or consensual), when the pledge creditor is a juridical person that no longer exists and has no legal successor, loss of possession on or after a certain period of time, and in other cases determined by law. These are in general the ways by which all types of pledge may be terminated. However, we must have in mind that contract mortgage can’t be terminated by loss of possession (since the mortgage creditor never takes possession of the mortgaged real estate) or after a certain period of time. We also note that since mortgage is inscribed in public records it can only be fully terminated when the contract mortgage is erased from the public records.

Realization of the contract mortgage is one of the most common ways for terminating the mortgage (the other is by payment of the debt). In order for realization of the contract mortgage to be enforced, according to the Law of Contract Pledge two conditions must be fulfilled: the debtor to fail in payment of the debt and the mortgage contract to be a document viable for immediate execution (art. 61). Among the authorized subjects who can execute realization proceedings for the contract mortgage are: notary publics, executors and real estate agencies. Notary publics execute realization proceedings according to the procedure regulated by the Law of Contract Pledge (art. 59-81). Executors, on the other hand, execute realization proceedings by a procedure regulated in the Law for Execution Proceedings. The third subjects who, according to the Law of Contract Pledge, may be authorized to execute realization proceedings are real estate agencies. However, we note that since there is no law regulating the procedure that real estate agencies need to follow in realization of a contract mortgage, the letter of the law in this part remains ineffective.

Selection of the authorized subject to execute realization proceedings is left to the mortgage creditor and the mortgage debtor. According to the Law of Contract pledge, the parties may choose the authorized subject at the moment of drafting the pledge contract, but if they failed to do so the authorized subject is chosen by the mortgage creditor when the conditions for realization of the mortgage are fulfilled (art. 59).

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30 The table shows the legal costs for drafting the mortgage contract by a notary public based on Notary Public Fee (“Official Gazette of Republic of Macedonia” number 19/11).
Legal practice shows that a mortgage creditor and mortgage debtor usually choose the realization proceedings to be enforced by the executors, rather than notary publics. The reason for this practice is the fact that the whole procedure, when performed by the executor, is least costly.

4. Issues in legal practice regarding contract mortgage

In this last part of the article we will address some of the issues encountered in daily legal practice concerning contract mortgage. These issues address the common problems in the legal practice, which are in part due to inadequate or incomplete regulations and in part due to adopted bad legal practices that contradict the regulations.

One of the worst problems that emerged in legal practice was due to the lack of regulations regarding the mortgaging of future things such as buildings under construction. As we have mentioned before, buildings under construction are considered future things and they may be the object of mortgage. However, the Law of Contract Pledge contained no separate articles regulating the mortgaging of future things, so the provisions regulating mortgaging of real estate were applied. The first issue that emerged related to the inscription of mortgages in public records. The real estate cadastre, until 2008, was not equipped to perform the inscription of mortgages on future things since there was no regulation regarding the manner and procedure for such inscription. This created a situation where most of the mortgages on buildings under construction so to speak “flew under the radar”, meaning that the principle of publicity was not enforced. Since there was no real publicity of the mortgages, in many cases the people who paid the investors for the construction of the buildings were ultimately unpleasantly surprised to find out that the building had been mortgaged while it was under construction. The problem with publication of the mortgages on buildings under construction was finally solved when the new Law of Real Estate Cadastre was passed in 2008. As we have explained before, the law prescribes that ownership and real rights (mortgage included) are noted in the pre-inscription sheet for buildings under construction. But there is still a problem regarding the realization of mortgages on future things. The general opinion is that realization of the mortgage in case the building hasn’t been finished can only be performed on the construction grounds where the building is being constructed.

Another difficult problem was a result of bad legal practices in executing the proceedings for realization of mortgages on real estate in cases where the building on the construction ground was owned by the mortgage debtor and the construction ground was owned by the state. There were many situations (in the past) where realization of the mortgage involved the sale of the whole real estate (the land and the building). This practice was stopped upon a justified reaction of the State’s Attorney, who argued that the land owned by the state may not be mortgaged, consequently the land must not be sold during realization of the mortgage.

The tendency in the Macedonian legal system has always been to make the executors the primary subjects in performing realization proceedings. However, in 2003 when the Law of Contract Pledge was drafted the executors were still part of the slow and ineffective court system for forced execution. That situation changed in 2005 when the Law of Execution Proceedings was passed. By the letter of this law the executors become independent subjects authorized for performing all types of forced execution proceeding. Since 2005 the executors have become quite effective, putting creditors in a much better position than before.

This legal solution solved much more than the problem with the publicity of mortgage. It also put an end to practices where people who paid an investor for buildings under construction were defrauded. The fraud that some investors preformed consisted of taking money from more than one person for the construction of the same apartment in the building. In the end two or more people paid for the apartment but only one of them would become the owner of the apartment. The rest were usually left without an apartment and without their money. This kind of fraud today is difficult to execute since all the people who paid an investor for buildings under construction are noted in the pre-inscription sheet for the building in the real estate cadastre.
The other issue that was debated in legal practice related to article 69 paragraph 3 of the Law of Contract Pledge, where it is said that if the claim of the mortgage creditor has not been paid in full during realization of the mortgage the mortgage creditor has the right to demand payment for the rest of the claim from the pledge debtor. Some legal practitioners considered this article to be the basis for continuing the execution proceedings on the rest of the estate of the pledge creditor. The author of this text considers that to be a mistake. The fact is that the article is badly formulated because instead of “pledge creditor” the article should read “creditor”. When interpreting this article we must bear in mind that the debtor and the mortgage debtor can be two different persons. The debtor is responsible for his/her debt with his/her entire estate, but the mortgage debtor (especially when he is a different person from the debtor) is only responsible with the mortgaged object. There is really no room for debate since article 13, paragraph 2 of the Law of Contract Pledge clearly states that when the mortgage creditor is a third person, this person responds for the claim only with the mortgaged object.

Summary

The subject matter in this article is the contract mortgage in the legal system of the Republic of Macedonia. The introductory note of this article contains a brief analysis of the legal frame for regulating mortgage in the Republic of Macedonia. The legal frame consists of several laws that regulate either the right of mortgage or certain aspects of protection and realization of the mortgage. Such laws are: the Law of Ownership and Other Real Rights; Law of Contract Pledge; Law for Securing of Claims; Law of Internal Sailing; Law of Obligations and Real Rights Relations in Air Traffic; Execution Proceedings Law etc.

- The Law of Ownership and Other Real Rights is a general law that regulates all matters regarding real rights in the Macedonian legal system. More precisely the law regulates: the types of real right in the legal system of the Republic of Macedonia, and the manner in which real rights are acquired, protected and terminated. It also regulates the possession and the object of real rights. Mortgage in the Law of Ownership and Other Real Rights is regulated as a real right on real estate.
- The Law of Contract Pledge is a special law that regulates the right of pledge acquired by contract. The law recognizes two types of contract pledge: contract pledge on movable things – pawn; and contract pledge on immovable things (real estate) – mortgage.
- The Law for Securing of Claims is another special law that regulates the pledge (pawn and mortgage) acquired by a court decision rendered in proceeding for securing of claims.
- The Law of Internal Sailing contains articles that regulate the right of pledge on boats acquired by contract, court decision or by law.
- The Law of Obligations and Real Rights Relations in Air Traffic regulates (among other things) the conditions and manner in which mortgages on aircraft are acquired.
- The Execution Proceedings Law regulates the proceedings where claims of creditors are forcibly paid up by debtors with the intervention of authorized executors. The executors on certain occasions may also be authorized to lead the proceedings for realization of mortgages.

Noting the fact that the civil doctrine has no unanimous stand on the legal nature of mortgage, the articles also shed light on the different theories on this matter. Generally, the theories vary from those that treat mortgage as a real right, to those that treat mortgage as an obligation. There is also a dual theory according to which mortgage as a pledge on real estate should be treated as
a real right, and the pawn as a pledge on movable things should be considered an obligation. The article also states that in Macedonian civil doctrine there is no doubt regarding the legal nature of mortgage because the Law of Ownership and Other Real Rights clearly determines pledge (pawn and mortgage) as a real right.

The article also presents the manner in which contract mortgage is acquired and terminated in the legal system of the Republic of Macedonia.

Regarding the acquisition of contract mortgage, the article demonstrates that certain constituent facts and conditions must be met:

- The constituent facts for acquiring mortgage are the pledge creditor and the pledge debtor, the object of pledge (the real estate) and the valid claim that must be monetary or expressible in monetary value. These facts are general and refer to acquisition of all types of mortgage (mortgage acquired by contract, court decision or by law).

- The conditions for acquiring contract mortgage are the drafting of a valid contract for mortgage, and the inscription of the contract in the real estate cadastre. These conditions only apply to the contract mortgage.

Regarding the termination of contract mortgage, the Law for Contract Pledge contains articles on the various ways that may lead to termination of mortgage. The usual ways by which a mortgage is terminated is by the payment of the debt secured by mortgage or by realization of the mortgage (by selling the real estate) when the debtor has failed to pay. In all cases the termination of mortgage is completed when the mortgage is erased from public records – the real estate cadastre.

The last part of the article refers to the legal practices concerning contract mortgage in the legal system of the Republic of Macedonia. This part of the article contains analysis of the problems that legal practitioners (judges, notary public, executors etc.) encounter in daily practice regarding the acquisition or realization of contract mortgages. The article shows that these problems are in part due to inadequate or incomplete regulations and in part due to adopted bad legal practices that contradict the regulations.

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12. Methodology for Appraisal of Market Value on Real Estate, “Official Gazette of Republic of Macedonia” number 54/12;
PART THREE
INTELLECTUAL PROPERTY LAW
AND LABOUR LAW
ACCESSORY OF A TRADEMARK IN PROPERTY RIGHT DISPOSITIONS
by dr. sc. Romana Matanovac Vučković, Associate Professor at the
University of Zagreb, Faculty of Law

Abstract
For a long time during its existence as a property right, a trademark was accessory to the undertaking (i.e. business) in connection with which it was created and in which it was used. Owing to that, the transfer of a trademark without the undertaking or goodwill was prohibited, and licenses were not allowed. In the transitional period towards a complete emancipation of a trademark from the undertaking (i.e. business), licenses were allowed, but only conditionally. The indirect permissibility of licenses was based on the understanding that the licensee acts under the complete control of the owner of the trademark. The harmonization of the trademark law at the European Union level has led to the complete separation of a trademark from the undertaking, i.e. to the application of the principle of non-accessority. No limitations of the property right dispositions with a trademark, the purpose of which would be to prevent the public being misled as a result of the license or the transfer of a trademark without the undertaking, have been provided for. Whereas today a trademark is multifunctional and whereas consumers do not take it only as an indication of the origin of a product but have attributed to it many other functions, there is no danger of the transfer of a trademark without the undertaking and of licenses. It may not be asserted that an a priori prohibition or control by the bodies maintaining trademark registers would protect the public from deceptive trademarks. Today, the public is aware of the fact that property right dispositions with trademarks take place. At the same time, it is not interested in the precise origin of a product or service, but in a certain quality and other characteristics of the product or service designated by the trademark. Therefore, it is the owner of a trademark and the persons acquiring the right of exploitation in the course of trade who have to take care of the reputation and perception of a trademark.

Key words: business, trademark, trademark functions, trademark license, trademark transfer, undertaking

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ACCESSIBILITY OF A TRADEMARK IN PROPERTY RIGHT DISPOSITIONS

1. Introduction

A trademark as an instrument of identification and communication on the market indicates that the goods and services originate from a certain source, which controls their production and distribution or provision, respectively. Owing to such control, goods and services have certain permanent characteristics on which consumers can rely. Consequently, the trademark functions protect, apart from the interests of undertakings, the interests of consumers as well. For that very reason it is right to ask oneself how the trademark functions affect the possibilities of the property right disposition with it, and whether it is justified to allow legal disposition with a trademark without the undertaking in relation to which the trademark has been created and in which it has been used. The answer to that question has not been the same in the history of trademark law.

2. Trademark Functions

The possibilities and ways of the property right disposition with a trademark throughout history and up to the present day have been connected with teaching about the trademark functions. While the older German legal literature claimed that subjective rights conferred by a trademark related only to those trademark functions that enjoyed legal protection, today the conventional wisdom is that a trademark is multifunctional. All of its functions exist simultaneously and are interconnected. In certain circumstances in the course of trade, depending on one’s point of view and the need to meet certain interests, a particular trademark function may be more emphasized than the others. Nevertheless, it does not mean that one, in a certain context more emphasized trademark function, may replace or cancel its other functions.

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1 E.g. Wilkof et al. claim that the nature and scope of a trademark license result directly from the trademark functions. Wilkof, Neil J., et al., Trade Mark Licensing, London, 2005, p. 20.
3 Fezer, Karl-Heinz, Markenrecht – Kommentar zum Markengesetz, zur Pariser Verbandsübereinkunft und zum Madrider Abkommen – Dokumentation des nationalen, europäischen und internationalen Kennzeichenrechts, München, 2001, 3rd ed., p. 75. Thus, e.g. in case L’Oréal SA, Lancôme parfums et beauté & Cie SNC and Laboratoire Garnier & Cie v Bellure NV, Malaika Investments Ltd and Starion International Ltd, C-487/07 the European Court of Justice has pointed out that in addition to the essential function of a trademark to indicate origin, it also has many other functions, such as the guarantee function, the communication function, the function of the protection of investment and the advertising function. He has supported his viewpoint concerning the same by mentioning judgments Arsenal Football Club plc v Matthew Reed, C-206/01, Anheuser-Busch Inc. v Budĕjovický Budvar, národní podnik, C-245/02 and Adam Opel AG v Autec AG, C-48/2005. In those cases the Court has mentioned that a trademark has several functions, but it has mentioned explicitly only its essential function to indicate origin.
The distinctive function of a trademark has always been its basic function. Immanent to it is the function of indicating origin. Each trademark must have a distinctive function in order to be a trademark. A trademark is used in the course of trade to distinguish goods and services of one undertaking from the goods and services of another undertaking. Although in the past it was considered that the role of a trademark was to help a buyer identify precisely the source of goods, very soon, under the influence of economic development and in particular trade, it was understood that it was not necessary that the buyer learns from a trademark about the precise identity of the manufacturer or about the person having placed the product on the market, but that he may learn from the trademark about the source, not giving it the precise identity according to its name. So for example, in England, as early as by the end of the nineteenth century it was argued that the buyer would be deceived if he could not learn about the origin of a product, and not if he could not learn about the precise identity of its manufacturer. Up to now, the old view on the strict function of indicating origin has changed and today, this trademark function is associated with a (slightly) fluid criterion which is called consumer’s awareness, and not with the objective and rational establishment of the facts on the part of consumers. A consumer is the center of the trademark functions’ activities, and he is the one who associates in his mind goods and services with a certain source. The function of indicating origin is referred to in recital 11 of Directive 2008/95/EC of the European Parliament and of the Council of 22 October 2008 to approximate the laws of the Member States relating to trade marks (Codified version) as well as in recital 11 of the Council Regulation (EC) No 207/2009 of 26 February 2009 on the Community trade mark (Codified version). They state that the function of the legal protection of a trademark is “in particular to guarantee the trademark as an indication of origin.” Here it has to be mentioned that emphasis is put on the word “in particular.”


5 See e.g. Lord Nichols in case Scandecor Developments AB v. Scandecor Marketing AB [2001] 2 C.M.L.R. 30; [2001] E.T.M.R. where he points out: “The function of a trademark is to distinguish goods having one business source from goods having a different business source. It must be ‘distinctive.’ That is to say, it must be recognizable by a buyer of goods to which it has been affixed as indicating that they are of the same origin as other goods which bear the mark and whose quality has engendered goodwill.”

6 See e.g. the explanation given by Judge Herschell in Yorkshire Relish (Birmingham Vinegar Brewery Co Ltd. v. Powell (1897) AC 710): “I don’t think that the name of the manufacturer is identified in the mind of the public, but that the public thinks of a particular manufacturer and if a person sells Yorkshire Relish, such as the defendant does by selling it to the public as Yorkshire Relish and by calling it Yorkshire Relish, and by representing it to the public as being the product manufactured like the one which is known and which is called Yorkshire Relish.”

7 Similar Cornish, William and Llewelyn, David, Intellectual Property: Patents, Copyright, Trade Marks and Allied Rights, London, Sweet & Maxwell, 2003, 5th ed., p. 390. Some will call it a “metaphysical source”; see Phillips, Jeremy, Trade Mark Law (A Practical Anatomy), Oxford / New York, 2003, p. 25., whereas others will point out that the very indication of the origin of a product is the most important argument for the protection of a trademark, because such a protection also protects the public interest, i.e. the interests of consumers, see Bently, op. cit., p. 718.

8 One of the most important cases in German court practice is Tiffany (BGH GRUR 1999, 496) in which the German Supreme Court has for the first time applied the consumers’ expectations criterion. It has asked itself what has been developed in the course of trade as the consumers’ expectations from the responsibility of an undertaking for the quality of products designated by its trademark.

9 Hereinafter referred to as Trademark Directive.

10 Hereinafter referred to as CTM Regulation.

The intention is to point out that there are also other trademark functions. Although the provisions of the *acquis communautaire* have defined the trademark functions very narrowly, the very words “in particular” have paved the way to granting legal protection, apart from to the origin function, also to other trademark functions.

Apart from the distinctive function, the quality function which is usually also called the guarantee function is also very important. It reflects the fact that the use of a trademark in the course of trade may create consumer confidence that the goods and services designated by it have the same characteristics and the same quality in the repeated use. As long as consumers are not disappointed in their expectations regarding the characteristics and quality of the goods and services designated by a certain trademark, the quality function is deemed to be fulfilled. It is not based on the actual responsibility of the undertaking for the precise characteristics and quality of his products, but it is based on the confidence of consumers based on experience, frequently in combination with the promotion activities. In this connection, slight quality deviations are not important and they are completely acceptable. On the other hand, he expects that the products’ and services’ essential features and content be of stable, solid quality. *Ideal Standard* is a frequently cited case in which the European Court of Justice stated that a trademark, in order to perform its function on the market, must offer a guarantee that all the products bearing it are manufactured under the control of a single undertaking which is responsible for their quality. However, the Court emphasized that a decisive factor for the fulfillment of the guarantee function is the existence of the possibility of controlling, but not the actual exercise of that control.

Advertising and promotion of products designated by a trademark make such products known to the public in the same way as the trademark is made known to the public. Therefore, a trademark has also an advertising function. By fulfilling such a function even the trademark itself acquires a certain suggestive force, the force of attraction for consumers. This has become its own value, independent from the value of products and services designated by it. Therefore, the advertising function comprises the own suggestive and attractive force of a trademark. Through its advertising function a trademark has become an instrument for creating the consumer’s need for demand of certain products and services and thereby it actually sells a product in the modern econ-

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12 Gielen has supported this view by mentioning the fact that in the draft of the Trademark Directive from 1980 and 1985, the same declaration didn’t contain the words “in particular”. After discussions, those words were introduced because it was deemed that a trademark had several functions and the origin function is only one of them. Gielen, Charles, Harmonisation of trade Mark Law in Europe: The First Trade Mark Harmonisation Directive of the European Council, in: European Intellectual Property Review, 1992, p. 264.


14 In its decision Swiss Army (BGH GRUR 2001, 240), the German Supreme Court has recognized the responsibility for product quality as a legally relevant fact, when concluding on a particular distinctiveness.

15 See also Lord Nicholls in the Scandecor case: “Although the use of a trademark is based on the buyer’s care for the quality of the product offered, the trademark as such does not guarantee the quality. It is better to say that it indicates that the goods meet certain standards that the trademark holder wishes to sell under his name.” See also e.g. Krneta, Slavica, Prijenos prava na žig u svjetlu savremenih kretanja u usporendom pravu, Godišnjak Pravnog fakulteta Univerziteta u Sarajevu, XXII, 174, pp 161-168, p. 162


17 In the *LOGO* decision (BGH GRUR 2000, 722) the German Supreme Court emphasized that the identification function and the advertising function shall not exclude each other.

18 In the case *Parfums Christian Dior SA and Parfums Christian Dior BV v. Evora BV* case, C-337/95 the European Court of Justice stated the need for the legal protection of the advertising or promotion function of a trademark protecting thereby the owner’s investment in advertising and appearance of a product, by which a better reputation of a trademark is achieved and thereby its value on the market is raised. See also cases listed in: Keeling, David, Intellectual Property Rights in EU Law, Vol.1, Free Movement and Competition Law, Oxford, 2003, p. 158, footnote 33.

19 Fezer, op.cit. p.74.
The more distinctive the trademark is, the more effective its selling power. The advertising function of a trademark has also developed its commercial function, which is expressed by the legal position of a trademark as a good per se. Namely, in certain cases a trademark ceases to serve for designating goods and services and starts to serve for itself. The consumer acquires a product bearing a certain trademark, although he knows for certain that such product does not originate from such source, but he wishes to have such product because it has become equal with the trademark affixed to it. Strengthening of the content of trademark protection has to be attributed to the development of understanding of trademark functions. At the time when a trademark was understood strictly as an indication of origin of a product, the content of the rights conferred by it to its owner was substantially narrower than it is today. The content of rights is also reflected in the possibilities of property right dispositions with a trademark by means of which the economic value of the trademark is multiplied for its owner, and also for other persons having authorization for its use.

3. Undertaking and Goodwill

The possibility of property right disposition with a trademark has always been considered through a prism of the connection between a trademark and an undertaking, taking into consideration its functions. The notion of undertaking has a special meaning in trademark law, although it has been basically taken from competition law. Therefore, this part of the paper will give the definition of the notion of undertaking using its meaning in competition and commercial law.

In competition law, an owner of an undertaking (often the notion undertaking is used to denote the owner of the undertaking) is any subject performing economic activity on the market, irrespective of his or her legal status and financing manner, and irrespective of his or her intention or fact of making profit. On the other hand, an undertaking (Germ. Unternehmen) is, in brief, an economic activity performed by one subject. Therefore, an undertaking is in English legal literature also denoted as business or business enterprise. In this context an undertaking (i.e. business) is a community of assets and persons, or a combination of capital and work, respectively, under a single leadership, focused on the realization of economic goals and showing a common purpose on the market. Such an economic entity has no legal personality, so the owner of the undertaking appears on the market and enters into legal relationships, irrespective of his or her organizational form.

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20 The advertising function appears in particular in endorsement contracts and by co-branding. Here, a trademark is not used to indicate the source, or such a function is not visible at a first sight.
21 Also e.g. Wilkof, op. cit. p.36.
23 Credit for spreading the idea of the need for stronger legal protection of a trademark as an individual intellectual property right at the beginning of the last century is due to a legal writer named Schechter. His doctrine was strongly supported in legal and economic circles. See e.g. Norman, Helen, Schechter’s The Rational Basis of Trade Mark Protection Revisited, in: Dawson, Norma and Firth, Alison (Ed.), Trade Marks Retrospective, Perspectives on Intellectual Property, Vol.7, London, 2000, pp. 191-210.
24 There are also views that legal protection of a trademark can sometimes become counter-productive and in some aspects absurd. Cornish and Llewelyn refer to Judge Edward’s speech in the Audi v. Deutsche Renault case [1993] E.C.R. I-6227 who, when deciding whether the use of the word Quadra constitutes the infringement of the trademark Quattro, stated the following: “Should a motor manufacturer really be able to come to a court to claim a monopoly in “fourness” on the basis that there are consumers who might go into a sale room to buy an Audi Quattro and come out by mistake with a Renault Quadra?” See Cornish, op. cit., pp. 591, 592.
25 See also Cerovac, Mladen, Pojam poduzetnika u pravu tržišnog natjecanja, Hrvatska pravna revija, no. 10, 2005, p. 61, which corresponds to the definition, used in the judgment on the Höfler and Elser v. Macrotroon (1991) ECR I-1979 case. The similar definition of an undertaking is also given by Pošćić, Ana, Pojam poduzetnika u europskom pravu tržišnog natjecanja, Zbornik Pravnog fakulteta Sveučilišta u Rijeci, br.29, 2008. p. 921, in relation to the definition of an undertaking according to European competition law.
26 See also Barbić, Jakša, Pravo društava, Knjiga prva, Zagreb, 1999, p. 196.
financing manner and intended or actual making of profit. But, as said here before, very often the word undertaking is also used to denote the owner of the undertaking.

In commercial law, the notion of undertaking (i.e. business) comprises an economic entity composed of objective, subjective and organizational elements, in other words, it is the community of assets and persons, i.e. a combination of capital and work, focused on the realization of economic goals and joint market appearance. However, an undertaking (i.e. business) has no legal personality, so the owner of the undertaking, i.e. an entrepreneur, who may be a natural or a legal person, enters the legal relationships on the market. This may be, e.g. a company or a sole trader, but also a craftsman or a partnership.

The comparison of the meaning of the notion of an undertaking (i.e. business), as used in competition and commercial law, respectively, basically leads to the same point. In both cases it is an economic entity which consists of assets and persons, i.e. of capital and work, and which appears on the market as an entity performing a certain economic activity (Germ. Unternehmen, Geschäftsbetrieb). An undertaking (i.e. business) itself is not a legal person. The same definition may apply to the notion of undertaking (i.e. business) in trademark law. Connection between a trademark and an undertaking concerns the connection between a trademark and the economic entity upon which the trademark is used on the market. In this sense, the trademark forms part of the undertaking. The notion of undertaking has to be understood very broadly. Among others, an undertaking may also be owned by a natural person dealing with an independent professional activity or freelance activity, e.g. an artist. It needs to be established as a permanent, and not only as a part-time activity with respect to which, on the other hand, it is not relevant whether it is carried out for profit or not. It does not have to be seated inland. Also, sometimes confusingly, the notion of undertaking, especially in European law terminology, means the owner of an undertaking. In this sense, the word undertaking is used in the definition of the sign in Art. 2 of the Trademark Directive. On the other hand, the notion undertaking as an economic entity is used to denote the concept of business in recital 11 of the Preamble of the CTM Regulation.

English law, in distinction from the continental European approach, considers connection between a trademark and the goodwill of an undertaking (i.e. business) in which the trademark is used. English legal writers prefer the notion of business instead of undertaking. Here, between a trademark and a business interferes goodwill. Goodwill represents a property right. It is a concept which should be interpreted according to common law rules. Goodwill and business are not

27 Ibid. Concerning such definition of the notion of an undertaking, Barbić argues that it corresponds to the definition of the notion of Unternehmen in German law, and the notion of fonds de commerce in French law, which means the economic organizational entity, a community of persons and assets (tangible and intangible), oriented towards the realization of economic goals.


29 Contrary to the present understanding, the notion of Geschäftsbetrieb referred to in Article 3/1 and Article 8 Warenzeichengesetz – WZG of 5 May 1936, BGBl II S.134, at the time that Act was in force, differed from the notion of Unternehmen. At the time of the strict application of the principle of accessibility of a trademark to an undertaking, it was considered that not any Unternehmen could acquire a trademark, but only such Unternehmen which had Geschäftsbetrieb based on the actual performance of the activities of manufacturing and processing of goods or trading with them or on the provision of services. See Fezer, op. cit., p. 180. Such a difference vanished after abandoning the principle of strict accessibility of a trademark to an undertaking, i.e. after the entry into force of the Gesetz über den Schutz von Marken und sonstigen Kennzeichen (Markengesetz - MarkenG) of 25.10.1994 (BGBl. I S. 3082; 1995 I S. 156; 1996 I S. 682), last amended 24.11.2011 (BGBl. I S. 2302).

30 Here, the passing-off actions claiming protection against the unfair competition in certain cases and under certain conditions have a particular role.
synonyms, although they are frequently used as such. Goodwill is a property right. On the other hand, a business is not considered to be a property right. The notion of a business comprises the actual performance of the activity of manufacture, processing or buying and selling of goods or the activity of providing services. However, this notion is not of direct importance where the accessority of a trademark is concerned. On the other hand, the goodwill of such a business, as a property right which is protected in the passing-off actions, is of decisive and direct importance.

4. Development of the Principle of Non-Accessority

4.1. Introductory Considerations

A central question as posed and considered, as well as analyzed here in connection with the property disposition with a trademark, is to what extent and how the trademark owner may dispose with a trademark in the manner that the trademark, having regard to its essential function of indicating origin and its other functions, does not become deceptive. Changes in perception of the functions of a trademark have moved the boundaries of considerations concerning the permission of particular forms of dispositions with a trademark.

Throughout history, legal regulations, court practice and, in particular, common law rules in England have provided “brakes” to legal dispositions with a trademark, aimed at preventing the misuse of this monopoly right. In other words, the essential trademark function is to indicate origin, therefore it is reasonable to ask oneself why the monopoly is to be given to a name, a title, or a sign as such, without its connection with the source of goods or services designated by it. On the other hand, a tendency of using a trademark on the market with such an aim – acquisition of a monopoly per se – has been observed. Traditional understanding of trademark law is not in any way well-disposed towards the trademark being profiled as the right per se, as a monopoly per se, but yet, under the modern economic and commercial tendencies such understandings have changed in the European Union.

4.2 The Principle of Strict Accessority

In the period after the industrial revolution commerce spread beyond the borders of the local environment and the local trade associations lost the possibilities to trace the distribution of goods in direct relationship between manufacturers and consumers. In such circumstances a trademark ceased to designate the proprietor or the manufacturer. It became an indication of the source of a product even in such cases in which direct connection between a manufacturer and a consumer didn’t exist any more.

31 See also Morcom, op. cit., p. 363, citing Lord Parker in Spadling v. Gammage states: “The property in the business or goodwill likely to be injured by the misrepresentation.” The notion of business and the notion of goodwill are used as synonyms.

32 One of the best descriptions of goodwill is the one given by Lord Macnaughten in Inland Revenue Commissioners v. Mueller&Co’s Margarine Ltd. (1901) AC 217, 223, HL: “Goodwill is a thing very easy to describe, very difficult to define. It is the benefit and advantage of the good name, reputation, and connection of a business. It is the attractive force which brings in custom. It is the one thing which distinguishes an old-established business from a new business at its first start. The goodwill of a business must emanate from a particular centre or source. However widely extended or diffused its influence may be, goodwill is worth nothing unless it has power of attraction sufficient to bring customers home to the source from which it emanates...Goodwill has no independent existence. It cannot subsist by itself. It must be attached to a business. Destroy the business and the goodwill perishes with it, though elements remain which may perhaps be gathered up and revived again...”

33 Following the harmonization of English trademark law with the acquis communautaire, the House of Lords has posed a question to the European Court of Justice in the Scandecor case to define what is an undertaking referred to in Article 2 of the Trademark Directive. The question has never been answered due to the fact that the plaintiff gave up the case. See Kitchin, op. cit., str. 355.
One of the first cases to appear before the English courts was based on the deceit of the buyer, occurring due to the deceptive use of the plaintiff’s trademark.⁴⁴ Such cases led to the development of a special action in common law and equity law in the mid 19th century.⁴⁵ At the beginning a problem was to define what was actually the subject matter of the protection, having in mind the fact that the idea of a trademark as a property right was still blurred. However, the understanding that a trademark is the property right which was supposed to be exercised by its owner and the protection of which may be sought even against persons having acted in all innocence, gradually developed over time.⁴⁶ In the E.G. Trademark case⁴⁷ from 1973, Lord Diplock explained the legal nature of a trademark as a property right, viewing a trademark from the historic perspective. He argued that a trademark is a right arising from the connection created between a sign and a product designated by it, and from the goodwill resulting from such a connection. Therefore, a trademark cannot be regarded as the right per se, but as the right inseparably connected with goodwill. The view that a trademark is a special type of property right undividedly connected with the goodwill is associated with the understanding that a trademark serves to indicate the origin of a product. It has to be pointed out that the source is considered to be a single, precisely specified source, the goodwill of which is connected with the trademark. This actually means a business.

The function of a trademark as an indication of the source, due to which it had been considered that a trademark was inseparably connected with a business, i.e. with its goodwill, had substantially limited the possibility of legal dispositions with the trademark. If a trademark was to be transferred to another person, it should have been transferred together with the goodwill with which it was connected. It was not possible to transfer a trademark separately, because it could not exist as an individual right. The trademark was accessory to the goodwill, i.e. the business in which it was used.

Also, trademark licenses were not allowed while a trademark was understood exclusively as an indication of the source.⁴⁸ If another person was allowed to use somebody else’s trademark to designate his or her products, the buyer would have been deceived concerning the source. He might think that the product came from one source, while it actually came from another source. In such a way the buyer had associated the product from the second source with the goodwill of the first source. He had bought the product having a misconception about its source. Therefore, it was deemed without exception that trademark licenses should not be allowed.⁴⁹ It was understood that if the product did not come from a source indicated by its manufacturer (or by the person who was first to put it on the market) and at the same time the owner of the trademark (and thereby also of the goodwill), then the public was deceived about the source of the product. It was considered contrary to the public interest to allow the existence of the exclusive rights in the sign which was not connected with goodwill. This would result in the recognition of monopoly in the sign per se, which was contrary to the ideas of that time.⁵₀

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⁴⁴ Sykes v. Sykes (1824) 3 B.&C.
⁴⁵ See Cornish, op. cit., p. 574.
⁴⁷ (1973) RPC, 297, CHL.
⁴⁸ This was at the time when the Trade Marks Registration Act from 1875 was in force. It was amended in 1876 and 1877, and incorporated in the Patents, Designs and Trade Marks Act in 1883.
⁴⁹ The judgment that in English court practice provided the framework for a view that trademark licenses were not allowed was the judgment given in the Bowden Wire v. Bowden Brake case (1914) 31 RPC 385.
⁵₀ See e.g. Kitchin, op. cit. p. 343.
Upon entry into force of the Trade Marks Act 1938\(^{41}\) in the United Kingdom, the situation concerning the accessority of the registered trademark changed tremendously. The essential function of a trademark to designate the origin of a product was transformed, and in particular the function of indicating quality was recognized. Yet, for the very safeguard of such functions, the transfer of a trademark without goodwill should not have made the trademark deceptive. Therefore, all such transfers were supervised by the Registrar. The conditions for the transfer of a registered trademark without goodwill were strict, and the Registrar had a discretionary power to prohibit transfers which could in his opinion deceive the public about the origin of a product. Therefore, although upon entry into force of the 1938 TMA the principle of non-accessority of a registered trademark was introduced whereby the trademark was separated from the goodwill of a business to which it belonged, such a principle was corrected by the rules as described. As regards licenses, the 1938 TMA provided for the system of a registered user. Such a system allowed the same effects as provided by licenses, although the 1938 TMA didn't allow licenses as such. The system of a registered user was also completely conditioned by the understanding of the trademark functions, but such an understanding has slightly been changed. Namely, a trademark indicates the source of a product, but it is understood that such a source is anonymous and that the confidence in such a source may be ensured by controlling the use of a trademark, i.e. by controlling the quality attached to such a trademark in the mind of the buyer. Thus, the function of an anonymous source is now connected with the function of quality. Therefore, the system of a registered user existed on the theoretical interpretation that the use by a registered user is deemed to be the use by the owner himself.\(^{42}\) Such an interpretation created preconditions for the application of the principle of the corrected accessority of a trademark.

A similar situation occurred in Germany, but a couple of decades later. From the entry into force of the *Markenschutzgesetz* in 1874,\(^{43}\) a trademark was an accessory right, completely connected with the business in which it was used.\(^{44}\) The same principle was the basis of WZG from 1936. A trademark was accessory to the business (i.e. undertaking) in which it was used, as regards the creation, the acquisition and the existence of a trademark, and as regards the property disposition with it. For example, according to the provision of Article 8/1 of WZG, a trademark could be transferred to another person only together with the business (i.e. undertaking) or the portion of the business to which it belonged. The German word for the notion of business was *Geschäftsbetrieb*. Any legal disposition performed otherwise was null and void and had no legal effects. Such a strict application of the principle of accessority reflected the contemporary understanding of the trademark function as the indication of origin. As described above, at that time, only the function of indicating the origin was considered to deserve the legal protection. Legal connection between a trademark and the business was determined by the view that the reason for trademark existence as the exclusive right is that it has the function of indicating the origin of a product.\(^{45}\) Therefore, the legal provisions before and after entry into force of WZG did not regulate licenses. Nevertheless, same as in England at that time, the licenses could only be granted indirectly. According to Article 5/7 of WZG, if a trademark was used by a third person having the authorization of its owner, such use was deemed to be the use by the trademark owner.\(^{46}\) According to this point of view the following was understood: if the owner of a trademark had obliged himself not to sue another person who is using his trademark for designation of another person’s products, this would not *per se* result in deception of the public.

\(^{41}\) Hereinafter: the 1938 TMA.


\(^{43}\) *Gesetz über Markenschutz – Markenschutzgesetz* from 1874, RGBl. S.143.


\(^{45}\) Hefermehl, op. cit., p. 502.

which would be legally relevant. In other words, since the licensee had the authorization to designate his products with the licensor’s trademark (i.e. trademark owner) it was deemed that both the products of the trademark owner (i.e. the licensor) and the products of the licensee were actually the products originating from the same source. Therefore, in principle, licenses were indirectly allowed.

A strict principle of accessority of a trademark was significantly moderated by the amendments of the WZG in 1992, when ErstrG entered into force. The purpose of that law was to create a completely unique and integral trademark system for the territory of the whole united Germany. The principle of accessority of a trademark was replaced by the principle of the legal connection between a trademark and a business, i.e. by the principle of corrected accessority. Still, the applicant for a trademark registration had to have a business in which he intended to use the trademark in respect of which he filed the application for registration. However, after the acquisition (and creation) of a trademark, the property right dispositions with it were allowed independently of the business in relation to which the trademark was created.

In Croatia, when the Law on the Protection of Industrial Property from 1922 was in force, a trademark was completely accessory right, i.e. completely connected with the business in which it was used, in terms of its creation, acquisition, existence and expiration (cessation) as well as transfer. Due to the application of the principle of strict accessority, trademark licenses were not allowed. The principle of strict accessority was moderated by the entry into force of the Law on Trade and Service Marks from 1961, where trademark licenses were allowed, but only under the obligation for the licensee to ensure the same quality of the goods or services as provided by the “authentic” source and to clearly indicate the “authentic” origin of a product or a service. In accordance with this, the Law on Obligations from 1978 also included provisions on the licensing contract, which regulate trademark licenses as well. Those provisions reflected the principle of corrected accessority, regulating the licensee’s obligation to control the quality of the goods and services manufactured or supplied under the licensing contract.

### 4.3 The Principle of Non-Accessority

The registration system regulated in the Trade Marks Act from 1994, in comparison with the old system regulated in the 1938 TMA, had substantially relaxed the connection between a trademark and the goodwill of a business (i.e. undertaking) in which it is used. Now, in the United Kingdom, the Registrar has no longer the power or duty ex officio to protect consumers against the trademarks that possibly became deceptive due to the transfer without goodwill or other legal dispositions. A registered trademark is now equally free from the goodwill of the business (i.e. undertaking) in which it is used, both in transfer and in licenses. One of the general principles and

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48 Namely, according to Gesetz über Warenkennzeichen from 1984 (BGBl. Nr.33 S. 397), which was in force in the former Democratic Republic of Germany, a trademark was a non-accessory right, independent from the business (i.e. undertaking) in which it was used in relation to the creation, acquisition, existence and property rights dispositions. See also Fezer, op. cit., p. 174.
49 Zakon o zaštiti industrijske svojine from 1922, Sl.n.69-IX.
50 Zakon o robnim i uslužnim žigovima from 1961, Sl. list FNRJ 45/61.
51 See also Verona, Albert, Pravo industrijskog vlasništva, Zagreb, 1978, p. 162, 163.
53 Hereinafter: 1994 TMA.
54 Also Cornish, op. cit., p. 650, points out that the 1994 TMA does not provide for the official supervision of the transfer of a registered trademark any more. Bently, op. cit., p. 962, points out that the Registrar does not exercise even the minimum control of the transfer. Contrary to this, they emphasize that the Office for Harmonization in the Internal Market has the power to refuse registration of the transfer due to which the Community trademark became deceptive.
55 Morcom, op. cit., p. 295, state that there are no limitations for the transfer of a registered trademark.
aims of the 1994 TMA, as also mentioned in the *Scandecor* case, is to free a registered trademark from "chains" put to it by the legal definitions of a trademark contained in the former laws.\(^{56}\) This principle was also expressed in the White Paper, which preceded the enactment of the 1994 TMA.\(^{57}\) However, the institute of revocation of a registered trademark, provided for in the 1994 TMA on the model of the Trademark Directive, allows deletion of the deceptive trademarks from the register. The revocation institute is available in the case where any registered trademark, in consequence of the use by its owner or by other person acting with his consent, has become liable to mislead the public, in particular as to the nature, quality or geographical origin of the goods or services. This provision could also apply to cases where the trademark was transferred without goodwill, or licensed.

In Germany, the principle of non-accessority of a trademark\(^{58}\) was completely affirmed upon the entry into force of the *MarkenG*. In property right dispositions a trademark is free, except for in one part. According to the provisions of Article 27/2 of the *MarkenG* it is presumed that the transfer of the undertaking (i.e. business) or of a part thereof shall include, in the case of doubt, also the transfer of the trademark used in it. Certain authors will call the provisions of Article 27/2 of the *MarkenG* a relict of the old principle of accessority.\(^{59}\) Consequently, after the entry into force of the *MarkenG* a trademark is said to be an independent part of the undertaking's assets which may be acquired and which may be disposed with independently from an undertaking in which it is used.\(^{60}\)

In Croatia, a trademark was freed from the undertaking (i.e. business) in which it was used by the Amendments to the Law on Trade and Service Marks, enacted in 1974. It has become free in the transfer. Namely, Article 14/1 of that Law expressly provided that a trademark may be transferred without an undertaking (i.e. business). After that, the questions of whether a trademark may be transferred without the undertaking and whether trademark licenses are allowed have not been posed any more. However, in trademark licensing there are still clear legal provisions left, the purpose of which are to ensure the same quality of the goods and services which the licensee puts on the market or provides under the licensed trademark. Some of those provisions are in force even today, in the contemporary Law on Obligations from 2005,\(^{61}\) in spite of the fact that a trademark is a completely non-accessory right.

As regards *acquis communautaire*, there is no doubt that the principle of non-accessority of a trademark has been supported from the beginning of the regulation of trademark law matters at the European Union level. Thus, the Community trademark is independent from the undertaking in which it is used.\(^{62}\) Nevertheless, with regard to the principle of accessoriness, the CTM Regulation

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\(^{56}\) See Kitchin, op. cit., p. 344.

\(^{57}\) From the *Scandecor* decision: "Whatever may have been the position in 1938, the public is now accustomed to goods or services being supplied under licence from the trade mark owner. For example there has been the growth of franchise operations. The potential for deception is therefore less. Moreover the strongest guarantee that a proprietor will maintain control over the way in which his trademark is used is that it is in his own interest to do so. A trade mark is a valuable piece of property, in terms both of its power to attract consumers and of the royalties which can be demanded from licensees. Its value is however ultimately dependent on its reputation with the public. If the proprietor tolerates uncontrolled use of his trade mark the value of this property will be diminished. In an extreme case the registration of the mark may become liable to be revoked if it has become deceptive or generic through such use. It is however the responsibility of the proprietor, not the Registrar, to prevent the devaluation of his own property." See also paragraph 4.36 of the White Paper (Reform of Trade Marks Law, Department of Trade and Industry, Cm.1203).


\(^{59}\) Ibid.

\(^{60}\) Ingerl, op. cit., p. 1319, and Fezer, op. cit., p. 174.

\(^{61}\) Zakon o obveznim odnosima, NN 35/05 i 41/08. About this problem see in details Matanovac Vučković, Romana, Prijenos i licencija žiga u kontekstu prilagodbe hrvatskog prava europskom, Ph diss., University of Zagreb Faculty of Law, 2010.

provides for certain limitations of which their purpose is to protect the public against Community trademarks which became deceptive because of their transfer without the undertaking or other dispositions. Thus the Office for Harmonization in the Internal Market may refuse to register the transfer of the Community trademark, where it is clear from the attached documents that because of this transfer the Community trademark is likely to mislead the public concerning the nature, quality or geographical origin of the goods or services in respect of which it is registered. It follows from the mentioned provision that in fact the Office has a right of discretion to assess whether the transfer of a trademark without the undertaking is likely to mislead the public. It seems to be contrary to the principle of non-accessority. Therefore, the fact that a case in which the Office would have used such a power has not been known is not surprising.

5. Conclusion

For a long time during its existence as a property right, a trademark was accessory to the undertaking (i.e. business) in connection with which it was created and in which it was used. Owing to that, the transfer of a trademark without the undertaking or goodwill was prohibited, and licenses were not allowed. In the transitional period towards a complete emancipation of a trademark from the undertaking (i.e. business), licenses were allowed, but only conditionally. The indirect permissibility of licenses was based on the understanding that the licensee acts under the complete control of the owner of the trademark. The harmonization of the trademark law on the European Union level has led to the complete separation of a trademark from the undertaking, i.e. to the application of the principle of non-accessority. No limitations of the property right dispositions with a trademark, the purpose of which would be to prevent the public being misled as a result of the license or the transfer of a trademark without the undertaking, have been provided for. Whereas today a trademark is multifunctional and whereas consumers do not take it only as an indication of the origin of a product but have attributed to it many other functions, there is no danger of the transfer of a trademark without the undertaking and of licenses. It may not be asserted that an a priori prohibition or control by the bodies maintaining trademark registers would protect the public from deceptive trademarks. Today, the public is aware of the fact that property right dispositions with a trademark take place. At the same time, it is not interested in the precise origin of a product or service, but in a certain quality and other characteristics of the product or service designated by the trademark. Therefore, it is the owner of a trademark and the persons acquiring the right of exploitation in the course of trade who have to take care of the reputation and perception of a trademark.
PROTECTION OF CONSUMERS IN GLOBAL PROCESSES: THE QUESTION OF DOMAIN NAME LAW

by dr. sc. Fatima Mahmutčehajić, Assistant Professor at the University of Sarajevo,
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Abstract

Cyberspace can change the most important determinants of competitive conditions in a market. In living circumstances that emerged with the development of cyberspace, concepts of traditional understanding of politics, culture and economy, as well as law, assume new contents. Therefore, understanding these new contents of traditional concepts is a pre-requisite for including them into the area of domain name law. Regardless of the view on these concepts, whether it is a synthetic or analytic one, it cannot bypass the concept of “consumer” and issues related to their protection in these new circumstances. The starting assumption of the paper is that at present the domain name most powerfully mediates between two spheres, that of the manufacturer resp. merchant’s, and that of the consumer. Since the manufacturer/merchant – consumer relationship requires regulation that would protect interests of both parties, the domain name is entering all areas of modern life as a new concept with a very broad semantic field, and is thus becoming relevant for both practice and theory of law.

Key words: consumer, domain name, cyberspace, consumer protection, mala fide actions

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PROTECTION OF CONSUMERS IN GLOBAL PROCESSES: 
THE QUESTION OF DOMAIN NAME LAW

1. Introduction: legal heritage and challenges in cyberspace

Expansion of industrial production over past centuries, which is inseparable from science and technology development, results in a change in the classic manufacturer – merchant – consumer relationship. Multiplication of the scope and kind of production, which implies parallel needs for a wider and more complex trading network that includes market expansion, leads to a paradox in which the consumer becomes the target of increasingly powerful manufacturers and merchants who have, at their disposal, financial, technological and other means of presenting their offer. Thus the consumer becomes an object which is the target of activities by increasingly powerful manufacturers and merchants operating on a transnational scale.1

Social and political stability in such a development depends, among other things, on recognizing, articulating and implementing consumer protection as the weakest spot in this development whole. Systematic dealings with this issue in legal theory and practice started in the late 19th century, and its development accelerated over the 20th century. Particular changes in this area took place at a time when cyberspace categories started almost explosively spreading to all areas of life.

In living circumstances that accompanied cyberspace development, concepts of traditional understanding of politics, culture and economy, and thus law as well, assume new contents. Therefore, understanding these new contents is a prerequisite for including them into the area of domain name law. Regardless of the view on these concepts, whether it is a synthetic or analytic one, it cannot bypass the concept of “consumer” and issues related to their protection in these new circumstances. A kind of obvious divergence – legal theory and practice that has been acquired through centuries can not be understood without national jurisdiction, on one side, and cyberspace within which all traditional space and time boundaries have been transcended, on the other side – has to be resolved with new theoretical achievements under a multidisciplinary approach to the theory and practice of law.

A domain name most powerfully mediates between two spheres – that of the manufacturer resp. merchant, and that of the consumer. Since the manufacturer/merchant – consumer relationship requires regulation that would protect the interests of both parties, the domain name is entering all areas of modern life as a new concept with a very broad semantic field, and is thus becoming relevant for the practice and theory of law as well.

In this research paper, the different ways in which companies establish their presence, represent themselves, and conduct their business via the Internet are investigated and described, as is the need to improve existing and develop new legal arrangements in Bosnia-Herzegovina. This is done through a combination of general and specialized legal research methods. This investigation, formally concluded in 2010, is justified by the accelerating pace of development of the Internet and of online business, which is related to an increasing number of regulatory and legal issues.

2. Consumer protection in cyberspace

Internet possibilities affect both a change in the way of doing business and the entire economy, which implies all the related areas of law. New problems arise that the legal system has to deal with, including cybersquatting. As early as 1999, the Anticybersquatting Consumer Protection Act (Anticybersquatting Consumer Protection Act, ACPA)\(^2\) was passed in the USA. It was intended to

“…protect consumers and American business subjects (…) by prohibiting bad faith and abusive registration of recognizable signs (names, firms and/or trademarks) as Internet domain names with the intention of profiting from clients related to these signs – a practice typically referred to as cybersquatting”\(^3\)

The Act prohibits registration of one or more domain names similar to a recognizable name, firm and/or trademark with the intention of profiting from the holder of this name, firm and/or trademark. Thus, for instance, Warner Brothers was required to pay US$350,000 for the right to domain names “warner-records.com”, “warner-bros-records.com”, “warner-pictures.com”, etc. A cybersquatter registered “911porche.com”, and offered the name for US$60,911. Other companies also encountered such attacks by “entrepreneurial” individuals. Gateway Computers paid US$100,000 to a cyber-pirate for the “gateway20000” domain name after that person had posted pornographic content on this website.\(^4\)

Other cyber-pirates, trying to increase the number of visits to their websites and thus increase their advertising revenue, registered domain names with the intent to capitalize on the possibility of users’ mistakes in typing web addresses, which is known as typosquatting. For instance, a cyber-pirate registered “dosney.com” attempting to attract visitors who try to find the Walt Disney website. Parents were shocked when their children erroneously typed “Disney.com” and entered a site showing hard pornography.\(^5\)

In broader terms, the goal set in the Anticybersquatting Consumer Protection Act (ACPA) is to decrease consumer confusion about the source and sponsorship of an Internet website. Consumers would thus be provided with a degree of reliability that, when visiting a site – for instance, site www.chanel.com – they would find products that correspond to that company rather than something entirely different. It was also intended to protect holders of the name, firm and/or trademark from losing consuming clients, which could be due to different use of their names, firms and/or trademarks in order to trade in bad or dishonest goods or services.\(^6\)

Within two weeks of passing the Anticybersquatting Consumer Protection Act three legal proceedings were initiated. Namely, the New Zealand America Cup team received a temporary restraining order on the use of the americacup.com domain as their website. Harvard initiated legal proceedings against registrants of various forms of the domain name that included the Harvard trademark, including the Harvard-lawschool.com. The National Football League initiated proceedings against Ken Miller, registrant of the NFLtoday.com domain.\(^7\)

\(^3\) http://www.chillingeffects.org/acpa/faq.cgi#QID33.
\(^7\) http://cyberlaw.harvard.edu/property00/domain/legislation.html.
According to Directive 2005/29/EC concerning unfair business-to-consumer commercial practices in the internal market⁹, ‘consumer’ means any natural person who, in commercial practices covered in the Directive, is acting for the purposes which are outside his/her trade, business, craft or profession.¹⁰ Consumer protection is of crucial importance for all participants in the international order, and is thus a factor of safe and stable business in cyberspace.

Laws in member states pertaining to bad faith commercial practices reveal differences, which can result in significant disabling of competition and barriers to unimpeded functioning of the internal market. Directive 84/450/EEC¹¹, which was amended by Directive 97/55/EC¹² concerning misleading and similar advertising, establishes the minimum criteria for harmonizing the misleading advertising legislation, although member states are not prevented from keeping or adopting measures that ensure more comprehensive consumer protection. Consequently, ways of regulating this area considerably differ across individual member states.

Directive 2000/31/EC on electronic commerce¹³ provides prerequisites for preventing or minimizing possible confusion and/or abuse of information means in cyberspace. Thus, Article 6 of Chapter 2 of the Directive provides for the following:

“In addition to other information requirements established by Community law, Member States shall ensure that commercial communications which are part of, or constitute, an information society service comply at least with the following conditions:

a) the commercial communication shall be clearly identifiable as such;

b) the natural or legal person on whose behalf the commercial communication is made shall be clearly identifiable.”

3. Consumer law and domain name: advantages and risks

Cyberspace can change the most important determinants of competitive conditions in a market. The first determinant includes the price of developing a product and then entering a given market by becoming a manufacturer. The second is the price of becoming well-known or gaining access to customers, through the ability to enter large areas of potential consumers. Cyberspace allows and encourages unique products, direct links between consumers and manufacturers, adjustable

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working arrangements, and simple entry among competitors across the world in an equally spread market.\textsuperscript{14}

Ways of doing business may be separated from fixed locations, offices and plants. At this time, it is not certain if cyberspace will become a new expansion, a space for democratic implementation of human aspirations, or simply another infrastructure that makes existing companies still more efficient.

By definition, national law is limited to a given territory and is not applicable outside this territory. Firms planning to use cyberspace must take informed steps and keep trying to control the scope of their interactions with other modalities.

The use of cyberspace for delivering goods and services and selling physical objects keeps increasing. With this trend, information technology is expected to drive economic growth over many years in the future. Progress in information and communication technology facilitated the development of new products and art forms, and their multiplication and distribution.

The greatest benefit provided by the digital economy is the universal availability of knowledge. Doing business using all the available possibilities of modern technologies allows for numerous advantages, but it also imposes a similar number of traps. Those who understand the impact of new laws, regulations and rules on business issues can avoid serious traps. Cost efficiencies and improvements in consumer positioning promote cyberspace expansion into the area of sales. Issues such as ownership rights, access, accuracy, privacy, confidentiality, responsibility and equality pose challenges to future forms and directions of development in the digital age. The electronic market must be competitive and transparent to ensure consumers’ ability to fully understand the value of goods and services before they buy them.

Electronic commerce development is not possible without regulatory liberalization of the communication network environment. Competition has opened new possibilities for new economic players. A great number of new kinds of business ventures, which try to make use of possibilities created by the Digital Revolution, put pressure on the already existing authorities of supervision and regulation whose main task includes the protection of consumers and citizens’ interests.

The question of domain name as a crucial factor of a firm’s entry into cyberspace cannot be answered beyond the above described trends and dilemmas. For each potential or existing participant in electronic commerce, domain name is the clearly personified presentation to potential partners or customers. For the domain name to correspond to its holder’s intention, its articulation implies taking into account the described possibilities and limitations.

A customer or service user identifies the domain name with its holder’s business, which has been planned and developed over a number of years. Thus the choice of a suitable domain name is decisive for business success. A domain name should reflect the company name and thereby describe the offer of goods or services. However, the domain name should be as short as possible for a customer or user to be able to remember it simply.

Having in mind the position and role of domain names in the overall modern political, economic and cultural relations, it can be concluded that the issue of regulation in the broadest sense presently includes this concept, as well as a new content of traditional practice and theory. Its presence includes a whole entity, starting from an individual involved in different forms of exchanges and exercising their rights, all the way to international relations at the highest level. Old and new conflicts of interest and the need for harmonizing transactional relations are reflected in the domain name and through it.

4. *Mala fide* actions in cyberspace

No matter how minimized differences between individual states’ regulatory systems may be, possibilities of acting in bad faith will not be eliminated. Harmonization of the ways for opposing such actions and resolving disputes when they have occurred is an enduring process, the completion of which cannot realistically be predicted in a perfect Internet order. It is therefore important to derive general conclusions about bad faith occurrences and ways in which they would construe from basic elements in the complex manufacturer-consumer relationship in cyberspace.

In a simplified picture of seller and buyer, i.e. manufacturer and consumer, it is possible to talk about the relationship between the manufacturer as a subject and the consumer as an object. The subject’s interest is to make the object as connected to him as possible, and drive him away from as many of its competitors as possible. Due to the fact that such a subject can have huge financial resources at their disposal, and the resulting ways of using and organizing resources in cyberspace, its effects on the consumer, achieved with the aim of getting maximum profit, also assume numerous new contents in cyberspace. Consumer protection from different forms of *mala fide* actions of the kind is becoming an increasingly complex problem with the expansion and improvements in cyberspace business.

In order to point out different possibilities of bad faith actions and possible legal responses to them, the case *Louis Vuitton Malletier v. J.N. Prade* will be presented in the paper. The plaintiff in the case is Louis Vuitton Malletier of France, while Dr. J.N. Prade of the United States of America is the defendant. The domain name which is the object of dispute is “louisvuiton.com”, registered on 18 March 2000.15

The disputable domain name is associated with the website that gives a page of text, in both French and English, where the Defendant ridicules the Plaintiff and their products. The following excerpts from the text in English demonstrate the tone and content of the document:

“LOUISVUITON is the proud sponsor of The “Louisvuiton Cup” for the world’s largest mule shit. The “Louisvuiton classic” a race for very old mules (10 years and older), ridden by very old ladies (80 years old and older)” or ‘We offer the following mules at outrageous prices in line with Rolls Royce® and Ferrari®.”

The Plaintiff claimed that the Defendant had registered the domain name which is identical or at least similar to a point causing confusion with the trademarks of the products or services over which the Plaintiff holds rights. The Plaintiff claimed that the domain name must be considered to have been registered and used in bad faith. With this respect, this allegation was supported by the fact that the web page to which the domain name was connected contained a link to the web site of Gucci, one of the most important competitors of the Complainant. This link could therefore cause a disruption for the Complainant’s activities.

Within the debate on the case, the administrative panel concluded that “Louis Vuitton” is the Plaintiff’s registered trademark, and that the domain name “louisvuiton.com” is confusingly similar to the Plaintiff’s trademark. The Administrative Panel concluded that the Defendant’s goal was to target specifically the Plaintiff’s business and to lead its potential customers to a major competitor, the Gucci company’s web site. In accordance with this and other facts, the Administrative Panel made the following decision:

“that the domain name “louisvuiton.com” registered by Respondent is confusingly similar to the trademark of Complainant; that Respondent has no right or legitimate interest in re-

spect of the Domain Name; and that Respondent registered and used the Domain Name in bad faith. (...) It is required that the registration of the Domain Name “louisvuiton.com” be transferred to Complainant.”

The described cases show that the fight for market and attracting consumers assumes different forms in cyberspace, demonstrating the necessity for regulatory procedures that would prevent or minimize unfair competition to protect market competition subjects and allow consumers to achieve their best interests within fair competition between manufacturers and merchants. It is not possible to achieve this goal without including domain names in almost all the related procedures. The established regulatory elements include legal premises that take into account these elements of competition and consumer protection.

Without these legal premises it is not possible to regulate consumer protection in distance commerce in any country involved in international commerce. The Law on Consumer Protection in Bosnia and Herzegovina was passed in 2006. It includes the issue of commercial communications, which means the issue of consumer protection within cyberspace. This category is defined as distance negotiation. Act 44 of Chapter X, “Sales based on distance contract” of the Law defined prerequisites and conditions for signing distance contracts:

“(1) Before signing a distance contract, a merchant shall, by means of distance communication, inform the consumer on the following:

a) merchant and supplier’s name, identification number and full address, tax number, phone and fax numbers and e-mail address, if there is one;
b) product or service’s name, and the name under which the product is sold;
c) main features and uses of the product or service;
d) price and all additional costs for the consumer, including all taxes;
e) any other costs including delivery costs;
f) method of payment, and the way and anticipated time of delivering the product or providing the service;
g) conditions for the fulfillment or termination of contract;
h) data on warranties and after-sales services (servicing and spare part sales during and after the warranty term, etc.);
i) right to and term for withdrawing from the contract, except in cases from Article 48 of the Law;
j) period (option) which applies to the offer or price;
k) shortest term of the contract, in case of uninterrupted or regular recurring protection;
l) court jurisdiction and application of given material law in case of dispute.

(2) Information from paragraph (1) of this Article should be unambiguous, clear, easily understandable, adjusted to the means of distance communication, with adhering to good faith in commerce, good business practices and principles that regulate protection of minors and other persons who are not authorized to give their consent for the purchase.

(3) During distance sales using means for distance communication, at the start of each communication the merchant shall communicate its identity and clear commercial intent.”

17 Law on Consumer Protection in Bosnia and Herzegovina, Official Gazette of Bosnia and Herzegovina, 25/06.
Since the described obligations are general, every manufacturer and goods and services merchant present in cyberspace has subjectivity equal to that of any other competitor. Thus the consumer, before entering a business relationship with a manufacturer or merchant can, in cyberspace, simply obtain information on the demanded goods or service and make a decision in line with his best interest. It can be said that cyberspace allows the consumer to use communication relations between manufacturers and merchants more efficiently, as well as manufacturers and merchants to approach potential consumers in a more reliable, fast and comprehensive way.

Domain name is an essential content of these new relations, since it is a crucial factor of a manufacturer or merchant’s presentation, their identification as a subject of market relations, and thus their accountability for all the activities they start and conduct in cyberspace. On the other hand, domain name is an indirect address that provides consumers with necessary information and guarantees on the subject they are entering a relationship with, with financial and legal consequences.

The conclusions on the position, role and significance for the relations between manufacturers, merchants and consumers highlight the desirable and regulated mutuality between all the involved parties. However, it is clear that these more complex and efficient possibilities offered by cyberspace also have another side – more numerous and complex bad faith actions, which threaten fair competition and consumer rights. It is this that confirms the necessity for developing domain name law as an essential factor of regulating all the contents of political, economic and cultural presence in cyberspace.

5. Conclusions

Since traditional borders of jurisdictions assume new meanings in cyberspace, and since physical location of a subject does not necessarily correspond to its name and location in cyberspace, actions and behaviors in Internet transactions transcend borders of all traditional jurisdictions. Besides, the anonymity of cyberspace transaction participants can be complete, which means that the existing instruments of imposing regulations frequently do not apply to cyberspace. Domain name is crucial for identifying Internet transaction participants. Although it is regularly associated with the subject involved in the online world, domain name is not necessarily associated with its legal subjectivity as well, and it therefore cannot be subjected only to existing legal solutions.

Based on the analysis of past experiences in electronic business, it is obvious that the fight for market and attracting consumers assumes different forms in cyberspace. It results in the necessity for regulation and supporting appropriate procedures that would prevent or minimize unfair competition, protect market competition subjects, and allow consumers to achieve their best interest within fair competition between manufacturers and merchants. It is not possible to achieve this goal without including domain name in almost all related procedures, which means it is necessary to articulate domain name law as a discipline with theoretical and practical implications. The established regulatory elements include legal premises that take into account elements of competition and consumer protection.
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THE DIGITAL REPRODUCTION RIGHT IN MACEDONIAN COPYRIGHT LAW

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Abstract

The paper analyzes the modernized reproduction right in Macedonian copyright law, and some of the most relevant issues in its digital application. The definition of this exclusive right, which was modeled after the main international treaties and EU legislation, has a wide scope that covers almost any activity on the Internet. On the other hand, the scope of exceptions is limited. The three most affected exceptions in the digital environment are those for temporary reproductions, for private copying and for interoperability of computer programs. The three-step test that serves as a frame for the exceptions takes into account only the interests of the right holders. The analysis reveals that the technological protection measures are the main obstacle for the exercise of the exceptions. These measures were introduced as a response to the new technologies, to give right holders better control over the digital use of their works. The possibilities to prevent the access or the copying of works place the balance too much in favor of right holders at the expense of the users, which is evident from numerous cases and complaints concerning the restrictive licensing terms under which digital works are offered online. In addition, the activities in the digital realm often entail the simultaneous use of several rights, including the right of reproduction and, most often, the public communication right. This overlap makes the rights management more difficult. It is hard to envisage how this right will develop in the future, but there are proposals to introduce an access-right to take into account the users' interests. In any case, the digital right of reproduction needs to become more flexible and balanced.

Key words: exceptions, Internet, interoperability, private copying, technological protection measures, temporary reproductions, three-step test

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THE DIGITAL REPRODUCTION RIGHT IN MACEDONIAN COPYRIGHT LAW

1. Overview of the Reproduction Right

The right of reproduction is perhaps the single most important economic right of authors and other right holders. Its importance stems from the fact that it is the oldest of the range of rights granted by contemporary legislation. In fact, historically, the right of reproduction was the reason for the creation of rules protecting authorship, and the term “copyright” itself implies that. From today’s perspective this term appears outdated, considering the level of evolution and the scope of modern copyright law, but it reflects the starting point of the copyright legal regime - to give control to authors over reproductions of their works. The Berne Convention laid out the basic elements and exceptions that make up its definition worldwide, including the one that can be found in Macedonian legislation.¹ According to Article 9, paragraph 1 of the Berne Convention, this right is granted to authors of literary and artistic works as an exclusive right to allow reproduction of their works “by any means and in any form”. Paragraph 2 contains an enabling provision allowing the countries to determine exceptions in the form of strictly defined cases of reproduction without the author’s authorization, subject to the conditions set out in the three-step test: the reproduction must refer to certain special cases, must not be in conflict with the normal exploitation of the work, and must not unreasonably prejudice the legitimate interests of the author. The last paragraph 3 states that any sound or visual recording shall be considered to be reproduction.

The importance of the right of reproduction additionally comes from the fact that it is at the core of almost any activity involving copyright use. This especially applies to the use of copyright works on the Internet and through digital media. The technological evolution has had an adverse effect on the exercise of the reproduction right, primarily due to the reduced costs for reproducing digital works. One of the most frequent activities on the Internet that we engage in on a daily basis, downloading music, movies or games, in the legal world means making reproductions of those works on the computer’s hard disk. Hence, it is no wonder that much of today’s debate and the case law involving Internet copyright violations are centered around the right of reproduction. This paper will shed light on the Macedonian copyright law provisions dealing with the reproduction right in the new digital circumstances, and the issues that may arise in their application.

1.1. The “Digitalization” of the Definition of the Reproduction Right

Macedonian Copyright Law (MCL) is drafted on the basis of the main international instruments and EU legislation.² In that sense, the international context cannot be overlooked, especially

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1.1.1. The WIPO Treaties

The modern “digitalized” approach to the reproduction right was attempted with the WIPO “Internet” Treaties of 1996, whose purpose was to respond to the challenges posed to the copyright system with the dawn of the digital age. In the course of drafting the Treaties it was concluded that the wording of the right of reproduction present in the Berne Convention is wide enough to cover digital reproductions. Therefore, this right was not specifically covered within the WIPO Copyright Treaty (WCT). Furthermore, it was agreed to improve the protection granted in the WIPO Performances and Phonograms Treaty (WPPT) by giving performers and phonogram producers an exclusive right of direct or indirect reproduction, by any means and in any form. However, it was difficult to agree upon the wording of an exception for temporary or incidental forms of reproduction. To avoid doubt as to whether the right of reproduction applies to the digital use of works, Agreed Statements were adopted for both treaties, according to which the right and its exceptions shall apply fully in the digital environment, especially when using works in digital form, and that it shall be considered that “the storage of a protected work in digital form in an electronic medium constitutes a reproduction.”

1.1.2. The influence of EU Directive 2001/29

In EU legislation, the definition of the reproduction right has evolved gradually in the various directives, but it was “codified” in the EUCD, which was taken as a model in the drafting of Macedonian provisions. The right of reproduction is defined as an exclusive right “to authorize or prohibit direct or indirect, temporary or permanent reproduction by any means and in any form, in whole or in part.” It applies to authors and to related right holders (performers, phonogram producers, film producers and broadcasting organizations).

1.1.3. The Definition in Macedonian Copyright Law

The right of reproduction in MCL is defined as one of the economic rights. It is an exclusive right of the author, giving him the authority to allow or prohibit any use of his work or copies thereof by third parties, except in the cases defined by law.

The reproduction right is defined in Article 28 as fixation or recording “of a copyright work onto a material or other appropriate medium, as well as making one or more copies of the work, in

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4 WPPT Articles 7 and 11.
5 Agreed Statement concerning Article 1(4) of WCT, Agreed Statement concerning Article 7, 11 and 16 of WPPT.
7 Article 2.
8 Article 2 a-e.
9 Article 26 -27.
whole or in part, directly or indirectly, temporarily or permanently, by any means and in any form”. It is obvious that the elements of the definition are the same that are present in the EUCD. Like the EUCD, the formulation is a conundrum of phrases taken from various instruments, such as “direct or indirect”, “temporary or permanent” reproduction, “by any means and in any form”, “in part or in whole”. The meaning of these elements can be stretched, which makes the reproduction right especially strong and wide-scoped in the digital context. The Article gives several examples of “means” of making reproductions, but this list is not exhaustive. Reproductions, according to the Law, are made in particular by graphic processes, tridimensional copying, photocopying and other photographic processes achieving the same effect, construction or building works of architecture, sound or visual recording, storage of the work in electronic form (electronic fixation), and transferring the work from analogue onto a digital system. The last three means are the most digitally relevant, though even without their mentioning the definition of the reproduction right, especially the phrase “by any means and in any form” is wide enough to integrate them.

The Law specifies that the reproduction refers to works fixed in a material or other medium. This would cover digital reproductions of the work, but to avoid any doubt the legislator makes this explicit by specifying that the phrase “appropriate medium” includes electronic or other media.

The exclusive right is enjoyed by:
- authors, with respect to their works;
- performers, with respect to recordings containing their performances;
- phonogram producers, with respect to their phonograms;
- film producers, with respect to their videograms;
- broadcasting organizations, for recordings containing their broadcasts;
- publishers, in certain cases determined by the law;
- database developers, with respect to reproduction/extraction of copies of the database or essential parts thereof.

Having laid out the elements of the reproduction right, it can be observed that, from the initial definition covering “direct or indirect” reproductions “by any means and in any form” in the Berne Convention, the present right of reproduction has come a long way, and its digital application raises several issues. Many problems arise in connection with the exceptions to the right of reproduction. Their scope seems to be restricted in the digital age. This situation is made worse with the application of the three-step test that is not suitable for the new circumstances. The most problematic aspect for the exercise of this right and the exceptions thereof is the application of technological protection measures (TPMs), the new tool for direct control given to the right holders. In the digital environment, the right of reproduction covers practically every use of the works, even in situations where similar activities in the analogue world (such as reception of a TV signal or reading a book) would be completely outside of the scope of copyright protection. This entails the overlap of various rights, especially the right of reproduction and public communication. The analysis of these issues provides a picture of the discrepancy between the law and the dynamic cyber reality.

2. Digital Issues Concerning the Reproduction Right

2.1. The Exceptions in the Digital Space

MCL provides for several exceptions to the right of reproduction, most of which are for the benefit of the public interest. Those that are most affected in the digital environment are the exception for temporary reproductions, the private copy exception and the exception for decompiling, which is specific to computer programs.

2.1.1. Exception for temporary reproductions

The Law, following the EUCD, provides for an exception for temporary reproductions as part of a network transmission. It is situated among the exceptions concerning use without remuneration, which include the usual public interest justified exceptions (for the benefit of libraries and other public institutions, special needs persons, educational purposes, informative purposes etc.). The copyright work can be used without remuneration in case of "temporary reproduction of the copyright work, where the reproduction is of transient or incidental character and/or is an integral and essential part of a technological process". Two cumulative requirements are placed on the reproduction - the reproduction should not in itself be of an independent commercial significance, and its only purpose has to be to enable the transmission of data over a network between third parties through an intermediary or to enable the lawful use of the work.

This exception applies to activities such as browsing and caching on the Internet. Hence, it is an exception of predominantly technical character that the legislator considered necessary due to the expanded definition of the right of reproduction that covers “temporary reproductions” by any means or in any form. There is a dilemma if the activities that fall under the exception can be considered to be reproductions at all, and if so, whether they should be covered by a separate exception or be contained as a restriction within the concept of reproduction itself - by specifying that such acts of temporary copying are not reproductions. Instead of introducing a separate exception, these activities could have been left to the judicial reasoning in individual cases. Furthermore, it is unlikely for such cases to lead to disputes, since the right holders are reasonable enough to avoid unnecessary court procedures. However, this was not the case in the past and, although there is no international basis or obligation to introduce this exception, the EU has introduced it in fear that its members might give various interpretations to the right of reproduction. Its inclusion into the MCL in any case is positive, as it is better to give precise guidelines to the judges in the law instead of leaving its interpretation to depend on their level of understanding of the digital technologies.

Concerning what constitutes “lawful use” of the work, since the formulation is taken from the EUCD, the Directive gives guidelines in Recital 33, stating that the “use should be considered lawful where it is authorized by the right holder or not restricted by law”. So this exception would cover uses allowed by the right holder, including those that are covered by exceptions defined by

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12 Article 52 paragraph 1.
13 Bernt Hugenholtz, Mireille Van Eechoud, Stef Van Gompel, Lucie Guibault, Natali Helberger, “The Recasting of Copyright & Related Rights for the Knowledge Economy”, Report prepared for the European Commission, 2006, available at http://ec.europa.eu/internal_market/copyright/studies/studies_en.htm, p.68. This issue appeared in the negotiations for the WIPO treaties in 1996. There was no agreement to include such exception in the definition of the right of reproduction, and this issue became so disputable that it resulted in the whole provision on reproduction being deleted from the final text of the WCT altogether.
15 Hugenholtz et al., supra f. 13, p. 69. See the US case MAI Systems Corp. v. Peak Computer, Inc., 991 F.2d 511 (9th Cir. 1993) where the court took the stand that temporary reproductions stored in the computer’s RAM memory violate the exclusive right of reproduction.
law. If this is the correct interpretation, then the phrase “lawful use” is not necessary at all, as such uses would be legitimate regardless of this exception. Some authors suggest that the only logical interpretation of this phrase would have to assume certain uses that fall outside of the mentioned categories, but are still considered lawful, although it is even more confusing what would be included in those types of use.\footnote{Zohar Efroni, “The Digital Reproduction Right” (January 19, 2011), in ACCESS-RIGHT: THE FUTURE OF DIGITAL COPYRIGHT LAW, p. 203, OUP 2011. Available at SSRN: http://ssrn.com/abstract=1743506, p. 244}

Another practical problem is that this exception does not apply to computer programs.\footnote{Article 51 paragraph 3.} Considering the process of digital convergence that results in multimedia works and services that incorporate “traditional” types of works and software, there is also a need to cover computer programs with this exception.

### 2.1.2. Private copy exception

Another exception relevant to the digital use of works is the private copy exception, especially in relation to music and audiovisual works. In the national legislations private copying is usually allowed under an exception, whereas the right holders have the right to remuneration that is paid from the sale of blank media or recording equipment. The key requirement is that the copying must be of a non-commercial nature, which means it must not generate profits for the user and must be for his own needs.

In Macedonian Law this exception is determined with Article 54, which lists two cases of use against payment of remuneration. The first case concerns reproductions on paper by photocopying, and the second concerns “reproduction on any carrier made by a natural person for private use, without direct or indirect commercial purpose.”

A correlative provision is Article 39 that defines the scope of the so-called “other rights” of the author. One of those rights is the right of remuneration from reproductions for private use. This right is regulated in detail in Articles 46-48. This right cannot be subject to waiver, disposal or judicial enforcement over the copyright. The remuneration for copies of phonograms and videograms is paid upon the first sale or import of devices for sound and visual recording, or other devices that allow achieving the same effect, and new blank sound and/or image carriers. Apart from the author, other subjects that have right to a portion of the remuneration are the performers, phonogram producers, film producers and publishers.\footnote{Article 105 paragraph 3, Article 111 paragraph 5, Articles 114 and 116.} The remuneration for private copying is shared among these subjects in the following way: for phonograms or videograms, the authors receive 40%, the performers 30% and the producers also 30%; for private copying on paper or other carrier the authors and the publishers receive 50% each.\footnote{Article 145.} The producers and importers of recording devices and of blank carriers have the duty to make payment of the remuneration and to provide information to the relevant collecting society on the type and number of sold or imported devices and carriers. The amount of remuneration should be determined by the Government of the Republic of Macedonia, according to the general criteria given in the Law.\footnote{Article 48.} So far, the Government has not adopted a regulation, so practically these provisions are only alive on paper.

The right of remuneration for private copying can be managed individually or collectively. It is listed among the rights that may, in particular, be managed collectively.\footnote{Article 131 paragraph 8-9.} It is positive that this is
given as an option rather than as a mandatory provision, as it should give the right holders freedom to decide whether they, in fact, want to collect the remuneration or not. However, a problem remains that the right cannot be waived according to the Law, so practically the right holders don’t have a choice on this issue. This can be a problem, having in mind that many authors choose to distribute their works on the web by using the Creative Commons licenses, some of which contain clauses stating that the use of works is allowed without remuneration.

The traditional justification for this exception was that the right holders cannot control private copying done in the homes of the users. Therefore, it was considered more efficient to legalize private copying, giving in return the right of remuneration to right holders for the economic loss. Among others, the remuneration system should make this exception compatible with the three-step test. However, in modern circumstances the right holders have mechanisms, such as technological protection measures, to exercise the reproduction right and control more directly the activities of users. The creative industries use the benefits of the Internet to offer their services directly to the public, including services such as Internet music streaming, or downloading of songs against payment. They claim that the private copying exception prevents the development of the digital market and new business models for distributing copyright content.

Therefore, the role of this exception in digital circumstances is put into question. First of all, it is disputable if this exception can pass the three-step test at all. Its interpretation in light of the test can produce varying results. In the digital environment where users can make perfect copies, private copying doesn’t seem to be a “special case”, and it is even less in accordance with “normal exploitation”. On the other hand, the non-commercial character of copying and remuneration are aimed at fulfilling the second and third step of the test. If we take into consideration the need for wide social availability of the works to fulfill the public interest goal that is entrenched in copyright law, this exception is no less aimed at fulfilling that goal at the end of the day, so it can be considered that it does not have an adverse commercial effect on the market for normal exploitation of the work.

The EUCD establishes a de minimis rule in Recital 35, according to which “in certain situations where the prejudice to the rightholder would be minimal, no obligation for payment may arise”. Examples of such use are the recording for later viewing (time shifting) and transfer of content from one medium or device onto another (space shifting). In this context, a problem arises with the definition of reproduction in the MCL that, among other means of reproduction, explicitly mentions “transferring the work from analogue onto a digital system”. This is far-fetched, considering that reproductions for purposes of time-shifting or space-shifting are both considered to be acts taken for private purposes that don’t violate the right of reproduction. This has been established in

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22 Roger Knights, “Limitations and Exceptions under the “Three-Step Test” and in National Legislation – Differences Between the Analog and Digital Environments”, Regional workshop on copyright and related rights in the information age, 2000, WIPO/DA/MVD/00/4/WIPO, point 42.
particular in American case law, with cases such as *Sony* for time-shifting, and *RIAA v. Diamond* for space-shifting use.27

An important limit of the private copy exception, and of the other exceptions to the right of reproduction, is the possibility for the exceptions to be set aside by contractual provisions. There is no provision in MCL that would prevent such situation. In this context, the biggest obstacles on the Internet are the technological protection measures that, in combination with electronic licenses, can effectively disable this as well as the other exceptions.

These factors minimize the importance of this exception in digital conditions. This is problematic for two main reasons. First, because private copying is sometimes only the means for the user to use other public interest exceptions. Second, it is an important prerequisite for enabling further creativity and authorship. That does not mean that copying over the Internet should be free, but there needs to be a wider margin for its use.

2.1.3. Interoperability exception

There are special provisions in MCL concerning computer programs, which cover the reproduction right and the exception for decompiling.28 The goal of the decompiling exception is to enable interoperability of two or more computer hardware devices or software components, as well as exchange of data. This applies to those from different developers, and is of key importance for competition, technological innovations and the entry of new actors in the IT market.

According to the exception, the authorization of the author is not needed for reproduction of the code or its modification, if it is necessary to obtain information to achieve interoperability of independently created computer program with other programs.29 These acts are subject to the conditions that they be carried out only by a license holder or other lawful user or a person authorized by them, that the information has not been previously available to that person and that such acts are only limited to those parts of the original program that are necessary to achieve interoperability.

However, the provision does not allow for the information obtained for the purpose of interoperability to be used for other purposes, to be given to third parties except if necessary to achieve interoperability, or to be used for development, production or commerce of another computer program that is substantially similar in its expression, or for any other act violating copyright.

The decompiling exception is made subject to the three-step-test, which is in this case somewhat modified. The exception cannot be exercised in a manner that unreasonably prejudices the legitimate interests of the author or would be contrary to the normal exploitation of the computer program. A question arises why there is a different formulation of the three-step test in this provision, and whether it means that this exception itself can be considered to be a special case.

2.2. Application of the Three-Step Test

The three-step test, which was introduced with the Paris Act of 1971 that amends the Berne Convention, had the primary purpose to frame the exceptions to the reproduction right. Later with the WIPO “Internet” Treaties its application was extended to all exceptions.30 It is incorporated into

28 Article 95-98.
29 Article 98, that has been modeled after Article 6 of the EU Directive on computer programs.
30 Article 10 of WCT and Article 16 of WPPT. It is contained also in Article 5 (5) of the EUCD.
Maja Kambovska • The Digital Reproduction Right in Macedonian Copyright Law

In the general provisions concerning the exceptions and limitations, the Law sets out that a copyright work may be used without authorization from the author, without or against remuneration, only if the work is published, and that such use may be carried out only in “special cases, where it is not in conflict with the normal exploitation of the work and where it does not unreasonably prejudice the legitimate interests of the author”.

The first obvious problem with this test, in the digital context, is that the three elements are cumulative and need to be fulfilled together and each one separately, which becomes difficult considering that the terms “special” cases, “normal” exploitation, and “unreasonably” are open to different interpretations. Lacking any local case law concerning this issue, some directions can be found in legal theory and international practice.

If the first element is to be looked at as a guideline in modeling national provisions, and not as a rule to be included in the normative acts, it seems redundant to include it in a specific provision in systems such as the Macedonian one, where all the exceptions and limitations are listed and defined in great detail in separate provisions in the Law, in the spirit of continental legal tradition. The exceptions are often additionally restricted with respect to the purpose of the use defined as “non-commercial”, so they can be considered to be “special cases”. Hence, this provision appears as a double obstacle - an exception that in itself represents a special case which would have to be re-examined and narrowed down to an even more restrictively defined special case. This could potentially become a problem in court should the party disputing the use of an exception invoke the three-step test.

The second step is the most problematic for the digital environment. According to the interpretations, the most important factor is the losses for the right holders. If it would be too expensive for the right holder should the use of the work be excepted, then he must retain exclusive control over that use, regardless of the public interest that such use would serve. On the other hand, the use is “normal” if the right holder can expect to use the work and make profit from it. According to this view the test could freeze the scope of exceptions and would not allow their extension, which weakens its normative value in coping with the modern circumstances. The analysis of the second element gives the impression that the public interest as a criterion is put aside and the commercial interest of the right holders is put forward. Another problem is that if the “normal exploitation” is jeopardized there is no remedy such as compensation for the right holders, because it is considered that the “conflict” cannot be resolved in that way.

The central point in the third element is the term “unreasonable”. It is a concept that quantifies the extent of the damage because, in theory, every exception causes some damage to the interests of the right holders, and if the “damage” couldn’t be quantified it is questionable if any exception would be allowed. It was pointed out at the Stockholm conference that “unreasonable damage” can be counter-balanced by ensuring equitable compensation that should put the damage within “reasonable” limits.
Obviously, in certain cases the normal exploitation and the unreasonable damage will be different in the digital context than in the analogue world. The three-step test, as it is, does not give enough space in order to take into account the interests other than those of the right holders. In order to adjust the test to the new circumstances, an inspiration could be found in the “fair use” provision of the American copyright law that was developed in case law before being incorporated into the Copyright Act. The fair use test offers greater flexibility and possibilities to weigh factors that are somewhat similar to the ones contained in the three-step test, but are more suitable for practical application by the courts. A quicker solution would be to “soften” the second element by mixing it with the third element - the use is not unreasonably in conflict with normal exploitation. But this would require revision of the international instruments, which is unlikely in the near future. The bottom line is, now that the technological protection measures provide the right holders with de facto control over every use, and the legal protection of these measures backs up this control de lege, even those exceptions that successfully pass the test could become irrelevant.

2.3. The Use of TPMs

The reproduction right can also be violated, especially with the use of modern digital media, by the act of circumvention of the technological protection measures, which are the key legislative novelty brought about by the rise of digital technologies.

The provisions on technological measures in MCL follow verbatim the formulation present in the EUCD. The TPM and the digital rights management information are regulated in a separate chapter, in Articles 163-165. These measures are defined as “any technology, computer program, devices or their component parts, which, in the course of their normal operation are aimed at prevention and restriction of the acts of violations of the right, as determined with this Law, that are carried out without the authorization of the right holder.” The Law considers these measures effective if the right holder exercises them by applying access control or protection processes, such as coding, scrambling or other ways of altering the work, as well as through copy control mechanisms.

If a person takes action aimed at circumventing the effective technological measures, it is considered to be a direct violation of the exclusive right concerned. Those actions can be taken with knowledge or even if the person could only have known that they may circumvent the protection measures. In addition to sanctioning the act of circumvention, the law sanctions the distribution of devices aimed at circumvention. In that sense, it is considered to be a violation of the exclusive rights if a person manufactures, imports for the purpose of distribution, distributes, sells, rents, advertises for sale or rental, or possesses for commercial purposes technologies, computer programs, devices or components thereof, or provides services without authorization. Such devices or services are considered to violate the rights if they are promoted, advertised or marketed for the purpose of circumvention, or have only a limited commercially significant purpose or use other than to circumvent, and are primarily designed, produced, adapted or performed for the purpose of enabling or facilitating the circumvention of technological measures.

The first obvious problem with TPMs is that they restrict the initial user access to the copyright works as well as any further activities, mainly copying. That makes them more problematic than the DRM information, which serves to identify the work and copyright related information. Hence, the conflict between these measures and the possibility to enjoy the exceptions by the users is obvious. These measures have a double restrictive effect:

39 In 1976 the fair use test was codified in Article 107 of the U.S. Copyright Act.
40 Koelman, supra f. 33.
with respect to end users - they restrict the private copying exception, and also other public interest exceptions;
- with respect to commercial users - they restrict the interoperability exception, thus distorting competition.41

The distribution of music and movies that contain protection generated strong negative reactions from users throughout Europe, who claimed that the copy protection mechanisms jeopardized their legitimate expectations concerning the use of content.42 The same happens now with the models for distribution and use of content on the Internet. Services such as Apple iTunes have enormous popularity, but are under constant criticism.

To ensure that TPMs won’t result with a digital “lock-up” of the content in a way that would make it impossible for the users to exercise their lawful privileges, the copyright rules contain duties to remove these measures in certain situations. There are exceptions to the use of TPMs in MCL to ensure the use of exceptions to the exclusive rights. The right holder that employs TPMs is obliged “without delay, in the shortest possible time, at the request of a person having lawful access to the copyright work, in case of the exceptions and limitations from Article 52 paragraph 1 points 2, 3, 4, 5 and 8 and Article 54 of this Law, to enable access and use of the work through the removal of technological measures or through providing other appropriate means”.43 The enumerated cases concern certain public interest uses.44 In addition, the provision applies in the case of private copying under Article 54. The application of the exceptions to the TPMs is made subject to the three-step test. This is confusing and unnecessary, as the exceptions to the exclusive rights mentioned in this provision are already subjected to the same test. Concerning the contractual regulation of the use of works between right holders and users, the Law reinforces the duty by stipulating that the “contractual provisions that are contrary to paragraph 1 of this Article shall be null and void.” However, the exceptions from the duty to remove the TPMs “do not apply to the right of making available to the public”.

It is unclear what will happen if the right holder does not fulfill his duty to remove the TPMs.45 The Law, apart from a misdemeanor sanction for the right holders which does not compensate for failure to fulfill the duty, does not provide for a mechanism for the users to request access in order to be able to enjoy the exceptions. The EUCD provision on the duty is elaborated in EU countries by providing mechanisms that vary between use of mediation, a special administrative procedure, or even court protection.46

Clearly, the TPMs affect the use of exceptions to the right of reproduction. The use of TPMs as a way of control over the digital use of works and of collecting remuneration may minimize the

42 Cour d’appel de Versailles, 1ère chambre, 1ère section, EMI Music France c. CLCV, 30 septembre 2004, RG n° 03/04771 (http://www.legalis.net/jurisprudence-decision.php?id_article=33); Tribunal de grande instance de Paris 3ème chambre, 2ème section Jugement du 30 avril 2004 (Stéphane P., UFC Que Choisir / société Films Alain Sarde et autres).
43 Article 164.
44 Non-commercial reproduction by public libraries, educational institutions and museums or archives for their own purpose; recording of works by broadcasting organizations; use of works for the purpose of illustrating in educational or scientific research; use of works by special needs persons; use of works for the public security or in court, parliamentary or administrative procedure.
45 This problem has been addressed by Jerome H. Reichman, Graeme B. Dinwoodie, Pamela Samuelson, “A Reverse Notice and Take-down Regime to Enable Public Interest Uses of Technically Protected Copyrighted Works”, (2007) 22 BERKELEY TECH. L.J. 981, 1058.
existing systems for private copying remuneration, or even cancel them out completely.\textsuperscript{47} To illustrate this situation, a user who has bought a computer, where the private copy remuneration is included in the price of the computer, will later download a song protected with encryption which will prevent him from copying that song onto a CD in order to listen to it in his car, although when he bought the computer he already paid to be able to make private copies for personal use. Besides, if he has to pay for downloading the music, the user will feel that he paid twice for the same use. In the long run, it is unlikely that TPMs will completely replace private copy remuneration, but its amount may depend on their application.\textsuperscript{48}

The TPMs are especially problematic from the aspect of the interoperability exception. It is unclear why MCL does not provide for an exception from the application of TPMs in the case of this exception, even though the previous Copyright Law did. In practice this conflict is often the reason for initiating court procedures and complaints by the users, whose rights are indirectly affected. The frequently analyzed case of the iTunes music distribution model demonstrates this problem.\textsuperscript{49} The inability of users to play music that they legally downloaded on any other player except the iPod, that was the result of the use of the FairPlay copy protection mechanism, provoked massive criticism and eventually forced Apple to relax its policies and forego the use of TPMs for most of its services. This conflict affected the technology providers, in this case music player manufacturers, who were effectively excluded from competition.

\section*{2.4. The Confusion and Overlap of Rights in the Cyber-World}

In digital circumstances, the right of reproduction serves frequently as the basis for right holders to request compensation for the digital distribution of content. The number of activities taken by content providers such as broadcasting organizations or digital content distributors is multiplied, which entails the need for multiple licenses for individual activities involving use. Previously, commercial users had to obtain a license or to pay remuneration either for public communication or for reproduction and distribution. Now, the Internet distribution of works often involves both the act of reproduction and the act of communication (transmission or making available to the public) so a double license is required.\textsuperscript{50} The simultaneous application of the rights of reproduction and public communication can adversely influence new distribution models, such as web sites for “webcasting” - digital transmission (streaming) of music or TV content. The right holders may demand remuneration with the argument that such activity entails not only communication to the public but also reproduction because of the incidental copies made in the process of streaming. Likewise, in the case of “podcasting” - placing digital music and audiovisual works on the Internet, the collecting societies for “mechanical” rights including reproduction might demand remuneration for the use, as well as societies for the rights of public communication. Some of the societies representing authors and music producers claim that every transmission is communication to the public, notwithstanding whether the purpose of the transmission is the sale of a copy of the work or simply allowing the pub-


lic to listen to the work. This exemplifies the danger from extreme widening of the reproduction right. Clearly, it is not possible to have at the same time a wide reproduction right and a wide public communication right that includes the right of making works available to the public via the Internet.

Extension of the reproduction right over the distribution of works on the Internet may make rights management more difficult, because the licenses for various types of rights are not administered by the same organization. An additional complicating factor is the number of different right holders involved (authors, performers, publishers etc.), as well as the fact that certain rights are managed collectively while others are managed individually.

The confusion of rights certainly does not contribute towards better transparency of the copyright legal regime. There is a proposal to develop a purpose-based approach, according to which the purpose of the reproduction should determine if there is a separate act of use or not, since the only purpose of copying in cases of digital distribution of works most frequently is to allow public communication, for which the user already has obtained a license.


Before the codification of the right of reproduction in the Directive, academic circles advocated a normative approach in relation to this right, which would be based on the purpose or goal of the activity, instead of the technical criteria that were adopted in the Directive. It was feared that the widely defined right of reproduction might lead to liability both of the users and of the intermediaries, including the Internet service providers (ISPs). It is not certain whether the exception for temporary reproductions can prevent an unwanted overlap of the various rights, especially those of reproduction and communication to the public.

In recent years, as a result of issues with the right of reproduction in the digital context, legal theory strives to offer solutions for the future of this right. A number of authors advocate the “access right” approach, and go as far as to even suggest that a completely new right of access should be independently introduced. The argument put forward is that, in the digital world, it is difficult to separate the act of reproduction from the user’s act to obtain access to digital works that are often protected with TPMs. In other words, obtaining mere access to works on the Internet most often amounts to interfering with the right of reproduction, as the Google Book Search case illustrates. The access-right proposals center around remodeling the right of reproduction by including normative criteria based on the purpose of the act (to gain access) that would exclude such acts from the reach of this right. It is difficult to expect major developments on this issue in the near future, but it is becoming more obvious that the present definition and scope of the right of reproduction is getting anachronous and, even with its wide scope and the system of exceptions, it is not flexible enough to adapt to future technological challenges.

51 Hugenholtz et al., supra f.13, p. 55.
52 Ibid.
4. Conclusions

The reproduction right is perhaps the most digitally affected of all exclusive rights. Macedonian Copyright Law follows the major international and EU instruments. The modern, expanded definition of this exclusive right is wide-reaching and vague. On the other hand, the exceptions have limited applicability, primarily due to the introduction of technological protection measures. These measures are protected by anti-circumvention provisions that apply both to acts as well as to devices that circumvent, which makes them a powerful tool to control users’ activities. There is a duty to remove these measures in order to enjoy certain exceptions, but it does not apply in the case of works made available online. In addition, a mechanism needs to be introduced to ensure the fulfillment of this duty. Inclusion of the three-step test in the Law narrows the exceptions further, since it does not strike an appropriate balance between the various interests involved. In Macedonian Law the exceptions are regulated in separate provisions, which makes application of the test an unnecessary obstacle. The three most relevant exceptions - for temporary reproductions made during a network transmission, for private copying, and for interoperability of computer programs - are modeled after the EU legislation. They could be easily overridden with the use of restrictive licenses for digital distribution of works. There is no provision in the Law that would guarantee that the legally defined exceptions cannot be set aside by contractual provisions. In addition, activities on the Internet often entail the use of various rights beside the right of reproduction, which could make rights management complicated. There is no instant solution to improve the rules, and any development would have to begin at the international level and then be accepted into Macedonian legislation. In any case, a long-term revision is needed, be it by following the suggestions to introduce an access-right to take into account the interests of the users, or by finding another way to make the reproduction right more flexible and accommodating.

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**Legislation**


**Case-law**

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CREATION AND DEVELOPMENT OF INTERNATIONAL LABOUR STANDARDS

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Abstract

The standards and procedures developed by the International Labour Organization (ILO) form part of what may be the most effective and thorough international mechanism for the protection of human rights. They have a particular relevance in the globalizing world, as the closest thing to a universal set of values to defend workers who are assaulted by foreign competition.

Working people find themselves affected either positively or negatively when globalization hits their country or their economic sector. Workers’ rights are implemented in the International Labour Organization principally through the adoption and implementation of international labour standards. By the beginning of 2010, there had been over 8,145 ratifications of the ILO conventions.

In 1998 the International Labour Organization took one important step in the protection of human rights, by adopting a Declaration of Fundamental Principles and Rights at Work. This Declaration recognizes that all Member States - even if they have not yet ratified the relevant Conventions - have an obligation by the very fact of membership to apply certain basic principles arising from the ILO constitution: freedom of association and the effective recognition of the right to collective bargaining, the effective abolition of child labour, the elimination of all forms of forced or compulsory labour, and the elimination of discrimination in respect of employment and occupation.

Since its foundation, the International Labour Organization has insisted on the thesis that economic growth, as an individual category, is not sufficient to provide better working and living conditions, or to ameliorate the unfavorable position of certain individuals and groups of individuals in the labour market. The fact is, that all relevant international institutions, besides the International Labour Organization, should assume their part in promoting international labour standards and ensure that no aspect of their policies and programmes impede implementation of these rights.

Key words: Declaration on Fundamental Principles and Rights at Work, foreign competition, International Labour Organization, neoliberal economic doctrine, social clauses.

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CREATION AND DEVELOPMENT OF INTERNATIONAL LABOUR STANDARDS

1. The Role of the International Labour Organization (ILO)

The development of international labour standards did not occur in a linear, continuous fashion and it has always been influenced by political and economic cycles. Its fate has been closely connected to the circumstances that prevailed in the International Labour Organization.

A conclusion was reached based on the experience in the aftermath of World War I that international peace cannot be achieved without social justice.¹ The International Labour Organization was founded many years ago in 1919, with the aim of establishing labour standards in the world by becoming the main international development agency for labour and the leading scientific institution. Since the very beginning, the primary aim of the International Labour Organization has been to promote equal working conditions and to regulate competition among states so as to allow trade to occur without jeopardizing living standards. Therefore, it represents a great potential for the regulation of international competition.²

The demand for International Labour Law to regulate international competition appeared shortly before World War II during the first great wave of international economic integration. Back then, each state could easily trade with any other one. Customs duties were low and the gold standards facilitated trade and investment financing. Ever since it was founded, the International Labour Organization assumed that unregulated international trade and free flow of capital would worsen working conditions and create difficulties for workers. The cure for what was initially termed “social dumping” or what nowadays is referred to as “the race to the bottom”³ would be an international commitment to establishing universally acknowledged minimum labour standards.⁴ For this to become effective, any potential participants in the market should follow the same norms and standards. Full compliance with the law should prevent those who do not abide by it from gaining unjust competitive advantage. The application of international labour standards should correspond to the size of the labour force, the amount of goods and capital markets. In this context, the ILO Constitution explicitly states that fair and humane working conditions should be adopted equally in all countries and that “the failure of any nation to adopt humane working conditions is an obstacle in the way of other nations which desire to improve the conditions in their own countries”⁵ However, in practice, this only had relevance in the industry of goods and services and had little impact on the regulation of competition between developed and undeveloped countries.

¹ This idea eventually led to “the famous crowning moment of courage and adventure” as Albert Thomas referred to the establishment of the International Labour Organization.
³ Race to the bottom is a socio-economic concept which describes the situation when countries compete with each other in a race that determines which country will be the first one to weaken its legislation and to what extent with the aim of attracting foreign investors. Sovereign states are destabilized as such and international labour standards become inapplicable.
During the first forty years of its existence, the International Labour Organization was undisputedly “an organization with European visions on the regulation of working relations” and it has never lost its orientation. From the beginning, all major countries accepted its authority because they believed it was a way to assist and guide the development of the working class, to establish labour standards and prevent socialist protests in Europe at the same time. The Cold War, which lasted until 1991 and caused a rivalry of its own among political systems, also seemed to provide a motivation for social politics and the development of international labour standards, since a belief was held that every treaty should ensure the loyalty of their satellite nations and gain support from many Third World countries.


The International Labour Organization has adopted up to 188 conventions until now and even more recommendations, which all became part of what is known as the International Labour Codex. Until January 2010, the total number of ratified conventions by 174 ILO member states rose up to 8,145 and the number of ratified fundamental conventions reached 1,278.

However, while observing the number of conventions and recommendations, as fundamental normative acts, adopted by the International Labour Organization during the first few decades of its existence, after 1980 we can notice a huge difference. This is not only about the number as a quantity of adopted conventions, but the overall number of ratifications by the ILO member states which is lower now than ever before. It is justifiable to question why this happened and what changes occurred within the International Labour Organization to cause such a turn of events. Does this mean that the International Labour Organization has lost the authority that it had been gaining for so long in the last decades of the 20th century?

The key moment in history which has greatly altered the position of the International Labour Organization, and thereby affected the further development of international labour standards, happened in 1970 when the United States of America decided to stop financing the organization and officially ceased being a member state five years later. Symbolically, the United States stopped giving financial aid to the International Labour Organization just after it received a Nobel peace prize in 1969.

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7 The United States of America didn’t become a member of the ILO until 1934.

8 The end of the Cold War weakened joint international efforts and it ‘reminded’ the workers, the employers and the Governments of capitalist states of their opposed interests and roles once again. This resulted in a sharp division between labour rights in capitalists and former socialist countries.


10 The most important instruments of the ILO were passed between 1948 and 1964, such as: Convention No. 87- Freedom of Association and Protection of the Right to Organize Convention, 1948; Convention No. 98- Right to Organize and Collective Bargaining Convention, 1949; Convention No.100- Equal Remuneration Convention, 1951; Convention No. 102- The ILO Social Security (Minimum Standards) Convention, 1952; Convention No. 105- Abolition of Forced Labour Convention, 1957; Convention No. 111- Discrimination (Employment and Occupation) Convention, 1958; Convention No. 122- Employment Policy Convention, 1964; and many others.

11 The 1950's and 1960's were the “Golden years of capitalism” and “the culminating point of social corporatism”, during which unions reached their highest number and employers were most willing to cooperate due to the ever-present shortage of labour. Public revenues were abundant, which enabled more funds to be earmarked for social spending and social security costs.

12 Symbolically, the United States stopped giving financial aid to the International Labour Organization just after it received a Nobel peace prize in 1969.
the United States had a negative attitude towards the International Labour Organization since the beginning. It was initially manifested in the statements of the U.S. administration declaring that the normative acts of the ILO are of no interest to them, and for this reason they did not ratify them. Furthermore, the idea of tripartism, on which the entire concept of the ILO is based, was completely opposite to the policy of open markets and weak union representation in the United States. The withdrawal of the United States as the main funder of the organization resulted in a permanent damage from which the ILO has never recovered, and it further changed the course of the development of international labour standards.\(^\text{13}\) Namely, the ILO was forced to seek additional resources for financing their projects (soft money) and “help arrived” from various international financial institutions. All of them that offered financial aid advocated for unregulated national legislations, the policy of open markets and also a reduced security level. This tendency was in direct conflict with the primary aims of the International Labour Organization. However, the ILO increasingly began supporting and promoting the global market so as to continue using the resources of these organizations.

Therefore, the International Labour Organization found itself torn between its primary goals (to promote labour standards as part of human rights) and attracting investments from wealthy international financial organizations in the 1970's and 1980's. The reduced activity of passing conventions and recommendations in that period resulted precisely for this reason, which as a consequence resulted in the loss of the International Labour Organization's credibility among its member states.\(^\text{14}\)

Another significant historic event occurred in the early 1980's when a discussion regarding a flexible labour market was held, which coincided with the return of the United States to the International Labour Organization, only taking on a different role this time. The main point of the discussion was the claim that Western Europe suffers from “eurosclerosis” with which increased unemployment and declining competitiveness of these countries was justified, and that this was a direct consequence of the European social model which was based on protective legislation.\(^\text{15}\) This became the strongest assault on the raison d’être of the International Labour Organization until then. The leaders of the International Labour Organization hoped that this was just a passing phase and for some time this organization failed to adequately react to the increasing pressures for a flexible labour market. During that time with the full support of the United States, international financial organizations had been working intensively on the promotion of new flexible forms of employment and the deregulation of national labour markets that would attract all foreign investors. The final product was a global social framework in which conventions and recommendations of the International Labour Organization and the international labour standards could not come into force.\(^\text{16}\)

\(^{13}\) It is important to emphasize that, since 1970, global economic conditions have worsened. Thus, for instance, GDP growth rates in the previous century fell from an average 5.3% in the 1960's to 3.5% in the 1970's, and from 3.1% in the 1980's to 2.3% in the 1990's. Also, the global per capita production increased only by 33% in comparison to the 83% increase over the last four decades. Long-term economic growth decreased everywhere except in some parts of Asia. The unemployment rate in most countries increased from an average 3% in the 1960's to 7.4% in the 1990's, with a higher rate of increase in the EU member states. The global unemployment rate reached a record 180 million including the inadequately employed. One-third of the global labour force is either unemployed or inadequately employed.

\(^{14}\) The International Labour Organization failed to react even when the social security system fell to such a low level that the average life expectancy dropped from 64 to 58 years of age in former Soviet Union countries.


\(^{16}\) Convention No. 177- Home Work Convention from 1996 which has been ratified by only four states until now is a more than obvious example.
3. Declaration on Fundamental Principles and Rights at Work

In 1998, the International Labour Organization finally adopted the Declaration on Fundamental Principles and Rights at Work to uphold the “fundamental principles at work” or the “basic rights at work” which includes: the freedom of association and the effective recognition of the right to collective bargaining, the elimination of all forms of forced or compulsory labour, effective abolition of child labour and the elimination of discrimination in respect of employment and occupation. The Declaration was unanimously adopted but the question of whether this proves to be the beginning or the end of labour standards arises. It is also debatable whether the Declaration has any positive effects on work and labour standards, except that millions of dollars were poured into the International Labour Organization by the United States to work on its support. Two basic problems with the Declaration seem to be put forth. Firstly, the preamble to the Declaration on Human Rights adopted by the United Nations in 1948 declares that all human beings are born with equal and inalienable rights and therefore the mere division and classification into fundamental or essential standards implies that standards which are “less fundamental” or “less essential” also exist. What is the logic behind the claim that the elimination of discrimination is more important than the right for: social insurance, safe working conditions, maternity leave, etc.? What does the guarantee of the freedom of association represent without a range of socio-economic rights to put this freedom into practice? Secondly, the Declaration on the fundamental principles and rights at work completely neglects the workers’ economic and social rights and it mainly deals with the negative aspects of some rights. For instance, individuals, groups and states are requested to “prohibit” discrimination, “abolish” forced labour and “eliminate” child labour. The situation is further complicated when one considers that the Court of Justice of the European Union did not accept the Declaration as part of European Law and that the European Court of Human Rights established the right of non-association, as the negative aspect of the union association freedom.  

The issue is brought to the foreground as to why it was necessary for the International Labour Organization to adopt such a Declaration considering its very limited scope of ability. If the goal had been to force states to take on its obligations without the act of ratification and prove that universality is still its characteristic, it failed to accomplish this. It is well know that the mere act of ratification does not necessarily mean the application of provisions of the convention. In fact, recent studies have indicated little evidence of statistical relationship between the ratified conventions of the ILO and actual working conditions.18 Massive violations of the International Labour Organization’s norms also refer to the act of non-abiding by the basic principles and fundamental conventions, which are nowadays considered basic rights at work. By accepting the organization’s Constitution all ILO member states have obliged themselves to respect, promote and realize in good faith the conventions independently of their ratification. In a large number of cases, the fundamental provisions are violated and this mostly refers to the non-recognition of union rights which includes discrimination, harassment, persecution and political campaigns against union members, existence of forced labour and extensive use of child labour. The thesis that social standards are not met is supported by the high number of unemployed and inadequately employed workers, low or unpaid wages, the minimum social security of the population as a whole, the high percentage of injuries in

17 This viewpoint of European courts is justifiable if one considers that the concept of the general principles of Community Law necessarily involve a corpus of fundamental social rights and gradually the conviction that the citizens’ fundamental social rights are a constituent part of the European Union grew stronger.

the workplace, occupational diseases and other deficiencies that the International Labour Organization calls a "decent job."\textsuperscript{19}

4. Social clauses as a way to improve working conditions

The International Labour Organization believes that their normative instruments are universally valid and enforceable. Considering that it is a voluntary organization, its ability to exercise its normative instruments in the member states is very limited. Its main assets are moral persuasion and technical assistance in promoting the adoption and implementation of the international labour standards. As a result, the entire concept of universality of international labour standards “collapses” when one takes into account the numerous attempts which ultimately failed to introduce the social clause to the World Trade Organization and the General Agreement on Trade and Tariffs, which would award those countries that comply a favorable economic status and impose sanctions on those countries which do not adhere to them with the trade sanction exclusion.\textsuperscript{20} The social clause aims at improving the working conditions in exporting countries by imposing sanctions on the exporters who do not comply with minimum labour standards. The typical social clause in international trade agreements restricts or suspends imports or preferential imports from countries, industries or companies where the working conditions are below the specified minimum standards.\textsuperscript{21} The manufacturers who do not meet the minimum standards are required to opt for the application of working conditions or take on the risk by facing increased trade barriers in their export markets.

The incorporation of the social clause into trade agreements did not take place without limitations and dilemmas. Firstly, the question whether the social clause is an adequate means of achieving the desired social changes is raised. Secondly, should compliance with the social clause be monitored by international financial organizations, the International Labour organization or some separate body? Thirdly, should this clause be based on existing provisions of the General Agreement on Tariffs and Trade or the instruments of the International Labour Organization?

The debate on the introduction of the social clause heated up during the Uruguay Round with proposals for the inclusion of the clause in the World Trade Organization’s deed of foundation. This would contribute to the sanctioning of non-compliance with the international labour standards and as such would represent a social development factor. Those who have criticized it claimed that it was an inadequate instrument, since working conditions are connected to the economic and social development of a country and as such the social clause would operate by offering protection to the most developed countries which could, with its aid, nullify the competitive advantage which the poorest countries have in terms of cheap labour. The developing countries did not support the introduction of the social clause for precisely this reason, claiming that it would encourage wealthier countries to stop importing goods produced in poorer countries which are unable to ensure compliance with the international labour standards.

The liberal critique of social clauses assumes that if the mechanism of free trade is enabled to function without hindrance, costs would be leveled and therefore the increase of productivity in developing countries would bring about the general improvement of living conditions and with that social improvement and the improvement of working conditions. The economic analyses deny

this claim and they show that the social clause can function only when equal conditions exist at the very beginning, otherwise there is a risk of damaging the poorest countries which cannot afford the high costs imposed by the clause. Finally, it can function only if all interested parties accept it as fair and if it brings a complete liberalization of the market accompanied by the improvement of working conditions to trade agreements.

5. **The international labour standards in the light of the neoliberal economic theory**

Adopting international labour standards entails their direct application to the labour market, with the goal of dealing with the competition, all the while allowing workers to stand in counterbalance to capital holders, so as to improve their working conditions.

From its foundation, the International Labour Organization has insisted on the thesis that economic growth, as an individual category, is not sufficient to provide better working and living conditions, or to ameliorate the unfavorable position of certain individuals and groups of individuals in the labour market.

The standpoint has been long disputed by neoliberal doctrine, which considers employment and working conditions to be defined by endogenous economic forces and that they mostly depend on the gross domestic product of any country. This means that, if the gross domestic product per capita were low, the working hours would be irretrievably long, the wages would be low and the working conditions difficult. The working conditions could not “artificially” rise above the framework of economic growth. International efforts to improve working conditions would be in vain, even detrimental. It would be an impact against the “laws of economy”. The lever to lift each country to the highest level of prosperity is an unconditional and limitless economic competition, within, as much as in between, governers and companies.22

Therefore, the essence of the neoclassical economic theory is that only a free market and competition without limits can generate not only the most efficient, but the most honest economic results, which are therefore in the workers’ best interest. According to these theories, the free market establishes a “real standardization” of work and wages. Competition influences the companies to be good employers who, above all, pay great attention to work efficiency. Contrary to this, imposing international labour standards on countries would generate a “false” standardization of work and wages. Unions, collective agreements, minimal wages, the social welfare system, etc., restrict competition and create a distortion in the labour market and an institutional “sclerosis” in the whole of the economy. They increase the cost of production by rising wages above the market average, hinder efficiency and limit flexibility, increase inequality, deter investments (thus limiting the economic growth) and reduce the overall level of employment. In the final analysis, they pose a threat to social progress. According to the supporters of this theory, the comprehensive and universal labour standards designed to set the minimal working conditions and bigger and more just earnings, damage economic growth the most, and the cost of such conditions and strategies could be too high for developing countries, and would bring only modest, if any, gain for developed ones.

This standpoint represents an echo of contemporary international trade economists, who find that the economic development and social system of workers are best found in a liberal trade regime.23 Limiting trade and investments outside of borders would render it more difficult for poor, developing countries, to catch up with economically more advanced nations.

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In theory and practice, the point of view that international labour standards are economically damaging, because they raise production costs and companies are being swept away from the market, has turned out to be one of the greatest obstacles toward advanced labour standards. Neoclassical economic theory has been the dominant view point since the 1970’s. Through its influence on the theory of the economy of standards, it has educated generations of students in large parts of the world, some of which have become, or are going to become, top politicians and decision makers. The neoliberal policies of the so-called “Washington Consensus” have led the greatest international financial institutions, especially the World Bank and the World Trade Organization. For instance, the World Bank deems social justice a necessity, but not *per se*, valuable as such, but as means that can decrease poverty and reach economic prosperity. In a World Bank report entitled “Equality and development”, the equality of possibilities is presented as the only form of equality acceptable. This is in complete accordance with the neoliberal doctrine’s attitude concerning equality, according to which individuals with more merits, i.e. abilities or characteristics which society finds valuable, have greater achievements in the race for success. According to such a concept, inequality is justifiable as well, since it encourages economic growth, hence, there are always winners and losers. According to the World Bank, only equality that has been understood in this sense leads to social justice, which is complementary with reaching long-term economic prosperity. If the market does not operate according to the principles of an open free market, the product is inequality of possibilities. The World Bank officially approved the international labour standards only four years ago, but has denied supporting them since they contradict its own policy. So the question of application of these standards in terms of the World Bank remains vague.

During the last few decades, economic arguments against international labour standards have also become popular among the politicians in Third World countries. The natural competitive advantage of the Third World countries and developing countries is that they have abundant supplies of cheap and unprotected labour, and this should not be eliminated by setting labour standards that the developed countries impose. Until they reach a higher level of economic development, improper employment and poverty create different political priorities than good quality jobs and good working conditions.

Surprisingly, the argument of excessive costs of international labour standards is also used in wealthy, developed countries so as to warn against further improvement of labour standards, even to call for a decrease in the existing ones. From the point of view of brutal international competition, social costs related to labour standards are not available (affordable) or would inevitably lead to a decrease in growth and employment. As countries open toward the international economy, abiding by international labour standards means increasing the costs of production, since, in the regime of liberal trade in which the prices are set by the international market, the overall expense of meeting international labour standards must be absorbed by companies or employees. Manufacturers can no longer (as is the case in a closed economy) pass the costs of meeting the standards to consumers, through higher prices. Therefore, the pressure on national standards will decrease, unless there is a mutual international standard for all participants in the market.

The economic arguments against international labour standards are erroneous on several levels. Partially, they are based on contradictions between the norms and the ways in which the International Labour Organization operates. The International Labour Organization declares uni-

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24 The “Washington Consensus” entails privatization, foreign and domestic trade liberalization, exchange rate stabilization and maintenance of a balanced budget. In the early 1990’s, the International Monetary Fund believed this to be the solution to the problem of poverty and development of undeveloped countries.

versality, but not uniformity when applying these normative instruments. This means that, while it indeed insists that the fundamental international labour standards are independent of a country’s level of development, on the other hand, these standards must obey the specific economical, legal and other circumstances of a member state, and while making a policy of application of international labour standards, one must take a flexible approach. For instance, the International Labour Organization does not call for equal minimum wages (as is often asserted) in all countries. Rather, it proposes that each state should engage in determining the amount of the minimum wage, whether through legislation or a collective agreement. Therefore, the International Labour Organization fully acknowledges that the minimum wage must correspond to the state’s level of development and other economical conditions, meaning that they cannot be the same in India and Canada.

The economic neoliberal ideology is yet to prove its assertions that international labour standards inevitably cause high costs of labour, thus rendering companies uncompetitive in the international labour market. We consider this kind of thinking to be partially wrong and exaggerated, since it is precisely the improved labour standards that quite often lead to greater productivity, meaning the decrease of labour costs. An employer who respects the eight-hour day, the minimum weekly break and standards of safety and security in the work place, is not considered to be in a less favorable position than the competitor who does not abide by these rules, because achieving a standard requires greater motivation on behalf of the worker, less fatigue, less mistakes and mishaps, etc. Furthermore, one should not suppose that the costs of applying labour standards should inevitably be paid by the employer alone, since a fair portion of these costs has been transferred to employees in the form of lower wages. Moreover, the International Labour Organization has demonstrated that, despite the popular views, the cost of obeying a ratified convention (i.e., those that have to do with social protection or safety and security in the work place in developing countries) is not too high. Finally, failure to abide by international labour standards can turn out to cost more than abiding by them. For instance, without any protection while hiring, employers can face excessive legal fees resulting from unlawful dismissal.

While the costs of applying the standards are mostly direct, comprehensible, momentary and localized, the advantages of applying them are mostly indirect and immeasurable. It is only when the negative consequences of low standards accumulate (e.g., taking the form of poverty, crime and social disintegration) do people become completely aware of the economic and social usefulness of international labour standards.

Unfortunately, the economic policies of certain states regarding international labour standards are rather weak and tend to limit themselves to microeconomic aspects alone, ignoring macroeconomic implications. Equality and the problems of distribution are neglected, and are surrounded by simplified and very cruel, unrealistic assumptions. In order to shrewdly evaluate the usefulness of international labour standards, they must be observed from a broader economic, social and political perspective.

**CONCLUSION**

After almost a century of the International Labour Organization’s existence, its normative framework remains controversial. During the second great wave of economic globalization, and especially the flow of investments across borders, the demand for reliable social globalization, and especially the flow of investments across borders, the demand for reliable social globalization, and especially the flow of investments across borders, the demand for reliable social dimensions in the

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26 See article 19 of the ILO Constitution.
27 Research conducted by the World Bank showed that the elimination of all forms of discrimination in the labour market, as well as equal education and training for men and women, would cause an economic growth rate increase in Africa of 100%.
process of economic integration has never been greater. To establish an efficient social system in the
global economy and advance constructive instead of destructive competition, international labour
standards must be vigorously applied everywhere.

The dogma of the neoliberal economy and the neopolitical labour program still generates a
very negative relation towards international labour standards. The supporters of this approach still
assert that labour conditions are a product of economic development, and that only a free market
can produce optimal working conditions, accompanied by sustainable international labour stan-
dards. This determinist attitude and its “insensitivity” to history and the institutions, are confl icted
with the philosophy behind international labour standards which claims that, although economic
growth influences better working conditions, it alone is insufficient to advance them permanently.

If we look at the bigger picture, the economic neoliberal philosophy is the main obstacle
to the advancement of international labour standards, considering that the representatives of this
economic approach have never managed to establish and prove the negative influence of interna-
tional labour standards on the economic success of a national economy. Therein lies one of the key
problems, the understanding of which would cause an even greater number of states to ratify and
apply international labour standards, not solely for moral reasons, but for economic reasons as well.

Finally, we can only state that the International Labour Organization has reached its limit
and has failed to give a proper response to the challenges of a fl exible labour market and the rise
in inequality as a consequence of globalization. Its concept, presented as a system of relations be-
tween an employer and an employee founded on an indefi nite employment contract, cannot keep
up the pace. The area of employment relations in the 21st century is much diff erent from that of
the 20th century, and the International Labour Organization has not adapted to it. The approach to
labour that they use was developed in the middle of the previous century, differentiating between
labour and merchandise, while simultaneously seeking sources of fi nance from international fi nan-
cial organizations which request a certain counterfavor for the money they have invested. The main
obstacles for complete adherence to international labour standards are in close connection with the
process of economic globalization. Therefore, it is beginning to appear that labour in the fi rst decade
of the 21st century is becoming a merchandise, and the International Labour Organization still fails
to oppose it.
PART FOUR

CONSUMER LAW AND E-COMMERCE
LEGAL ASPECTS OF USING ARTIFICIAL INTELLIGENCE TECHNOLOGY IN ELECTRONIC CONTRACTING:

Balancing Between the Need to Create an Encouraging Legal Environment and the Need to Secure Legal Certainty for the Parties to the Contracts Formed Via “Electronic Agents”

by dr. sc. Vladimir Savković, Assistant Professor at the University of Montenegro, Faculty of Law

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1. Introduction

Progress achieved in developing information technologies throughout the second part of the 20th century, along with some other major changes, gave birth to a specific business practice, a phenomenon commonly known as the world of electronic commerce. However, contracting and generally doing business with the help of electronic communication technologies did not come exactly under the spotlight of the legislators and of the legal science up until the advent of the Internet, a world-wide open computer network that virtually changed all of our lives. But just as we were witnessing the first efforts on drafting and implementing comprehensive and enabling regulatory solutions for the commercial use of electronic communication technologies, the dynamics of scientific progress in this field had already brought new, even bigger challenges before the legal science. Namely, at some point in time during the late 20th century, after a number of failures to make the expected landmark breakthrough, scientific researches dealing with the development of artificially intelligent entities had started to produce some amassing results. As a consequence, for more than a decade now we have been witnessing slow but steady spreading of the commercial use of the second generation of so-called “electronic agents”; computer programs, i.e. software not only capable of searching the Internet for information and automatic processing of gathered data, which was the case with their first generation predecessors, but also capable of making autonomous decisions on the basis of predetermined criteria. Furthermore, second generation electronic agents are not only capable of autonomously making decisions such as to enter into a contract, in addition to this they are frequently executing such contracts through the use of open communication networks they are connected to. Finally, these modern traders already have an implied but far from fully developed ability to make decisions on the basis of their own experience, in other words, the ability to emulate human cognitive process, which is yet to be fully developed.

It is sometimes hard to even imagine the types of problems that these developments are already putting or will be putting in the near future before the courts and legislators around the world, as well as before the legal science itself. On the other hand, it seems obvious that the most important and immediate ones are the questions of validity and enforceability of such contracts.

2 This is only the most common term used. Other terms, such as “software agents”, “artificial agents”, “bots” or just “computers” are used more or less often. Lately we can encounter even more imaginative terms such as “actants” and “hybrids”. See Teubner, Gunther, “Rights of Non-humans? Electronic Agents and Animals as New Actors in Politics and Law”, Journal of Law & Society, Vol. 33, No. 4 (2006): 497 – 521.
and the pending issue of allocating responsibility for some or all of the electronic agents’ actions. In fact, the problems concerning validity, along with reflections on liability aspects of contracting via electronic agents are key issues that have been put under scrutiny in the following text. However, before we turn our attention to them and debate how they may be resolved in practice, in order to better understand these problems we shall first examine more closely what electronic agents really are, as well as the technological characteristics that the agents being used for facilitating electronic contracting presently possess and will soon be possessing.

2. The Notion of Electronic Agents

There are various but not essentially opposing definitions of electronic agents. Practically, each definition stresses the ability of these computer programs for independent, autonomous action towards meeting objectives preprogrammed by their human users or in line with their explicit directions, with an associated and obvious tendency that the above-mentioned level of autonomy is rising slowly but steadily with each new technical solution, we might add. In order to better understand the practical capabilities of these products of artificial intelligence technology and the kind of legal issues those capabilities may provoke, let us take a closer look at some of their other important features that are compatible with the above explained key characteristic or derived from it. Hence, specimens of present, i.e. second-generation electronic agents that have been present and operational for more than a decade now are capable of:

- “Moving”, i.e. roaming through their virtual environment in order to find information or establish contact;
- Interacting with other electronic agents and humans using the means for the electronic transmission of information;
- Continuous and persistent activity towards the realization of a given objective;
- Recognizing changes in their virtual environment and adapting to those to a certain degree;
- Designing and synchronized execution of a large number of sub-activities directed towards achieving the final aim;
- Providing a record of every single action undertaken, as well as its “traceability” to the user of the electronic agent undertaking it.

The above listed features are a good basis for illustrating what electronic agents can currently do and, more importantly, how they can be used in electronic commerce and electronic contracting in particular. As we already mentioned, electronic agents went from being a relatively simplified means for gathering, systematizing and presenting information to being relatively autonomous entities that can act proactively, meaning that they can search the Internet, interact and negotiate simultaneously with several other humans or similar entities, enter into contracts and execute them autonomously, i.e. without the previous approval of their human users. Thus, legal and other

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actions these electronic agents undertake are not only made on the basis of predetermined criteria and information entered into their memory before their release into their virtual surrounding, but also on the basis of information gathered by them during the course of their “lives”, as well. A typical present-day example of such an electronic agent would be one operating an online store or auction website, and it is exactly the fact that these entities possess the above-mentioned characteristics and other human and superhuman abilities that has made the use of electronic agents for entering into, executing and generally facilitating legal transactions a very frequent occurrence. Accordingly, there are now various classifications and types of electronic agents depending on the level of their mobility, their usage or the level of autonomy. However, as we mentioned earlier, although most of their manufacturers or users still hesitate to enable their electronic agents to use this capability, some of them are capable of even more than acting autonomously. They can act creatively, meaning that they can emulate human cognitive process and learn from their own experience, modify to a certain extent their primary instructions based on the changed circumstances and accordingly make and execute various decisions with specific legal consequences for both their users and the persons they interact with. An example of this kind of potentially very creative electronic agents are the ones used by institutional investors on commodities or securities markets, which are utilizing “intelligent algorithms that respond to market information in real time using short-term predictive signaling techniques to determine the optimal execution timing, trading period, size, price and execution venues, while minimizing market impact.” These electronic agents are providing us with a glimpse of what the next generation of electronic agents will be capable of and it is already obvious that, among other things, it will be making a huge step in further depersonalizing electronic commerce and electronic contracting in particular. Yet this depersonalization does not come without a cost, which includes various puzzles to be solved by contract and civil law in general in order to ensure the adequate level of legal certainty for the parties to such contracts, whoever they may be.

3. Contracting Via Electronic Agents – Legal Issues

The use of artificial intelligence technology, i.e. electronic agents for contracting purposes, is already making various legal professionals face some complex challenges and it is almost certain that the future will bring some more. Therefore, within the law as an academic discipline these challenges demand a cautious approach and multilayered analysis. However, the key question is undoubtedly one for contract law. Can electronic agents characterized by the described level of autonomy and at this point only limited creative capabilities form valid and enforceable contracts? In other words, is it possible at all and, if so, how can we secure the validity of a contract entered into by one or more electronic agents and remain within the boundaries of traditional contract law doctrines at the same time? Furthermore, from a practical point of view an even more important question is how can we achieve all this whilst avoiding the deterrent of potential users from utilizing electronic agents to facilitate their contracting and, in doing so, their businesses and everyday lives? Or, to rephrase the previous question, once we envisage it, how should we create, i.e. stipulate an enabling but at the same time not so hindering legal environment for the use of electronic agents?

In light of the above questions, we are going to face the following empirical problem. How can we accept and treat as legally valid a contract whose terms and conditions are negotiated and

5 Such superhuman abilities are interacting with hundreds of humans and other entities simultaneously, searching the Internet and processing gathered data with enormous speed in comparison to humans using them for those purposes.
agreed exclusively by electronic agents, with such a contract being entered into and fully executed also by electronic agents without any previous revision and approval of the agreed contract terms by their users and alleged contract parties? Hence, in situations like this one the problem is the fact that, although they were aware or should have been aware of the possibility that a contract of similar legal content may be concluded, human users of electronic agents had not been aware of the fact that a specific contract was actually being concluded nor had they the opportunity to approve all its unique terms and conditions once they were negotiated and agreed between their electronic agents. By putting *consensus ad idem*, i.e. mutual assent of the contracting parties at the very centre of contract law, at the first glance it seems that governing contract law theories in both civil and common law do not leave much room for speculating on the validity of contracts concluded via electronic agents in a manner described above. More precisely, it is almost common knowledge today that in order for a contract to be recognized as valid it must be preceded by the mutual assent of the contracting parties, as well as the condition that a contracting party may only be an entity with the recognized legal personhood, such as a natural or a legal person. Since electronic agents, however, are still not recognized as legal persons and they certainly could not qualify as natural persons, it is obvious that finding a “legal formula” for enabling contracting via electronic agents is a widely open issue. So then what is the solution?

Should we award legal personhood to electronic agents? Should instead or in addition to awarding them legal personality they are to be treated as agents of their users under agency law? Or should we make an effort to help legal practitioners interpret governing law theories as extensively as is required in order to secure the validity of contracts concluded via electronic agents and, in doing so, should we make any changes to existing legislation or consider it to be unnecessary? Finally, if we decide to make appropriate changes to our regulatory regimes, what is the extent of the intervention that needs to be made, keeping in mind not only the necessity to make contracting via electronic agents legally valid, but also the necessity to avoid inhibiting the use of electronic agents?

Stated above are the key issues that we will deal with in the next part. However, before we go there, we should stress one other fact. Although it is probably the most urgent and challenging legal issue linked to the use of electronic agents that, once resolved, will strongly influence all other future development in this field of law, apart from the issue of legalizing contracting via electronic agents, there are other legal problems provoked by the described use of electronic agents. However, it is important to stress again that the ways of solving those problems will vastly depend on the manner in which the above key issue is going to be resolved. One of the most important is definitely the issue of liability for the actions of electronic agents, especially for those considered to be unforeseen deviations from the programmed “behavioral parameters”.

An electronic agent action that is considered to be tortious needs to be attributed to a specific person, *i.e.* tortfeasor whoever it may be.

The fact that there are now electronic agents capable of creating other electronic agents will further complicate this problem, since it will become even more difficult to trace the origin of a specific action and the electronic agent that initiated it to a specific natural or legal person. Another important issue is establishing product liability rules for the software companies programming and selling artificially intelligent electronic agents. Namely, it is going to be a very difficult task for the legal profession in general to differentiate between design or instruction defect on the part of the producer and mistakes made by the user in operating the electronic agent, while establishing appropriate liability standards at the legislative or judiciary level at the same time. Finally, some authors are even argu-
ing that, in light of the steady increase in the use and technological proficiency of electronic agents used, the fundamental legal principal of good faith may be in need of thorough revision in order to accommodate new contracting techniques.10

4. Solving the Problem – From Awarding Personhood to Electronic Agents to Ignoring Them

4.1 Introduction

Generally speaking, there are two directions in which the efforts to secure legal validity of contracts formed via electronic agents can be made. On one hand, we can create and enact entirely new regulatory solutions that would create a more or less radical legal foundation for creation of valid contracts via electronic agents. On the other hand, we can interpret creatively and extensively the existing regulatory solutions and their theoretical foundations, generally recognized contract law doctrines. In doing so, we could even try to avoid making any intervention in existing laws, but whether existing legal doctrines can actually be stretched that far is doubtful at this point. Particularly having in mind the complexity of the technology involved, it seems that relying exclusively on extensive interpretation in combination with the absence of any legislative intervention would be a solution that may entail a considerable amount of legal uncertainty, at least for the first decade or so, until unified rules of interpretation and according judicial practice is established. Be it as it may, in this part we will present and critically analyze key proposals for solving the problems of utilizing artificial intelligence technology in electronic contracting, ones that we can encounter in academic literature dealing with this issue. In doing so, we will begin with examining the proposal that, apart from probably being the one most disputed, is considered by many to be the most radical.

4.2 Electronic Agents as Legal Persons

Treating electronic agents as a person in law is prima facie the most radical solution for legalizing electronic agents. They would certainly not be the first artificial entity with the recognized capacity of having rights and duties, since various human creations, such as corporations and municipalities today or ships and temples in the past, have or at some point in time had legal personality. However, whether this is a practically acceptable and scientifically justifiable solution when it comes to contemporary electronic agents is something that needs to be carefully examined before any conclusion is made.

It seems that most of the relevant arguments that can be considered as ones that are at least conditionally in favor of personhood for electronic agents can be summed up in three basic categories.11 The first group of arguments is based on the view that electronic agents have a sui generis moral right on personhood, considering their artificially generated self-consciousness. Notwithstanding the fact that there are some scholarly standpoints mildly advocating the solution which would entail awarding artificially intelligent human artifacts legal personhood under the as-


assumption that they develop self-consciousness, at least for the present time, it seems that this is the group of arguments having the least strength of all. One of the reasons for this is that there is no valid and scientifically recognized evidence that an electronic agent, nor any other artificial human entity for that matter, has ever displayed self-consciousness or something resembling it. Furthermore, it seems to this author that the proponents of this idea forget that a primary objective of legal science, as well as of legislative authorities and of the courts, should not be the protection of doubtful moral rights of software programs but rather the protection of legitimate interests of natural and legal persons utilizing them.

The second group of arguments advocates legal personality for electronic agents on the basis that it is less important whether electronic agents are aware of their own existence and of far more importance is their capability to interact with humans to the extent that they are actually considered by those humans to be separate entities equal to themselves when it comes to certain activities such as contracting. Thus, it is the "social capacity" of the electronic agents that should be considered as the decisive factor in awarding them status of legal persons, eventually. It is further argued that other entities in the past, after having gained a certain level of sophistication in their actions, were treated in time as separate entities capable of having rights and duties by their surroundings. Thus, in adapting to social reality the legal system is being forced to create new legal fictions, i.e. new legal persons. It seems that this group of arguments, keeping in mind the example of entities that had been recognized as legal persons in the past, stands on firmer ground than the previous one. However, it is not only the described social capacity that has been deemed as a precondition for creating new legal persons in the past. There were also some other preconditions that needed to be satisfied in order for a "socially recognized entity" to be legally recognized, which brings us to the next group of arguments in favor of recognizing electronic agents as legal persons.

The third group of related arguments simply relies on the usefulness of recognizing electronic agents as legal persons. Considering this idea, we can actually find at least two prima facie very important benefits of it becoming operational, with the first one being that in the case of electronic agents being treated as legal persons, we would avoid problems with attributing liability for their actions in a number of occasions, since the agents themselves would be deemed responsible. In other words, the dilemma as old as the notion of electronic agents on whether all of the actions of electronic agents can and should be attributed to their human users, which is increasing its relevance in light of the dynamically sophisticated processes of electronic agents, would seemingly be resolved by adopting this solution. Thus, there are scholars, such as Wein, or Karnow, finding this to be a fair solution in light of the attribution problem involved and the above-described usefulness criteria applied, as well.

12 In his landmark article on the possibility of awarding legal personhood to an artificially intelligent human artifact Solum stressed the following: "The fact that, so far as we know, only brains have ever given rise to consciousness in the past is enough to raise a presumption against consciousness arising from computers. But it is only a presumption. If an AI exhibited behavior that only has been produced by conscious beings in the past, that behavior would at least be evidence counting against the presumption." See Solum, Lawrence B. "Legal personhood for artificial intelligence", North Carolina Law Review, (April 1992): p. 1265 - 1266.


The second benefit of recognizing electronic agents as legal persons is avoiding the *consensus ad idem* problem described earlier in this article. Namely, if they were to be granted legal personhood, electronic agents would be considered as contracting parties and not their users. Accordingly, the fact that users were unaware that a specific contract had been negotiated, concluded and executed by their electronic agents would not stand as a doctrinal and practical difficulty any more. However, would this solution, on the other hand, provoke some new, even greater difficulties?

In order to implement the idea of awarding legal personhood to electronic agents and considering them to be liable for their actions it is necessary at the very least to make sure that there is a way they can actually pay for the damages they caused to the persons interacting, i.e. doing business with them, as is the case with other legal persons. Without this, the idea of electronic agents gaining legal personality would become practically meaningless. In this respect, there are some suggestions that a way to make this possible may be to create a register of electronic agents and stimulate the insurance of the registered ones against liability for the damages they may cause, whereas the insurance premiums would be paid by the users of the electronic agents.\(^{16}\) It does seem that this idea for solving the problem of the lack of any property on the part of electronic agents has some potential. However, even if the registration process is organized and insurance encouraged, due to the above explained high level of unpredictability of sophisticated electronic agents, there would be a number of risks that insurance companies would not be willing to cover by their policies. Thus, a huge legal vacuum would remain evident every time an uninsured risk occurs, which would eventually result in more and more reluctance when it comes to using electronic agents, especially the most sophisticated ones. Furthermore, there are authors stressing that the costs of establishing such a registration and insurance system would surpass by far benefits that the users of electronic agents may incur in utilizing artificial intelligence technology in electronic contracting, hence there would be no financial motivation on the side of its designers and users to maintain such a system.\(^ {17}\)

Having in mind the above said, along with the amorphous concept of electronic agents and the fact that the world has just started getting to know them, it seems that this is not the moment for such a radical solution as the one advocating legal personality for electronic agents. However, as we get to know our new best friends better and with them evolving into more sophisticated forms of artificially intelligent entities, even this solution will become more acceptable with each new phase in the “life” of this friendship.

### 4.3 Electronic agents as *sui generis* agents of their users

Contracts have been entered into by the agents of contracting parties since ancient times. Such contracts are negotiated, entered into and frequently executed without the involvement of the contracting parties, apart from the initial authorization, expressed or implied. It is this apparent analogy with the use and role of electronic agents in the contracting process which probably gave birth to the idea of treating them as *sui generis* agents of their users.

There are number of debates on this matter, including a few interesting ones whose authors are actually advocating this idea quite openly. In one of these Fisher states the following: “When computers are given the capacity to communicate with each other based upon preprogrammed instructions, and when they possess the physical capability to execute agreements on shipments of goods without any human awareness or input into the agreements beyond the original programming of the computer’s instructions, these computers serve the same function as similarly instruct-

\(^{16}\) See Id. at p. 163; See Widdison, Robert and Allen, Tom, op. cit. at p. 42.

ed human agents of a party and thus should be treated under the law identically to those human agents."^{18} Apart from this key statement, Fisher presents the argument that electronic agents are characterized by a much higher level of precision in executing their instructions than their human counterparts and that this, along with the fact that they do not exist out of the computer world, additionally lowers the possibility of malpractice.^{19} Accordingly, he stresses that the agency law should be adapted in order to accommodate his idea.

In another study advocating the idea at hand Kerr states that it is a "well established principal of agency law that one need not have the capacity to contract for oneself in order to be competent to contract as an agent."^{20} Furthermore, in an attempt to overcome the implied problem of consensus between the principal and an agent, Kerr stresses that neither a contract between them nor consent on the side of an agent is needed for the agent-principal relation to be recognized by law, since under agency law even a person without contractual capacity can be an agent under certain preconditions. Hence, he concludes that an "agent’s capacity and intent are superfluous to the transaction, so long as the agent is able to manifest the principal’s assent to contract."^{21}

Although the above cited notable proponents of the idea of electronic agents being considered under law as *sui generis* agents of their users are both admitting that applying their idea directly in existing legal systems, without any regulatory intervention in agency laws, having in mind all the dilemmas that it would bring out, should not be an option, they did not offer any such proposal nor have they provided comprehensive solutions to the few seemingly visible problems associated with it. First of all, the fact that an agent does not need to have contractual capacity in order to be recognized as such does not mean that it should not have personhood. So, in order to surpass this obstacle we either turn back to the debate on awarding legal personhood to electronic agents, or we commit ourselves to thorough reform of agency law key principles. The latter option becomes even less acceptable once we turn our focus to another problem associated with the implementation of the idea at hand. What would happen in the case of an electronic agent exceeding the authority vested in him by its principal, since, having in mind the progress made to this day in developing artificial intelligence technology, this is already a realistic scenario? Furthermore, as a rule, under appropriate circumstances an agent may be deemed liable for damages incurred not only by the principal, but for the damages incurred by the third party too. So, against whom should the third party turn in order to secure indemnification in any such case? This is the question that remains unanswered, unless we turn back to reconsidering the possibility of awarding electronic agents with legal personhood. Adding to this is another problem that must not be only theoretical in nature. What if an electronic agent delegates to another electronic agent the carrying out of some duties that are considered by the law to be vested in him by its user? Transfer of authority by one agent to another is also something that has been regulated by agency laws a long time ago, but having in mind the alleged inability of electronic devices such as electronic agents to express their own will, this author believes that *ex analogia* application of agency law rules in cases such as the one described is even less feasible, since applying agency law to a physical person – electronic agent relationship is one thing and applying it to an electronic agent – electronic agent relationship is quite another.

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19 See id. at p. 558 -560.
21 See id. at p. 240. On the other hand Fischer has a somewhat different opinion on this matter, since he suggests that the consensus problem should be solved by adopting a legal fiction of the consent between principal and his agent. See Fischer, John P. op. cit. at. 569.
Finally, keeping in mind the above presented pros and cons of electronic agents being treated by the law as *sui generis* agents of their users, it seems that it is safe to say that, although the idea has some apparent advantages, at least so far, the lack of its proponents to provide solutions for significant problems related to it disqualifies the very idea from being the core of the solution searched for in positioning electronic agents in our legal systems.

### 4.4 Expanding the Boundaries of Contract Law

There are two leading theories concerning the nature and interpretation of the consent to enter into a contract. Subjective theory of contract formation, being one of them, emphasizes the importance of each parties’ subjective expectations and anticipations, their real desires and not their statements or actions being interpreted by others as the consent to contract. To the contrary, objective theory of contract formation is based on the standpoint that the external acts of the party are the ones of key importance when it comes to determining whether consent to a specific contract has or has not been given. Thus, it is what a reasonable person interacting with the party allegedly consenting would make out from the external communication of purported assent and not the actual intent that is of the utmost importance. However, it seems today that these two theories, as well as regulatory solutions based on them, have converged to the extent that there are not many differences when it comes to applying those to specific situations in various legal systems belonging to western civilization and its legal tradition. Also, it seems to be the fact that this process of convergence led to many basic principles of the subjective theory of contract formation being discarded in favor of the objective theory, which has now essentially prevailed even in most of the legal systems still supporting the subjective theory on the formal level. This, of course, should be considered as “good news” for the future of electronic agents, since for obvious reasons it is much easier to try to fit these artificially intelligent entities within the boundaries of the objective theory of contract formation, than to try the same within the boundaries of the subjective theory. Be it as it may, it is this author’s opinion that, no matter the convergence of the subjective contract law theories in civil countries towards common law objective theory, there is obviously no way to legalize contracts formed via electronic agents within existing legal systems based on civil law without legislative intervention, by relying exclusively on extensive interpretation of existing theories and associated regulation. Thus, the question at hand is whether electronic agents can be fitted within the boundaries of the objective theory of contract formation and regulatory regimes embodying this theory without making any changes to it?

There are authors suggesting that electronic agents should be treated as no more than a mere tool of communication, that their users should be considered liable for all their actions, as well as that it is feasible in practice without any changes to existing contract laws based on the objective theory of contract formation. This reasoning is more or less based on a simple premise that it is the act of programming and putting to use the electronic agent that is to be uncontest-
able indicator, or better still, the very act that signifies human user contractual consent to whichever contract is entered into via his electronic agent. However, there is no comprehensive effort to further elaborate and scientifically justify such reasoning, or better yet, such assumption, within the context of objective contract theory and regulatory solutions based on it, especially in the case of contracts formed as the result of electronic agents interacting between themselves, since these contracts are much more questionable than the ones formed as the result of human to electronic agent interaction processes. The above fact, along with the absence of any similar “extensions” in the interpretation of key theoretical positions and according regulatory regimes that may be applicable or at least indicative enough in the context of contracting via electronic agents, especially via “creative” ones that are capable of adapting to new circumstances and of altering their activity patterns in order to improve their ability to meet preprogrammed objectives, led this author to believe that, despite its apparent attractiveness, the above assumption is a far-fetched interpretation of objective contract theory as we know it. Hence, accepting the idea of the electronic agents being treated as the extension of their users would require adopting a specific legal fiction, which would eventually lead the efforts at hand from extensive interpretation of the existing contractual consent theories to a point where one might actually need to create and implement a whole new theory or make such radical changes to the existing one that it would lead to reconsidering its very foundations even to the point where one might ask if it is still the same theory. On the other, it needs to be emphasized here that this way of legal reasoning is an effort as legitimate as any other made towards adequate regulation of the use of electronic agents, but as we stated already, it seems that the implementation of it would represent more than just extensive interpretation of objective theory. However, this seems to be exactly the road that the legislators had taken in United States, the first country to explicitly include electronic agents in its positive law. Hence, the only regulatory intervention that has been in made in respect to contracting via electronic agents in the United States was the one to reaffirm this way of legal reasoning by the legislator.

The United States Uniform Commercial Code stipulates that “a contract may be formed by the interaction of electronic agents of the parties, even if no individual was aware of or reviewed the electronic agents’ actions or the resulting terms and agreements”, as well as that it can be formed in the interaction of electronic agent and an individual. From this it is obvious that United States federal legislation adopted the above legal fiction that contractual intent is inferred directly from programming and the use of the electronic agent. However, it is not solely this author’s belief that, in doing so, it considerably altered the widely recognized notion of contractual consent. Furthermore, it was done without any subsequent legislative solution being offered in regard to electronic

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26 An interesting effort encountered by this author was one made by Bellia who reasons that programming an electronic agent and putting it to use may safely and without extensive interpretation be considered as an open contract offer and asks a question: “may not both parties, as offerors, assent in advance to the anticipated assent of the other?” However, notwithstanding the fact that by referring to advanced assent he indirectly negates the idea that the very act of putting an electronic agent to use should be considered as sufficient manifestation of such an assent, he fails to further elaborate whether an assent may be given in relation to the expected but still nonexistent and uncertain offer, with its content, in addition to this, being confined within programmed parameters but completely unspecified as well? See Bellia, Anthony J. “Contracting With Electronic Agents” Emory Law Journal (Fall 2001): p. 1057 – 1509.

27 Similar positions have been taken by other authors. See Widdison, Robert & Allen, Tom, op. cit. at p. 52.

28 The fact that specific regulatory solutions for the validity and enforceability of contracts formed via electronic agents were considered necessary can also be thought of as the implicit confession by the United States legislator that the existing regulatory frame at that time, which was already based on pure objective contract formation theory, was not enough to support this idea.

29 See Subsection 4 of the Article 2–204 the United States Uniform Commercial Code, which was amended in 2003. Similar in essence to this is the regulatory solution embodied in Article 12 of the 2005 United Nations Convention on the Use of Electronic Communications in International Contracts, which still hasn’t come into force.

agents being branded here as creative ones. This means that no matter the gravity and type of the deviation displayed by the electronic agent within his activities, under this legislative solution any of the activities undertaken by such an electronic agent would still be directly attributed to its user, which would accordingly make the user directly liable for those activities.\(^{31}\) The above said is reason enough to find that the United States regulatory solutions for electronic agents is not as enabling and encouraging as one would expected it to be, although its simplicity made it seemingly a comprehensive one.

On the other hand, situations considering the legal status of electronic agents seem to be even less resolved by positive law in Europe. More precisely, this issue has not been addressed by legislators at the national or the supranational level. The Directive on electronic commerce,\(^{32}\) surprisingly or not, does not address the issue of electronic agents at all. It only obliges member states to remove any obstacles to achieving full legal effectiveness and validity of contracts concluded through electronic means.\(^{33}\) Weather this should be considered to be a lack of any legislative guidance on the matter at hand or implicit encouragement to member states’ legislators and courts to enable the described use of electronic agents in contracting through extensive interpretation and more detailed regulation remains a dilemma for the time being. Hence, having in mind the situation in Europe as well as the above described insufficiencies of United States positive law on the matter, it seems that we are still to search for the comprehensive, that is to say, clear but also enabling regulatory solution for electronic agents and contracts formed as the result of their interaction.

5. Instead of Conclusion – Removing the Remaining Legal Obstacles

The solution introduced by the United States legislator is a comprehensive one, since it directly attributes liability for almost each single activity of an electronic agent to its user. However, whether this is an extension or serious alteration of the ruling common law contractual consent theory is one question, but whether this is a practical and economically sound solution is quite another, even more important one. Namely, although it seems to represent a comprehensive regulatory solution, the fact that it practically makes users directly liable for each single activity their electronic agents undertake, with almost no specific exceptions to go along with generally recognized excuses for nonperformance, make it also a deterring one when it comes to the use of electronic agents in electronic contracting. On the other hand, as we have seen, it seems that it is still not the time for electronic agents to be awarded legal personhood or treated by the law as \textit{sui generis} agents of their users. So, what is the solution then?

First of all, since there are no magic solutions in legal science, it seems that, at least for the time being, when it comes to the validity of contracts concluded via electronic agents, we might just have to accept and find a way to implement a specific legal fiction that legal relations may be formed as a result of their interaction. For most of the civil law countries this should represent a big change in positive contract law. As for contract theory and the law on obligations in generally, it may signify the extension or the revision of existing doctrines in various directions. For example, one of the legitimate efforts would be to analyze if we could consider interaction by electronic agents to be the new

\(^{31}\) There is an exception, but it concerns only contracts formed as a result of interaction between the electronic agent and an individual. Namely, Section 2-211 stipulates that a contract formed by the interaction of an individual and an electronic agent “does not include terms provided by the individual if the individual had reason to know that the agent could not react to the terms as provided.” However, this doesn’t make a huge impact on the general rule that human or corporate users of electronic agents are deemed to be responsible, i.e. liable for their actions.


\(^{33}\) See Article 9 of the Directive.
source of quasi-contracts. Another, even more drastic idea would be to reconsider envisaging some revolutionary new source of obligations, distinct from contracts. In any case, undertakings of electronic agents will and presently should stay attributable to their users. However, it is safe to assume that in the near future, along with their dynamic “evolution”, the voices asking for electronic agents to be treated as legal persons will become much louder. Actually, one must admit that it is not hard to imagine that sometime soon they will be given certain assets to manage for their owners (e.g. stocks, bonds and other equities). Is it then not so hard to imagine that they will eventually become formal owners of such assets as corporations are, as well as that their owners might be considered to bear limited liability for their obligations, as is also the case with the owners of a corporation? This author believes that it is not. Law has always had the duty to adjust and accommodate the needs of every aspect of human activity, especially the commercial ones.

Back to the present, as stated earlier, legally recognizing contracts formed by electronic agents and attaching all liability for their acts to their users is not enough to encourage the use of electronic agents any more. There are now autonomous and creative electronic agents that are very helpful to their users, but sometimes unpredictable as well. Notwithstanding the above insinuated future developments, this author believes that, at this point in time, regulatory solution intended to encourage the use of such electronic agents must combine legal and technical standards. More specifically, building on the idea mentioned earlier in this article, a legislator may envisage and encourage to a certain extent the establishment of the system of registration requiring the electronic agent to satisfy minimum technical, i.e. security standards in order to be licensed. These standards would have to be focused on narrowing down the potential for mistakes to a relative minimum. Furthermore, narrowing down the risk of mistakes should encourage insurance companies to protect users against liability for their electronic agents’ activities. Accordingly, physical and legal persons would be encouraged to use even the most advanced specimens of artificially intelligent entities, at least those that satisfy established standards. Obviously, this is much easier said than done, but this idea, if implemented successfully, might just have the potential to take current electronic agent regulation from being seen as deterring and “disinterested” to being understood as generally encouraging, as well as one that provides contracting parties with a satisfactory level of legal certainty at the same time.

There are other authors supporting this concept and suggesting even that this registry should not be limited exclusively to registration. They argue that the system behind it should be authorized to monitor all transactions and intervene in particular cases, those in which some anomalies may indicate that electronic agents are exercising too much creativity. Furthermore, it seems that this solution would allow manufacturers and users to manifest even more creativity in producing and commercially using electronic agents, since the expected “mistakes” arising from the higher level of creativity displayed could be prevented or undone by a trusted authority. See Kafeza, Irene, Kafeza, Eleanna and Chiu, Dickson K.W. “Legal Issues in Agents for Electronic Contracting” Proceedings of the 38th Hawaii International Conference on System Sciences (2005): p. 7, available at http://www.computer.org/comp/proceedings/hicss/2005/2268/05/22680134a.pdf.
ELECTRONIC COMMERCE AND THE ELECTRONIC CONTRACT - CONSUMER PROTECTION

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Abstract

This paper explains the concept of electronic commerce and electronic contracts, encompassing its specifics and characteristics vis-à-vis traditional forms of trading and contracting, security of legal transactions, protection of personal data, protection of consumer rights, electronic signatures and other aspects of e-commerce. Starting from that point, this paper focuses on domestic and international legal frameworks for electronic commerce and electronic contracts and the practical aspects of their application. Besides the general issues relating to electronic commerce, this paper examines the legal protection of consumers as subjects of e-commerce. From the perspective of consumers, several legal acts are analyzed, including the Macedonian Law on consumer protection. Particular attention is paid to the problem of the “weaker contracting party”, violations of the principle of equality of the parties, and the principle of autonomy of the will. This paper analyzes the general conditions of contracts, with particular emphasis on formulary, typical and adhesion contracts as the dominant type of contracts under e-commerce.

Key words: consumer, contracts, E-commerce, legislation

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ELECTRONIC COMMERCE AND THE ELECTRONIC CONTRACT - CONSUMER PROTECTION

Technological and economic development, and the progress of civilization in general, have changed the basic rules of living and working in recent decades. Novelties are marked as information society (IS) and electronic commerce (e-commerce). The term information society is used to indicate the growing use and impact of information and communication technologies (ICT) progress in social, political, cultural and economic spheres of life in the society. Technological innovation, which primarily started in the 15th century, transformed the forms of communication together with skills in collecting, storing and manipulating information, and became an important catalyst for political, economic and social changes. At the same time this development began to redefine the existing social and economic institutions.

All these developments have been reflected in the development of trade. The main features of the information society in comparison to previous times are quantitatively richer interconnectivity, interactivity, and fast variability of the social framework. As a consequence of the above mentioned, there is increased uncertainty in all commercial entities and an increased need for adaptation to change, informality and the availability of abundant information.

Globalization, liberalization, the Internet and other ICT characteristics define the framework of society which arises when such changes are possible due to the innovation of more powerful computers and technologies. These phenomena are often interconnected and they produce very complex entities characterized by significantly strong dynamics. The identity of the entities involved in these phenomena is one of the most important factors facing the society in terms of expectations of consumers, which is particularly increased by positive experiences in the field of electronic commerce.

In this so called “new economy”, consumers, legislators and businesses are very often faced with constant processes of adaptation to new technological improvements, strengthening of international competition and mobility of (former) national resources. For businesses and public sector entities, this adaptation necessitates continuous organizational restructuring and strategic research. At the individual level, adaptation requires permanent education.

The last decade has marked a sharp upswing in the use and adaptation of a wide range of users of ICT. The Internet has grown to unprecedented proportions, which has caused an outbreak of e-commerce. At the same time revolution in the field of commercial delivery services was realized. Public administrations around the world have prepared (or are currently preparing) strategy for electronic service delivery, from which we can expect a new electronic revolution in the near future. Enthusiasts predict that reorganization of the existing public sector (generally worldwide) will save money and time while increasing reliability and customer satisfaction, establish a so called digital democracy, increase the transparency and interactivity of management, and will secure proper redistribution and allocation of financial resources.

Electronic commerce and particularly the electronic contract itself in some aspects differs from the traditional concept of contracting considering its specific characteristics, prompting the need for its precise definition in accordance with international legislation and practice. An aim of
the research of the mentioned subject is complex and consists of two key aspects: to contribute to Macedonian legal theory through scientific analysis of electronic commerce as a significant global phenomenon and a relatively new form of trade relations, and to examine electronic contracts in the context of its differing characteristics from traditional forms of contracting. Further, special consideration will be given to defining specific measures to be taken in the Republic of Macedonia for the development and promotion of electronic commerce.

The meaning of e-commerce still isn't uniformly defined, but the most accepted definition of the term e-commerce is: the commercial use of the Internet or use of information communication technology (ICT) through which businesses communicate to their (potential) business partners or their (potential) customers. It is considered that e-commerce is at the crossroads of many different legal areas: contract law, international private law (conflict of laws), legal regulation of advertising, the right of intellectual property, consumer protection, data protection, taxation and tax law, and other regulatory areas. In addition to these traditional areas, a process of creation and development of two legal areas which are relatively independent of the previously mentioned can be seen. These two areas are related to digital editing and electronic signatures, and the registration and use of domain names.¹

In modern business there have been significant changes in the relationship between the merchant and the consumer. The consumer now has the possibility to search and to use the almost unlimited possibilities of the Internet. He has the possibility to change locations and to be closer or farther from the electronic store of the merchant. A single mouse click is sufficient to leave the store, or make a transaction and execute the purchase of a particular product or service, or just to establish communication with the trader to obtain a certain product's data, with no obligation to buy it. In the framework of globalization, in respect of easily available information the market has taken on a different shape. For example, trading in the traditional model, the buyer will visit a real estate agency, a bank (for credit), will see an apartment and make comparison with similar offers on the real estate market. In the conditions of e-commerce, a customer can visit a website which contains information about the real estate market and in one place can find all the necessary and relevant data about the apartments that are on offer, their cost, construction deadlines, payment conditions and more, with the opportunity to preview the apartment through virtual reality technology.

One of the most important issues in the field of e-commerce is that of legal protection of consumers. With the development of the Internet as a market which uses modern technologies (ICT) as its own medium, this problem becomes more and more significant. Besides the new goods and services available to consumers, the electronic market (e-market) contributes to the emergence of new regulatory issues. The lack of transparent legislation for the protection of consumer rights precludes realization of the full potential of the e-market. The consumer, without knowledge and understanding of his rights and responsibilities, may be hesitant and insecure regarding the decision to participate in transactions via the Internet. In regards to electronic contracts (signed online), consumers can come across one of the (certainly for lawyers) most interesting clauses - limiting liability or relief from liability, the so called disclaimer notice. This clause is a legal notice placed on the website of the merchant by which consumers that have visited the website are informed that the owner of the website does not take liability for data and inaccuracies that may occur, which could bring a potential buyer to confusion regarding the matter of the contract. In fact, the essence of this declaration consists of unilateral disclaimer of liability, provided by the merchant in order to reduce or minimize the risk of initiation of court proceedings in the member states of the European Union,

or wherever they want to trade, or rather, not to trade. Such a disclaimer usually states: "The owner of this website is not responsible for any errors..., or for example with regard to legal advice and services: "the materials available on this website are for informational use or serve as legal advice only. You should consult your legal advisor/advocate to obtain the relevant service to resolve your problem. The use of, or access to this website does not create an advocate-client relationship between the Advocate Association and visitors to this website. The information and opinions expressed on this website are individual opinions of the author of the page and do not necessarily reflect the opinions of the company or any individual Legal Advisor." This clause must be clearly visible (although in practice this is not always so). The clause must be placed on the home webpage of the company, or the page that refers to the product or service which is subject of sale. A highlighted link located at different places on the website can also be placed.

Companies most often use a disclaimer notice for the following reasons:

- Removing the liability of the company for actions committed by their employees;
- Ensuring that email cannot be considered as a binding contract;
- Reminding the recipient that the message content is confidential;
- Warning the recipient that it is possible the message may contain a virus;
- Emphasizing that the message is intended exclusively for the selected recipient, and that it can not be forwarded to another recipient without prior consent of the company.

No international convention or legal instrument attempts to define such a disclaimer clause, primarily because it represents a unilateral declaration of will. So the question is whether and to what extent such a unilateral declaration of will of one of the contracting parties may limit its liability. Opinions are divided, but I consider that traders that have in advance restricted their liability for fear of collapse of the contract or its failure, by using this clause may refuse any customer (or at least those who managed to find and read the clause on the website!). The proper solution on this issue is defined in Directive 1993/13 on the unfair terms in consumer contracts.

The Internet opens opportunities for various irregularities and illegal acts. These opportunities are directly related to commercial transactions and the flow of information that follow these deals, which again brings us back to the question of the relationship between national and international legislation. Special attention is warranted by e-commerce that takes place between professional traders and consumers (B2C), where the consumer is positioned as the weaker contracting party and has a weaker negotiation position vis a vis the professional merchant. Consequently, there are a number of legal instruments to protect consumers in e-commerce. Also, it is evident that even a limited international market for Internet commerce may, if not precisely regulated, have significant negative consequences for consumer protection within traditional national markets. If the international legal framework governs certain types of transactions, the question of whether it would be possible to establish and maintain national legislation with rules that differ substantially from international legal legislation for the Internet, may be raised. Certain issues concerning consumer protection such as authenticity, quality and reliability, cancellation period, payment, marketing practices and privacy, are already mentioned and analyzed in the reports of representative international organizations. Finally, in circumstances where modern trade provides a broad offering with the need to

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4 Naumovski Goce, and Dokmanovic Miso, Pravo i informaticka tehnologija, Skopje, 2009.
achieve a high level of consumer protection, which is the basic precondition for equal participation of the Republic of Macedonia in the single European market, it is necessary to create unique and high quality institutional structures as the basis for implementation of effective consumer protection. In order to achieve such a goal, all national bodies, governmental and nongovernmental organizations in the area of protection of consumer rights should act and cooperate in compliance. It means developing the administrative infrastructure that will perform market surveillance and enforcement of the law. Also, it is necessary to adjust and develop legislation in line with international legislation, the ongoing development of electronic commerce and overall globalization of the market. In this regard, the European Parliament and the Council on 25 October 2011 adopted Directive 2011/83/EU on consumer rights6.

This Directive provides the highest level of protection of consumer rights and establishes a quality and efficient internal market, and cheaper and easier mobility of traders in cross-border transactions, thereby providing more choice and competitive prices for consumers. It replaced two existing consumer directives and amended two others. Simultaneously, this Directive will contribute to the improvement and modernization of existing consumer rights, in step with technological change (e.g. mobile commerce, also known as m-commerce, and online auctions) and the strengthening of provisions in critical areas where consumers have problems.

In the Republic of Macedonia consumers are protected by the Law on Consumer Protection adopted in 20047. The law contains a special chapter dedicated to distant contracts. The distant contract (B2C contract) is considered as an agreement concluded between a trader and a consumer within the organized sale of products or provides services organized by the trader who, at the time of concluding the contract, has the exclusive use of one or more means of distance communication. The means of distance communication are defined as assets that are suitable for concluding agreements between a trader and a consumer without the simultaneous physical presence of the merchant and consumer. Inter alia, means of distant communication are considered to be video text, fax, television, electronic mail and the like. The law defines the operator of the means of distant communication as any public or private natural or legal person whose trade activity, business or professional activity allows the supplier to use one or more means of remote communication.

Application of the Law on Consumer Protection is excluded for agreements already listed in the Directive on Consumer Protection Agreements: contracts for providing financial services (insurance, investment services), contracts concluded by means of automatic machines for sale, with means of telecommunication operators and through the use of publicly available telephone-public speakers; contracts for construction or sale of real property or other rights related to real estate, with the exception of the lease, contracts concluded in an auction, as well as certain contract supply of food products, food, accommodation, transport and catering, delivery at a specified time or period, as well as contracts for the sale of products in limited circulation, such as pharmaceuticals, medical and veterinary products and flammable and explosive substances.

The merchant is obliged to notify the consumer within a specified period of time before signing the contract, and in particular to provide: name, business name, ID number and full address of the merchant or the person to whom the consumer can make its objections, the names of offered products or services, the main features of the products or services, prices including tax and other taxes, the cost of delivery, conditions of payment, method of delivery of products or services, servic-

ing, guarantees for the products or services, the right of the consumer to cancel the contract and the
deadline for termination, the cost of the means of remote communication, if they are not included in
the price, the period in which the supply and price are valid, etc. The Macedonian law also regulates
the issues related to verifying prior notification, the right of cancellation when prior notification
is delivered or not delivered, the method of termination of the contract and the consequences of
termination, and cases where termination of the contract is allowed. Finally, the Law on Consumer
Protection contains provisions governing the issue of misuse of credit cards and consumer bans on
sending products without prior consent by the consumer.

Technology is changing people’s lifestyles and the law must follow these changes. With the
rapid growth of e-commerce, consumers want to be able to buy goods and services from home and
it is evident that home shopping is a rapidly growing, increasingly sophisticated sector. Traditional
catalogue companies have a long established reputation and many new Internet sites which have
either evolved from traditional bricks and mortar companies, new dot.com companies or interactive
television have already built up confidence and trust with consumers. The government wants to be
sure that legislation gives consumers the confidence to take advantage of the choice and opportu-
nity available from the Internet, as well as from catalogues and other types of home shopping. In this
context, the EU Distance Selling Directive (Directive 97/7/EC) was adopted on 20 May 1997\(^8\), which
gives legal protection to consumers who purchase goods and services from businesses via distance
contract. This concerns cases where the consumer and supplier are not physically present together
up to and including the moment when the contract is concluded, including also:
- e-commerce and email sales;
- telephone and fax sales;
- newspaper, catalogue and mail order sales.

The Directive does not apply to all distance selling contracts, namely not to contracts: for
the sale of land or construction of buildings, relating to business-to-business financial transaction
services, concluded by means of an automated vending machine or automated commercial prem-
ises, concluded with a telecommunications operator through the use of a public pay-phone, and
contracts concluded at auction.

There are numerous rights reserved in favor of consumers. First, the right to be provided
with information relating to the transaction in advance of any contract being made. Suppliers will
be required to provide information which will include the name and address of the supplier, the
price and description of the goods or services, payment options, the cost of using the necessary
communications channel and, most importantly, the right to withdraw from the contract. The sup-
plier must make his commercial purpose clear, and in the case of telephone sales do so and identify
himself at the outset. Second, the right to receive written confirmation. The consumer must be given
confirmation in writing or other durable medium, which must include details of the transaction, the
conditions for exercising the right to withdraw from the contract, any cancellation conditions, after
sales service and guarantees, and a physical address to which complaints can be sent, if necessary.
The means of written information or other durable medium are not specified because of the con-
stant developments by which communication is possible. However, e-mails are considered a durable
medium and therefore an acceptable method of sending confirmation. Third, the right to withdraw
from the contract. The consumer has an unconditional right to withdraw from a distance contract
and have their money refunded. Any related credit agreement will be cancelled automatically, and
the supplier must inform the creditor accordingly. Fourth, the right to receive delivery of goods/
services within 30 days, unless otherwise agreed. If the supplier does not perform the contract and

\(^8\) Directive 97/7/EC has been repealed as of 13 June 2014, see Art. 31 of the Consumer Rights Directive 2011/83/EU.
deliver the goods/services within 30 days, then unless the parties have agreed to a longer period the consumer will be automatically entitled to a refund, unless substitute goods or services are supplied and he or she accepts them. If a refund is requested it must be made within 30 days.

There are some exceptions to the right to withdraw from a contract. Namely, the right to withdraw from the contract shall not apply to certain contracts (unless the parties have agreed otherwise) such as those for the supply of goods or services the price of which is dependent on fluctuations in the financial market which cannot be controlled by the supplier, the supply of goods made to the consumer’s specifications, or which by their nature cannot be returned or are liable to deteriorate or expire rapidly (e.g. pizzas and flowers), the supply of audio or video recordings or computer software which have been unsealed by the consumer, newspapers, periodicals, magazines, gaming, betting or lottery services.

A consumer who cancels a distance contract after receiving any goods supplied under the contract must restore them to the supplier and take reasonable care of them in the meantime. The consumer is only under a duty to deliver the goods to the supplier at his or her own premises, on receipt of a request in writing or other durable medium. Once the consumer has done so, or sends them back to the supplier at his or her own expense, he or she is no longer obliged in any way to take care of the goods. Where the consumer sends the goods back, he has to take reasonable care to ensure the goods are received undamaged, but has no further obligation.

E-commerce as a kind of universal phenomenon is transforming the common learning on contracts and bringing innovations in several segments of contract law. Consumers are in doubt, confused by the surge of “fast”, covered, packaged deals. By opening a software package or by simply pressing the “agree” or “accept” button, the consumer puts himself, often unconsciously or based on inertia, in a series of binding conditions that can create unwanted obligations. It puts consumers at a disadvantage with a significantly lower negotiating positions as part of those agreements. This, in turn, means a violation of the basic contract law principle of equality of the parties. According to this principle, parity and equality of the parties consists of the premise that none of the parties has an authoritative or subordinated position and, that neither party in the genesis of the relation can dictate the scope and content of that relation. However, in modern commerce, particularly in terms of e-commerce, neither merchants nor consumers have the time or opportunity to negotiate on the basis of equality of the parties. On the other hand, the use of advanced technologies through processes of simplification and accelerating trade transactions are de facto transforming the contracts into a common technique for achieving business objectives. We have traders who offer goods and services online, and to initiate transactions usually take just a few clicks with the resulting instant and unconditional agreement to accept the price, the deadline for delivery, guarantee and method of delivery. This is the kind of abuse of position by traders in B2B and especially in B2C relationships, and is often expressed through their monopoly or oligopoly power and their identification as a stronger contracting party to dictate the terms of contracts and speak from a position of take it or leave it, as opposed to the inferior consumer. This inequity not only applies to consumers; this group typically includes suppliers, carriers and other entities involved, in one way or another, in business ventures who are forced to sign commonly part-time contracts for business and technical collaboration with pre-specified rights and obligations, without negotiation and bargaining. Legal remedies are rare because initiating court proceedings can generate higher costs than that which the “damaged” side has suffered.

When it comes to contracting, we must not forget the principle of party autonomy, which is expressed in two forms: the freedom of contract and disposition of subjects. Freedom of contract comprises three segments: the legal entities have freedom to independently decide whether to en-

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ter into obligatory and legal relations, to choose with whom to enter into such relations, as well as to regulate the content of the relationships on their own will, without coercion.\(^\text{10}\)

We must not forget to mention a fourth segment.\(^\text{11}\) The party autonomy in conditions of modern commerce, in particular electronic commerce, suffers greater limitations which produces division of the contracting parties into weaker and stronger entities. Often the stronger parties are considered to be those entities that have developed long-term trading practices. These subjects perform pre-prepared contracts, which usually contain the general conditions, and submit them to the other side which just has to accede and to accept, with possible minor changes incorporated into specific contractual clauses. Consistently, the general conditions of contract are not negotiable and they represent an integral part of the contract, unless the parties clearly did not preclude their use, when possible, or they were not changed by special contractual clauses.

General conditions have a double effect: they represent, on the one hand, a general contracting offer, and on the other hand, if the contract is signed, they become an integral part of the contract. The principle of freedom of contract guarantees only the right but not the actual behavior of the freedom of contracting parties. The party which is economically or socially disadvantaged must adjust to the will of the stronger party, therefore its freedom is in fact limited. Such limitation is expressed exactly by the standardization of contracts through formulary contracts. Although the legal system tries to reduce the gap between the two parties and their wills, market conditions dictate that the weaker party must accept or give up.\(^\text{12}\)

General conditions are part of the so called formulary law, in which, despite the formulary contracts, are included typical (where there is minimal chance for the parties, on the basis of negotiations, to amend some of the clauses) and adhesion contracts (template, in which there is no bargaining, which are en bloc accepted).

Statistics show that 95% of the total number of contracts in the global economy are formulary contracts. These agreements are being prepared by the merchant as a contracting party (seller), and at the moment of signing the contract are presented to the buyer, who usually is not in a position to change the terms and has to accept them as they were served. The conclusion of these agreements is usually made quickly, and this fact makes them extremely suitable for e-commerce and contracting between absent persons; in these cases the buyer does not have time to become familiar with the contents of the contract, but simply signs it or presses the button on the mouse. For the buyer there is often a subjective feeling of being manipulated, but the stronger party compensates by “decoration” of contracts as a psychological strategy, i.e. changing the font, size or color of the letters and thus conceals unwanted obligations or disadvantages which that agreement imposes on the buyer/consumer. When observing the genesis and evolution of adhesion contracts, as well as their application, we can conclude that their existence depends on substantive and practical reasons. The essential nature of this kind of agreements is reflected in the inequality of economic entities and the intention to “formalize” the will of the economically stronger party, while its practical nature is determined by the techniques of conclusion of contracts and their unification, due to the huge number of identical or very similar agreements that are being concluded by entities within their business. In any case, I think that the practical aspects of these contracts are prevailing, due to the large number of entities that are present in the market as well as the increasing degree of modernization of the manner of trading and contracting. A opposed to negotiated content agreements, the offer in case of an adhesion contracts is general and permanent. The “generality” of the offer may

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be recognized in the fact that it is addressed to an indefinite and unlimited number of entities and that each of them may accept the offer, as offered and in whole, and as a result thereof the content of the offer becomes content of the contract\(^{13}\). The “permanency” of the contract, however, stems from the fact that the entity which is posing the offer conducts continuously, i.e. it is part of the performance of its regular and constant activity. With application of the general conditions of contracts, the content of the agreements is being standardized. The reason for this is mass production, mass distribution and delivery of services, especially in the field of e-commerce and e-contracting. Individual negotiating and contracting is a slow and expensive process, particularly for large companies. The use of new technologies and rapid transmission of data through the Internet simplifies the signing of contracts, and the negotiations refer only to the technical and logistical aspects of the contract—the amount, the terms and the manner of delivery etc. The creators of the general conditions of contracts always strive to provide, as much as possible, a dominant economic position for themselves. They are in a psychological advantage to users because the content of the contract and general conditions are prepared by legal, economic and other experts without rush and pressure. The opposite side is usually lacking time to study and investigate all details of the contents of the general conditions of contracts in order to develop its own position, and thereby is in a weaker economic position with no special knowledge of law and economics. Therefore, based on the need to protect the rights of consumers as weaker and deprived parties compared to retailers, the European Commission adopted the Council Directive 93/13/EEC of 5 April 1993 on Unfair Terms in Consumer Contracts. The provisions of this Directive are fully transposed in the Macedonian Law on Consumer Protection\(^{14}\).

Formulary contracts, by definition, are a set of written clauses formulated by one of the parties of the contract that in such or modified form will constitute the content of a contract when concluding a particular contract in the future. These agreements do not contain some of the essential elements of a contract to be concluded, but instead empty spaces to be subsequently completed are provided in advance, and at the same time the general conditions are printed in advance. Also, the contracting parties may, upon mutual consensus, change the clauses prepared in advance. On the other hand, adhesion contracts may not be amended, i.e. the possibility to negotiate in regard to clauses is excluded (this results in the consumer being the weaker side, given the fact that the consumer did not participate in the drafting of the agreement and establishment of the contents of its clauses). Thus, the role of party autonomy in this case is reduced to the minimum possible extent, which leads to a decision of the weaker party to accept and sign, or to reject the offered contract. This leads to questioning of the freedom of contract, as well as the opportunity for declaration of free will of the consumer as the weaker contracting party\(^ {14}\).

The issue or the problem of a weaker contracting party previously existed and will exist in the future, given the positioning of the subjects of trade and the rising frequency of commercial transactions, particularly those with an international (foreign) element. It is clear that, in terms of e-commerce, where the consumer is happy and satisfied because he is “attacked” by numerous offers for various goods and services that can be purchased online via the Internet, he is actually blind and ignorant regarding the legal regulation of these transactions and has two dilemmas: whether to engage in a venture called e-commerce and the online signing of electronic contracts, or to unconditionally accept what he was offered and to enter into obligatory and legal relations and to fulfill the obligations imposed by retailers, with virtually no opportunity to influence the scope and char-


\(^{14}\) Васильев Е.А., Комаров А.С., Гражданское и торговое право зарубежных государств -1 том", Международные отношения, Москва, 2004.
acter of those obligations, and without duress to accept those by pressing the button on the mouse which means perfection of the contract. Often the consumer is not aware that, in this particular case, he becomes the weaker contracting party. Although this may seem complicated and a bit upsetting for the consumer, the global trend of expansion of e-transactions indicates that consumers have confidence in e-commerce and do not feel disadvantaged or subordinated. On the other hand, any country that aspires to develop and stimulate e-commerce must create a legal framework that gives consumers a solid legal protection from possible abuses and violations of their consumer rights.

Final remarks

Electronic commerce is just an alternative way of trading. E-commerce does not replace traditional commerce, it is just a sophisticated upgrade of traditional commerce. Both ways of trading are complementary, to some degree competitive, and must exist and function in symbiosis. Furthermore, there are opinions that e-commerce globally has not yet reached its zenith, although there is an excellent legal framework based on several international legal instruments transposed into national laws. In Macedonia there is a solid legal framework for all segments of e-commerce, but practice shows that there is almost no e-commerce, or only isolated forms. The reason for this situation lies in the inactivity of the subjects of e-commerce, mentality and habits of the population, consumer habits and fear of the “unknown”. There must be an aggressive promotion and education of the benefits of e-commerce, supported by the state, banks, retailers, consumer associations and other entities involved in this area of trading.

REFERENCES

TOWARDS A GENERAL PART OF THE EU CONSUMER CONTRACT LAW

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Abstract

The need for a general part of EU consumer contract law has been continuously increasing with the adoption of every new consumer directive for more than the last two decades. The Commission responded with the initiative for a horizontal directive in the Green Paper on the Review of the Consumer Acquis. The Commission suggested in its proposal that the structure of the new horizontal instrument should have one general part containing provisions on all types of contracts. Since the scope of application as well as the content of the adopted Directive on Consumer Rights of 2011 are more modest than originally announced, the development of the general part is still at an early stage. However, the new Directive provides a good basis for further development of the general part of EU consumer contract law. Thereby, the parallel development of general provisions of EU consumer contract law in other new legal instruments, namely the Draft Common Frame of Reference, the Proposal for a Regulation on a Common European Sales Law and the Rome I Regulation, needs to be examined for coherence, considering that coherence on an EU level is the main goal these instruments seek to achieve.

Key words: Consumer Rights Directive; Common Frame of Reference; optional instrument; Directive 2011/83/EU; Rome I Regulation; consumer contract.

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1. Fragmentation of National Laws - Fragmentation of EU Directives - General Part of EU Consumer Contract Law

The existing directives in the area of EU consumer law arose as a response to particular regulatory needs in specific fields of law, with independent values and characteristics.\(^1\) After more than 25 years of legislative activity in the field of consumer contract law, consumer Directives represent the vast majority of the EU law on obligations. The question of necessity of a large number of consumer directives regarding the division of competences between the EU and its member states relies on compliance with the principles of subsidiarity and proportionality. Instead of on the argumentation for fulfillment of the criteria of subsidiarity and proportionality, the argumentation of the EU legislator for the adoption of consumer directives on the grounds of 114. TFEU (ex Art 95 or 100 EC) was based on the formula that “the disparities between national legislations distort competition, and are likely to create barriers to free movement of goods and services”\(^2\). This argumentation is rightly called “a stereotype repetition of an empty formulation”\(^3\), because the harmonization of consumer directives reaches far beyond the orientation towards the internal market.\(^4\) The ECJ decision *Tabakwerbung I*\(^5\) of 5 October 2000 showed that this ground for legislative competence is not unlimited. Contrary to the extensive debate in the science, the later ECJ jurisprudence confirmed that the importance of *Tabakwerbung I* is not as wide as originally assumed.\(^6\) In its decisions *Swedish Match*\(^7\) and *Arnold André*\(^8\) on the competence for the adoption of Tobacco Advertising Directive\(^9\), ECJ regarded even the future disparities between national legislations as sufficient reasons for using Art 114. TFEU (ex Art 95 EC) as a legislative basis. Thereby the development of new trade barriers had to be probable, and it was necessary for the Tobacco Advertising Directive to have the aim to prevent them. Consequently, *Tabakwerbung I* has for the first time enlightened the limits of the Art 114 TFEU.

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2. Lehmann, Friederike, Die Rezeption des europäischen Verbraucherschutzes im österreichischen Recht. Frankfurt: Peter Lang, 2002, p. 35; See e.g. first Recital of the previous Timeshare Directive: “the disparities between national legislations on contracts relating to the purchase of the right to use one or more immovable properties on a timeshare basis are likely to create barriers to the proper operation of the internal market and distortions of competition and lead to the compartmentalization of national markets.”
as a legislative basis and created an obligation for more detailed explanation on the adoption of the measure in question, but nothing more than that. Foremost, in Tabakwerbung the ECJ avoided the discussion on the fulfillment of the subsidiarity criteria.10

Although disparities in national provisions on consumer protection justified the adoption of Directives, with every new consumer directive differences in legislative systems and definitions in individual directives become more distinct. Reason for that cannot be found in the particularities of separate fields of European consumer law, but in the fragmentary approach of the EU legislator towards the adoption of consumer directives for over 25 years.11 The lack of coherency in the EU legislation in the field of EU consumer law has had its impact on the national transpositions. For the national legislator it is almost impossible to systemize its national provisions which implement the directives, because it is not predictable if it is going to be possible to incorporate the future demands of the directives into the previously created system.12 Additionally, the process of implementation of the Directives into the national laws offers multiple opportunities to deviate from the formulation provided by the Directives, which have been extensively used by the member states.13 The comparative analysis of the EU consumer law compendium shows differing implementations in national legal systems on many occasions, which cause or could potentially cause barriers in the EU internal market.14 Even such a fundamental term, like the definition of consumer, does not have a unified application in the member states.15

Thus the need for a "horizontal approach" has grown in the EU legislation, and the Commission answered this need with the Green Paper on the Review of the Consumer Acquis.16 The horizontal approach has found great support in legal science: demands for the systematization of consumer law17, for a general part of consumer law18 or even its codification19, were expressed long

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12 Büßer, Janko, p. 59 (fn. 1).
13 Kammerer, Christoph, p. 246 (fn. 6).
16 OJ 2007, C 61/1.
before the green paper of the Commission.\(^{20}\) Howells/Wilhelmsson already in 1997 mentioned three reasons for codification of consumer law\(^{21}\), which are now appropriate as arguments in favor of the horizontal approach: 1. the codification would ensure unified use of terms of consumer law, enhance the coherence of this legal field and in general offer opportunity to review the existing legislation; 2. EU consumer law would become more clear and accessible, which would increase its reputation; 3. legal gaps in existing legislation would be discovered and create a cause for posing some new legal questions.

The initiative of the Commission resulted in the adoption of the Directive 2011/83/EU on consumer rights\(^{22}\) in October 2011, which contains first evidence of the formation of the general part of EU consumer contract law.\(^{23}\) This legislative process may be regarded as pioneering for other fields of private law. However, such method of creation of EU private law can be criticized for creation of the regulation of particular needs, adopted with deficiencies that create further obstacles for the free movement between member states. Thus it creates itself an opportunity to use the legal basis for a full harmonization in one field of private law, and thereby avoids the subsidiarity test. Namely, a full harmonization for a particular field of private law as the first EU measure in that field would certainly not be justified. At the same time it is not the intention to deny that a gradual creation of a common level of consumer protection, particularly in combination with the minimum harmonization clause, beside other effects, treats the sovereignty of the member states with most respect.


Regarding the structure of the new horizontal instrument in its Green Paper of 2007, the Commission proposed that one general part should contain provisions on all types of contracts. The general part should consist of definitions, general provisions, and provisions on information duties, withdrawal rights and unfair terms. For the purposes of the analysis on the level of development of the general part which has already been achieved with the new Directive on consumer rights (CRD), it is necessary to establish criteria by which it may be determined which provisions should be regarded as belonging to a general part of a particular legal field. The question is, whether we consider the provisions to belong to the general part only if they are applicable to all provisions of the special part, or whether it suffices that they are relevant for some groups of provisions within the special part, but not for all its parts.\(^{24}\) The special part of the consumer law is built by the provisions of con-
sumer directives which directly or indirectly regulate contract law. Right at the beginning it should be noted that the Green Paper of 2007 initiated the review of 8 consumer directives, namely the Doorstep Selling Directive, Package Travel Directive, Unfair Contract Terms Directive, Timesharing Directive, Distance Selling Directive, Indication of Prices Directive, the Injunctions Directive and Consumer Sales Directive. Thereby the Indication of Prices Directive and the Injunctions Directive are not a part of contract law. The Consumer Credit Directive, which is a core part of EU contract law, is left out of the analysis. Further on, it is important that the Directive, in its adopted form, fully amends only two out of the eight reviewed Directives (Doorstep Selling and Distance Selling Directives), and partially amends the Unfair Contract Terms Directive and Consumer Sales Directive. It is obvious that the CRD does not contain any provisions applicable to all regulations of the special part of consumer contract law. They are simply not included into the scope of application of the new Directive. Solutions which existed in the Proposal for the Directive, such as Art 3 (3) stating that fully harmonized provisions on unfair contract terms shall apply to the Package Travel Directive as well as the Timeshare Directive, are left out of the final text of the Directive. Nevertheless, some provisions are applicable to all or groups of provisions within the scope of the application of the CRD, which could, by inclusion of further Directives in the special part of the CRD, evolve to provisions on the general part. Namely, the structure of the CRD is formed in such a way that reviewed provisions from other Directives can be included without further difficulties. This process has already started with the provisions on Doorstep Selling and Distance Selling, because this subject matter is not regulated one after the other, but the common aspects of both Directives are regulated uniformly. In particular the two most important rights of consumers are covered by uniform rules, the right to information and the right to withdrawal. Including the provisions from other Directives in the horizontal Directive, foremost the provisions on consumer credit, Timesharing and Package Travel, the proportion within the CRD would move in favor of the horizontal approach, while vertical harmonization would be restricted to questions characteristic of a particular subject matter. Such a process has already been announced by Recital 62 of the CRD with regards to unfair contract terms and consumer sales. Both fields were included in the Proposal for CRD, but could not be preserved during the legislative process and were left out of the final text of the CRD, with the exception of a few provisions on consumer sales.

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35 Meškić, Zlatan, p. 19 (fn. 11).
36 Meškić, Zlatan, p. 46 (fn. 23).
37 The Directive regulates the delivery (Art 18), fees for the use of means of payment (Art 19), passing of risk (Art 20), communication by telephone (Art 21) and additional payments (Art 22).
Further, it needs to be taken into consideration that the goal of the provisions on the general part of consumer contract law is to create more coherence in consumer contract law by making it possible for the provisions of the special part to be applied uniformly. Increasing the coherence in EU contract law is the common goal of all three projects evolved from the initiative of the Parliament and the Commission on EU Civil Code\textsuperscript{38}, namely the Draft Common Frame of Reference (DCFR)\textsuperscript{39}, the optional instrument in the form of a Proposal for a Regulation on a Common European Sales Law (CESL)\textsuperscript{40} and the adopted CRD. Coherency shall be achieved by the removal of varying scopes of instruments with the introduction of a unified scope of application, unification of concepts used in different meanings, elimination of norms with different content for similar situations and conflicting basic principles and values applied in that branch of law, removal of concrete contradictory norms and with the correction of the “wrong” placement of the norm within the instrument.\textsuperscript{41} The general part aims to achieve most of the mentioned aspects of increased coherency. Such an approach was also taken by the CRD which, in addition to the unified scope of application (Art 3 CRD), contains definitions (Art 2 CRD), unified degree of harmonization (Art 4 CRD) and pre-contractual information duties (Art 5 CRD) as provisions which generally apply to all provisions within the scope of application of the CRD. Additionally, provision on the general part applicable only to certain groups of provisions are foremost the provision on information duties and the right to withdrawal, for now applicable only to Doorstep Selling and Distance Selling Contracts. As already stated, it is expected that with time, the scope of application will be extended to other types of contracts regulated by consumer directives not incorporated into the CRD.

3. Maximum Harmonization as a Necessity of a General Part?

The principle of minimum harmonization, which allows member states to retain existing or adopt new provisions which provide for a higher level of consumer protection, for more than two decades was a precondition for the member states to agree on the adoption of provisions in the area of private law.\textsuperscript{42} The EU legislator already introduced the principle of maximum harmonization in four consumer directives of newer date.\textsuperscript{43} The CRD also follows the principle of maximum harmonization. In its Art. 4 CRD provides that member states “shall not maintain or introduce, in their national law, provisions diverging from those laid down in this Directive, including more or less strin-


\textsuperscript{42} Kammerer, Christoph, p. 16 (fn. 6).

gent provisions to ensure a different level of consumer protection, unless otherwise provided for in this Directive. The provision on full harmonization principles, applicable to all provisions of the CRD, deviates from the outcome of the Green Paper of 2007, where the majority of the respondents opted for targeted full harmonization.44 As Howells/Schulze rightly argue, the CRD is targeting at full harmonization rather than aiming at targeted full harmonization.45 Nevertheless, the CRD allows the member states in several provisions to narrow down the scope of application (Art 3 (4) CRD), to provide a higher degree of protection (Art 5 (4) CRD) or that the transposition of some provisions is optional (Art 7 (4) CRD). Consequently, the CRD combines the mostly applied principle of maximum harmonization with individual provisions on minimum or optional harmonization.46 The provisions which have been previously recognized as the foundation of the future general part of consumer contract law fall under the principle of maximum harmonization. Taking into consideration that their aim is to increase coherency on an EU level as well as the coherency at the level of the member states, the principle of maximum harmonization may seem as a necessary requirement for the establishment of a general part of the consumer contract law. Insofar, the exception to the principle of maximum harmonization in Art 5 (4) DCR is surprising, because it allows the member states to introduce more stringent pre-contractual information obligations for the traders. Firstly, the provisions on pre-contractual obligations are the only ones which regulate consumer rights and are applicable to all types of consumer contracts.47 Secondly, the matter on information duties is pointed out as particularly unsystematic, because of the use of the principle of minimum harmonization. Consequently, the only uniformly regulated field on consumer rights within the CRD, pursuant to Art 5 (4) CRD, in effect does not follow the principle of maximum harmonization, but the principle of minimum harmonization. Therefore the answer to the question, whether maximum harmonization is a necessity of a general part, from the view of the EU legislator seems to be negative either because of political or legal reasons. The arguments in favor of the principle of minimum harmonization are that the legal tradition is taken into consideration to a great extent,48 and at the same time a common minimum degree of protection for consumers is created independently of their domicile.49 The disadvantage is that national legislators have used the opportunities given by minimum harmonization too often, whereby the degree of consumer protection was increased, but also greater differences between national laws were developed. Therefore, traders had to adjust their cross border business practice to different national laws, despite the harmonization by EU Directives.50

On the other hand, maximum harmonization also causes some disadvantages, which should not be neglected. Firstly, member states have so far, by using the minimum harmonization clauses, provided for a higher degree of consumer protection and will now have to lower that level, because maintenance of diverging laws is not allowed. Secondly, the Directive which unifies the existing consumer contract law and at the same time does not allow national legislators to deviate from its provisions, in fact requires the transposition into a new national law. Thus the provisions of the CRD cannot, except with great effort, be transposed into national civil codes or acts on obligation. The consumer contract law is moved further away from general provisions on obligation, which is not

47 This does not apply to contracts concluded away from business premises and distance selling contracts, which are subject to vertical harmonization.
48 Herwig, André, 66 (fn. 15).
49 Lehmann, Friederike, p. 61 (fn. 2).
50 Kammerer, Christoph, p. 17 (fn. 6).
desirable for its use in practice, especially not in the region of the Western Balkans. Finally, maximum harmonization decreases the willingness of the member states to adopt contract law at an EU level. This is already proven by the fact that out of eight Directives reviewed by the Green Paper 2007, and out of four which made it into the Proposal, only two are fully regulated by the CRD.

In the discussion on advantages and disadvantages of the maximum harmonization for EU consumer law, it is often neglected that maximum harmonization causes pre-emption. Namely, according to Art 4 CRD, it is not only prohibited to provide for a higher or lower degree of consumer protection, but also to maintain or introduce new provisions which depart from the CRD. A field of law where full harmonization is achieved, according to the principle of pre-emption, prohibits the activity of member states, because they have given away their right to regulate the subject matter within that field of law. With regards to the general part of EU consumer contract law, the question of pre-emption as a consequence of the principle of full harmonization will be shown on the example of the consumer definition. The ticket to the protection offered by the Directive is the fulfillment of the criteria set by the consumer definition, which corresponds to the definition of consumer provided by most consumer Directives. According to Art 2 (1) CRD, consumer means any natural person who is acting for purposes which are outside his trade, business, craft or profession. The definition is criticized because the ECJ has continuously given it a narrow interpretation, excluding from its scope of application, e.g., start-up contracts, mixed-contracts or atypical contracts concluded by small enterprises. On the contrary, some member states such as Austria and France approve a broader concept. In the CRD only the extension with regards to "mixed contracts" is adopted. According to Recital 17 of the Directive in the case of dual purpose contracts, where the contract is concluded for purposes partly within and partly outside the person's trade and the trade purpose is so limited as not to be predominant in the overall context of the contract, that person should also be considered as a consumer. This explanation provided in Recital 17 brings a broader interpretation in comparison to the jurisprudence of the ECJ, which in case of "mixed purpose" contracts provided protection only "if the link between the contract and the profession is so slight as to be marginal, and therefore has a negligible role." With regards to other cases, the question remains whether they are covered by the principle of full harmonization and pre-emption or not. On the one hand, it could be argued that by introducing a broader definition of consumer into their national laws, the member states simply protect non-consumers in the sense of the CRD definition, which are not covered by the Directive and therefore not prohibited by the principle of pre-emption. For example, the ECJ confirmed that the extension of consumer protection by national law to small enterprises is allowed, because it does not fall within the scope of application of the consumer directives. Although the de-

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52 Meškić, Zlatan, p. 45 (fn. 23).
54 The expressly mentioned craft is a novelty, but it was already included by the terms business or profession.
cision was adopted on the basis of a minimum harmonization directive, the ECJ explicitly stated that the extension of the consumer definition to traders is not covered by the minimum harmonization clause, because it falls out of the personal scope of application of the Directive.\(^{61}\) The full harmonization principle therefore leads to a paradox situation where the member states could set mandatory contract law standards outside a narrow scope of personal application of the Directive, and consequently “non consumers” would enjoy a higher level of protection than consumers.\(^{62}\) The consumer organizations could now argue in favor of less consumer law at the EU level, if national provisions in that area provide for a higher level of consumer protection.\(^{63}\)

Directly connected to the question of maximum harmonization of the general part of consumer contract law is the choice of the form of legal act appropriate for the harmonization. It needs to be put into question, whether the Directive is a proper solution for the establishment of maximum harmonization in private law.\(^{64}\) Namely, if the consumer contract law had been harmonized by a Regulation instead of the Directive, there would be no need for transposition in 27 national laws, with all the modifications that the transposition inevitably causes. Thereby a truly uniform consumer contract law, directly applicable in the member states, would be created.

4. The relation of the general part of consumer contract law to other initiatives of unification of contract law

The work on the horizontal Directive occurred parallel to other projects on unification of substantive contract law, DCFR and the CESL. The first, so called “interim” DCFR was adopted in 2008, while the first Proposal for a CRD was adopted a year later. Considering that one of the major goals of the CFR is to be used during the review of EU consumer law, it was expected that the adopted Proposal for the CRD had taken the DCFR as its first reference. The opposite is the case. In the Proposal for the CRD hardly any influence of the DCFR could be found.\(^{65}\) In the adopted version of the CRD it may at least be stated that some provisions of the CRD were created as a result of criticism over the lack of influence of the DCFR.

Thus, as already presented above, following the model of DCFR, the problem of “mixed contracts” is expressly regulated in the CRD. Nevertheless, there are more conflicting examples. With regards to pre-contractual obligations, whose regulation is of key importance for the exercise of consumer rights, the EU legislator did not respond to the critique on the solutions in the CRD, as well as to suggestions of taking over the provisions from DCFR. In Art 5 CRD the unsystematic listing of information obligations of the trader was kept, while the decisive question of sanctions in case of non-compliance with his obligations is left to the national legislators. The DCFR has taken a more systematic approach, and has introduced a general clause on pre-contractual obligations before listing particular information duties (Art II-3:101), and later on also the sanctions in case of non-compliance (Art II-3:109).\(^{66}\) Sporadically it is possible to find individual similar solutions, such as the delay of the withdrawal period in case the trader violated provisions on obligatory information or

\(^{62}\) Micklitz Hans-W. and Norbert Reich, p. 484 (fn. 53).
\(^{63}\) Micklitz Hans-W., p. 60 (fn. 44).
the withdrawal period of one year of absolute character (Art. II-3:109 (1) DCFR and Art 10 CRD). The same solution is introduced in the “optional instrument”, in Art 42 (2) CESL. Even if CESL in its name is restricted to sale contracts, it also regulates a great part of general contract law, and thus its provisions are also of indicative character for coherency of EU consumer contract law. CRD and CESL show more similarities regarding the novelties incorporated in them, such as the new definition of contracts concluded away from business premises, or identical withdrawal form, than the CRD and the DCFR. However, there is no common approach to coherent regulation of the questions relevant for the general part of consumer contract law in the CRD, DCFR and CESL. It is of particular interest that the DCFR, contrary to its basic function, has not achieved any remarkable influence in consumer law. The lack of a coherent approach to the reforms could be justified by the fact that all three documents were developed almost at the same time, but this could serve as a contra argument as well.

Work on the horizontal directive stood additionally under the influence of the creation of uniform private international law of the EU, in particular the Rome I Regulation. Namely, with the introduction of conflict of laws rule in Art 6 (2) of the Unfair Contract Terms Directive, a model was created for the conflict of law rules in future consumer Directives. It provides that “Member States shall take the necessary measures to ensure that the consumer does not lose the protection granted by this Directive by virtue of the choice of the law of a non-Member country as the law applicable to the contract if the latter has a close connection with the territory of (one or more) Member States”. These provisions follow the exclusive goal that EU Law, harmonized by the Directives, needs to be protected from the choice of law of a third country. These provisions seem to have an ordre public and give to the provisions of the Directive a character of international mandatory provisions (Engriffsnormen) in the sense of Art 7 (2) Rome Convention. The different and mandatory provisions in the classic sense is that they do not possess an unconditional will to be applied, but only if the chosen law is less favorable to the consumer that the provisions of the Directive. Besides that, the conflict of laws rules of the consumer directive, with the exception of the Art 9 Timeshare Directive, do not contain provisions on objective connecting factors. Thus the consumer protection in case of absence of the choice of law, regardless of the strong connection with the EU, may fall behind the criteria of the Directives. In legal science there is a justified doubt whether this was a conscious decision of the legislator. Furthermore, this characteristic leads to the conclusion that they are not one-sided conflict of laws rules as mostly assumed in science, but provisions which intend to broaden their territorial scope of application and are therefore comparable to the “scope rules” of Dutch legislation.

68 Povlakić, Meliha, 56 (fn. 40).
70 Art 12 (2) Distance Selling Directive.
Conflict of laws rules formulated in this way were subject to strong criticism. While the goal of the legislator to protect the EU as a “state territory with its own national interests”, and thereby create an independent legal category of harmonized EU law, may be understandable, the legal technique used does not contribute to its fulfilment. With the introduction of conflict of laws rules in almost every consumer protection directive of newer date, and the 27 different transpositions into national legal systems, the unification of consumer protection by conflict of laws rules, previously achieved with the Rome Convention, was abolished. Thereby, only uniform conflict of laws legislation provides the advantage that in case of different provisions on substantive law, at least the effort involved in finding applicable law is reduced. This is the reason why state parties to the Rome Convention have signed a “Joint Declaration” on prevention of differences and fragmentation of EU sources of conflict of laws rules.

Additionally, considering the explicit goal of the conflict of laws rules to achieve “international harmony of decisions”, the Directives which contain minimum harmonization clauses represent the least appropriate instrument for the establishment of EU conflict of laws legislation. The chaos in the conflict of laws legislation on consumer protection is completed by the imprecise formulation of “close connection”, which every member state transposed in a different way. The relation between the conflict of laws rules of the directives, or more precisely of their national transpositions with the Art 5 Rome Convention, is regulated by the Art 20 Rome Convention, pursuant to which the conflict of laws rules of the Directives enjoy supremacy in application over the Rome Convention within their scope of application. Thus, Art 5 of the Rome Convention lost its most important material scope of application, namely the contracts on supply of goods, because of the conflict of laws rule contained in the Consumer Sales Directive. The hope put into parallel works on the horizontal consumer directive and the Rome I Regulation was that the modernization of provisions on the applicable law to consumer contracts within the Rome I Regulation would bring the EU legislator to leave conflict of laws rules out of the horizontal directive, or provide for supremacy of the Rome I Regulation over the horizontal directive.

With the adoption of the Rome I Regulation the second mentioned possibility has not been used, because its Art 23, despite a completely contrary provision in the Proposal for Rome I Regulation, provides that its provisions shall not prejudice the application of provisions of Community law, which lay down conflict-of-laws rules relating to contractual obligations. However, the EU legislator has recognized that the new Art 3 (4) together with 6 Rome I diminishes the need for the existence of one-sided conflict of laws rules in the CRD. Therefore, at least the conflict of laws rule contained

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78 Sonnenberger, Hans Jürgen, p. 386 (fn. 74).
80 OJ 1980 L 266/14; Consequently, it was held in legal science that conflict of laws rules of the Directives should be regarded as “narrative provisions”, which do not need to be transposed; Jayme, Erik and Christian Kohler, “Das Internationale Privat- und Verfahrensrecht der EG 1993 - Spannungen zwischen Staatsverträgen und Richtlinien”. 13 IPRax (1993): 357-371, p. 358.
81 Leible, Stefan, p. 379 (fn. 73).
82 See Jayme, Erik: “The chaos we were afraid of has arrived. Every state transposed Art 6 (2) Unfair Terms Directive in a different way”; “Zum Stand des IPR in Europa”. 16 IPRax (1996): 65.
84 Directive 2008/122/EC.
in the Distance Selling Directive has been amended. Additionally, Recital 17 of the new Directive on Timeshare contracts\(^{85}\) states that consumers should not be deprived of the protection granted by this Directive where the law applicable to the contract is that of a Member State, whereby the law applicable to a contract should be determined in accordance with the Rome I Regulation.\(^2\) This foresees a positive development that the conflict of laws rules slowly disappear from the consumer directive, and the determination of applicable law is left to the conflict of laws legislation of the EU.

5. **Final remarks**

The development of a general part of consumer contract law is still at an early stage. The horizontal directive could not fulfill the expectations raised by the promising announcements of the Commission in the Green Paper of 2007. However, the CRD provides a solid basis for the incorporation of further provisions which naturally belong to a general part, whether they are applicable to the special part as a whole or only to certain groups of provisions within the special part. Additionally, some of the provisions already included in the CRD will automatically develop into provisions of the general part, when the special part incorporates other subject matter covered by existing consumer directives. This particularly refers to the provisions on information duties and right to withdrawal, now only applicable to doorstep selling and distance selling contracts. The parallel work on three projects for unification of EU contract law did not bring more coherence to the field of consumer contract law. The differing goals, scopes of application and legal nature of the CRD, DCFR and CESL cannot justify the divergence in regulation of legal fields, such as the information duties or the right to withdrawal, whose uniform regulation at EU level was one of the important arguments for the creation of these legal instruments in the first place. Leaving conflict of laws rules out of the CRD, a long expected coordination between the legislation on substantive and conflict of laws regulation in the field of consumer contract law is close at hand. The EU legislator seems to end the battle of methods between the Consumer Directives and EU Private international law rightly in favor of the latter.

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\(^{85}\) Art. 12 of the new Timeshare-Directive does not represent an unilateral choice of law rule, but confirms the Directive as an overriding mandatory statute, regardless of the applicable law, when the immovable is situated within the EU; Kuipers, Jan-Jaap, p. 582 (fn. 75).
Abstract

Competition law and policy are an essential part of the institutional and regulatory framework of each country. In the recent period, competition policy in the large number of legal systems worldwide implemented liberalisation of the market through the introduction of competition in certain sectors which previously were characterised by the existence of monopolies, such as the sectors of air traffic, telecommunications and energy. These sectors were opened to many new competitors, thereby resulting in the offering of more quality services by lower prices for consumers.

The application of competition policy principles to regulatory and structural reform has also been vital for economic growth in South East European (SEE) economies in transition. The paper gives a detailed overview on the process of restructuring the telecommunications sector in these countries. This reform process began in the 1980s and involved commercialisation, corporatisation, privatisation and liberalisation. The process was followed by establishment of independent regulatory authorities that will guarantee application of non-discriminative competition rules in the telecommunications sector and protection of consumers’ rights.

In order to eliminate the risk of regulatory evasion, complementarity between sector-specific regulation and competition law enforcement in SEE countries is needed. Effective inter-institutional cooperation between national regulatory authorities, national competition authorities and consumer associations in the telecommunications sector is a prerequisite to combat anti-competitive practices. For the time being, the dualism of competition rules and sector-specific regulation continues to significantly shape the regulation of the telecommunications sector in SEE countries. In terms of EU policy goals and the Lisbon Strategy, it is vital that competition rules in SEE countries as a tool of economic integration ensure conditions that are advantageous to innovation, especially when the telecommunications sector and services offered to consumers are in question.

Key words: competition rules, sector specific regulation, anti-competitive business practice, telecommunication sector, competitive safeguards, non-discriminative competition rules

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REGULATORY ENFORCEMENT OF COMPETITION RULES AND CONSUMER PROTECTION IN SOUTH EAST EUROPE: THE CASE OF TELECOMMUNICATIONS

1. The concept of competition in the sector-specific regulation of the field of telecommunications

In telecommunications, the competitive market delivers consumers the freedom and opportunity to make choices. Consumers have been empowered, as evidenced by their movement from former national monopoly providers to alternative providers. In general, freedom and opportunity is about people having the capability to make life-improving choices.

Competition policy has allowed multiple players to provide telecommunications services. This has cut the cost of telecommunications services and enhanced consumption possibilities. The distributional dimension of wellbeing supports the policy goal that consumers should be able to access telecommunication services, at least of some minimum standard, without being unduly disadvantaged by where they live or their income level.

1.1 Introducing sector-specific regulation

Sector-specific regulation has long been regarded as a welfare enhancing device in cases of market failure. One example of market failure is the so-called natural monopoly, defined as sub-additivity of the cost function over the relevant range of output. The existence of so-called natural monopolies, in many cases in network sectors, and their national regulation turned out to be an impediment to market integration in Europe. A new approach to handle the competition problems of network sectors arose as a need to be developed in order to break up closed national markets and to establish an Internal European Market in those sectors of the economy, which in the past had traditionally been reserved for national monopolies.

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Such a move towards opening up regulated national markets was in line with a world-wide deregulation movement which began in the United States, was then introduced in the United Kingdom, and from there spread to the European Continent.

At the European level, deregulation in national markets was combined with a re-regulation move towards European sector-specific regulation of former national monopolies (in the fields of telecommunications, energy, postal services, railway transport, etc.).

The basic regulatory concept was simple: access regulation, in order to allow competitors of the former monopoly (incumbent) the possibility of engaging in competition on downstream markets (for example markets for telecommunications services).

1.2 The economic rationale of sector-specific regulation

Sector-specific regulation has a long history. It has been considered to be an alternative to state monopolies in fields in which competition appears not to be feasible. The conventional wisdom in the case of ‘natural monopolies’ is to regulate them rather than to try to introduce competition. Network sectors - like telecommunication markets - are a special case. In this case access to the infrastructure has to be regulated in order to enable competition on the downstream service markets. Regulatory devices have to be developed to make sure that competitors on downstream markets have non-discriminatory access to parts of the infrastructure which cannot be duplicated and which are essential to be able to stay in business on downstream markets.

The rationale of sector-specific regulation may thus be defined as enabling competition in downstream markets which hitherto were monopolies because of vertical integration between monopolistic networks and connected downstream markets. Whereas regulation according to traditional concepts of so-called regulated industries had the task of curing existing market failures with the goal of enhancing overall welfare, the modern approach to sector-specific regulation is focused on regulating access to certain monopolistic bottlenecks in order to create competition at another level in the market.

1.3 Interaction between competition rules and sector-specific regulation

Telecommunications activities are subject to both specific regulation and competition rules, and therefore the issue of the relationship and interaction between these different sets of rules aris-
es. Competition rules are general rules aimed at protecting consumer interests by prohibiting firms from reducing competition through collusion or mergers with competitors, or by abusing market power. Competition rules (with the exception of merger control) apply ex post to market conduct.

In contrast, two types of sector-specific regulation may be distinguished. On the one hand, certain rules aim at protecting specific public interest objectives (e.g. universal service, affordable pricing, protection of privacy, safety and of the environment). These rules promote social justice or consumer or environmental interests. In that sense, because they pursue different objectives, these rules have little in common with competition rules and are applied somewhat independently. On the other hand, another type of sector-specific regulation of a specific economic nature involves ex-ante regulation of matters such as price control and network access (e.g. interconnection, access to conditional access systems). 11

These rules have been adopted on the assumption that market forces alone, even under the threat of ex post application of competition rules, would not suffice, at least in the short term, to achieve full market liberalisation. In this sense, they complement competition rules. Accordingly, sector-specific regulation and competition rules represent different sets of rules which apply, independently of each other, with specific objectives and enforcement methods.

Sector-specific regulation and competition rules complement each other to attain the objective of market liberalisation. Competition law may be used as an instrument of regulation of the market, as an alternative or a complement to sector-specific regulation. In particular, this is the case when the European Commission subjects the approval of a transaction or a joint venture to specific conditions or undertakings from the parties. Often, these measures will have a permanent impact on the market structure, which would pre-empt the subsequent adoption of sector-specific regulation. 12

2. Anti-competitive business practice and consumer protection

Certain practices that may violate competition law may sometimes be upheld because of the benefits they provide to the consumer. A consumer exemption can be found, for example, in Article 101(3) TEU. This Article makes the prohibition in Article 101 (1) TEU inapplicable to agreements or categories of agreements that contribute to the improvement of the production or distribution of goods, or promote technical or economic progress, that pass a fair share of the benefits to the consumers, and do not impose restrictions that are not indispensable for achieving these benefits or afford the parties the possibility of eliminating competition in respect of a substantial part of the products in question. The consumer in this regard is not limited to the final end-user, but extends to entities acquiring products or services in the course of business.

While the Commission has not quantified what share of benefits to consumers is fair, the Commission is likely to look at long-term effects of the agreement and to consider whether there is a sufficiently high level of competition in the market to ensure that a reasonable proportion of the benefit is likely to be passed on to consumers. Exclusive distributorship agreements have been exempted on the grounds that consumers benefit from the additional choice made possible through the existence of a firm charged with the promotion of the goods. Similarly, non-price vertical restraints may be upheld as the market may otherwise be unable to supply the information absent re-

straints. Also, a practice that eliminates the option of negotiating prices after an exchange is closed, and could therefore otherwise be deemed to be anticompetitive, may be upheld on the basis that it protects sellers' ability to protect themselves from fraud or monopoly power, and therefore their ability to choose in the market.

It can be observed that passing a benefit to consumers is a necessary condition to the exemption. The closer the benefits are to consumers, the more likely it will be that a practice will be exempted, whereas the more far-removed the benefits are to consumers the less likely it is that they will be given weight. Insofar as consumer efficiencies may justify otherwise anticompetitive conduct, and insofar as the benefit to consumers is a necessary precondition to the exemption, the interest of consumers may be seen to be a necessary factor to the lack of antitrust control.

Competition violations traditionally rest on a finding of 'restriction of competition' or other 'harm to competition', such as foreclosure effect, which ultimately harms consumers. The 'harm to consumers' is often not considered: it may be direct or indirect, and at times it may also be presumed. Article 102 TEU does not require it to be demonstrated that the conduct in question had any actual or direct effect on consumers. Competition law concentrates upon protecting the market structure from artificial distortions because by doing so the interests of the consumer in the medium to long term are best protected.

Accordingly, what consumer harm consists of is not clear. In some cases the consumer may be harmed by virtue of higher prices. In other cases, however, the harm may relate to other non-price factors such as innovation, product variety and product quality. Harm to consumers may vary according to the market in question.

A more consumer-focused competition law may need to consider more explicitly harm to consumers, as compared to harm to competition. The effect on consumers is an important factor in assessments of the anticompetitive effects of a practice: high benefits to consumers may justify otherwise anticompetitive conduct, and therefore the absence of harm to consumers may be a necessary factor to the absence of antitrust control. Equally, however, the absence of harm to consumers will not excuse anticompetitive conduct; a benefit is required. Conversely, however, harm to consumers is a sufficient factor for finding of anti-competitiveness (absent other detriments).

In all SEE countries the generic competition law applies fully to the telecommunications sector. No countries reported exemptions in the application of their competition law to the telecommunications sector. Competition cases are common in the telecommunications sector. All the forms of anti-competitive abuse of a dominant position (including denial of access to an essential facility, predation, tying and bundling) can be found. Most abuse cases relate to access to essential facilities, that is:

- Whether or not a particular service must be offered to a rival;
- The timeliness and quality with which the service must be provided; and
- The price at which the service is offered, particularly in comparison to the price, timeliness or quality that the dominant operator provides service to itself.

All SEE countries also have telecommunications sector-specific laws enforced by a separate national regulatory agency (NRA). In virtually all SEE countries, both the NRA and the NCA have some responsibility for controlling anti-competitive behaviour in the telecommunications industry. In many countries the NRA and NCA have explicit coordination and co-operation agreements.

3. Liberalization and deregulation of the telecommunications sector in SEE countries

South East Europe is a region that includes countries that are potential candidates for membership in the European Union, some in the shorter term and other countries from a longer-term perspective. Over recent years, all SEE countries have started an effort that involves a complete transition in order to bring telecommunications regulation closer to the European Union rules. Towards this direction, the majority of SEE governments have proceeded in the creation of independent regulatory bodies. All these countries are in the process of adopting and/or implementing the EU regulatory framework for electronic communications. Their position on the regulatory development ladder varies from Romania’s very advanced status, which has adopted the 2003 acquis and is well into its implementation, to countries that are still grappling with the tasks of establishing the initial conditions for a competitive telecommunications sector.15

Moreover, strengthening of the regulatory authority in the telecommunication sector and aligning with the EU acquis communautaire, all of which is undertaken as a responsibility for these countries within the EU accession process and determined as short-term objectives, requires that the liberalization and deregulation processes should be completed rapidly. That means the liberalization process should lead to opening and establishment of competition in the telecommunication sector, and deregulation to ensure efficient operation of regulatory bodies.

The strong desire of SEE countries to join the EU has ensured that the general direction of telecommunications policies would be towards the opening of markets. This created opportunities for foreign operators to buy stakes in incumbent telcos and to acquire new licenses, in particular spectrum for wireless services. Under EU influence and tutelage, telecommunications policies and regulatory instruments were going to be adopted by parliaments and enforced by regulators in ways that, in time, would approximate those of the rest of Europe.16 For governments, the substantial shortage of infrastructure and also of capital to build new networks was seen as being resolved – to a significant extent – by creating opportunities for Foreign Direct Investment (FDI) through privatization and the granting of new licenses. The challenge was to ensure that sufficient investment could be brought in to meet likely demand and that the terms granted would ensure sufficient competition, without unreasonably constraining future policies.17 Market liberalisation and competition in these countries is pushing down prices and increasing choice, which in turn is leading to increased take up of services. The key trend dominating markets across the region is broadband, be it fixed, wireless or mobile.

There is a clear economic incentive to invest in Information and Communication Technologies (ICTs) in order to stimulate economic growth and also to attract FDI in all sectors of the economy. The problem has been to find the capital for investments in telecommunications infrastructure. The combination of the shortage of capital and the presumption of eventual membership of the EU, meant that the governance model adopted for telecommunications markets was one of (partial) privatization and liberalization within complex and evolving policy and regulatory frameworks.18

This was reinforced by the primary source of potential investors being companies based in the EU including: Deutsche Telecom (DTAG), France Telecom, Hellenic Telecommunications Organi-

zation (OTE), Telekom Austria, Telekom Slovenije, Telenor1 and Vodafone. These operators were not only familiar with, but had helped to shape EU policies and had regulatory teams that expected to find similar structures, issues and, especially, instruments. The result has been the slow diffusion into SEE countries of basic elements of the EU approaches, including privatization of state-owned operators, together with the liberalization of markets under evolving legal frameworks and the gradual strengthening of national regulatory authorities. Progress has been made in the implementation of regulatory instruments for the benefit of alternative operators. A number of operators from other parts of Europe, some from countries with historic links through the former Yugoslavia and the previous Austro-Hungarian Empire, have invested in the region. The level of that investment is difficult to assess, since the operators have given considerable scope to manufacturers to finance the construction of networks and also to manage them.19

In addition to this process, below in Table 1 an overview of the regulatory framework in SEE countries is given. What can be noticed is that the SEE countries are fast catching up in adopting the regulatory reform. Although the approaches to sector policy and regulation still vary, the overall impetus is towards greater liberalisation. Competition has generally become the accepted tenet in all telecommunications markets in these countries. The EU’s implementation of a common telecommunications regulatory framework has demonstrated how successfully such an approach to market regulation can be applied across different countries with variable initial market characteristics. The adoption of the EU framework has been viewed as a defining step towards better functioning markets, as well as being an essential part of the EU accession process. The progress that some countries in this region have made in recent years has been remarkable, given earlier records of relatively low investment and poor economic management. The key success factor in the EU (and in the transition countries that demonstrated high compliance in the assessment) is the existence of an independent regulator in each country with powers of secondary legislation to enforce low barriers to entry, effective market access and proper competitive safeguards.20

As a conclusion, Croatia, Macedonia and Romania achieved full compliance, having aligned their frameworks with the EU’s acquis communautaire. Bulgaria did not succeed in fulfilling full compliance due to remaining concerns about regulatory independence and weaknesses in its market review implementation. Albania and Bosnia and Herzegovina achieved high compliance. In the medium compliance category, Montenegro had weaknesses in its identification of, and remedies for, market dominance. Serbia is in low compliance because its licensing regime is not yet developed and it has insufficient competitive safeguards.

19 Sutherland, p. 2.
### Table 1: Regulatory overview in South Eastern European countries

<table>
<thead>
<tr>
<th>Countries</th>
<th>National operator</th>
<th>Ownership</th>
<th>Regulatory authorities</th>
<th>Regulatory evolution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Albania</td>
<td>AlbTelecom</td>
<td>- 76% shares owned by a joint venture of Calik Enerji and Turk Telekom</td>
<td>Albanian Authority of Electronic and Postal Communications (AKEP) as a new regulatory</td>
<td>Telecommunications industry has been liberalised and legislation has been recently</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- 24% of the shares still owned by the state</td>
<td>authority established under the new Law on Electronic Communications as of 2008.</td>
<td>introduced that adopts regulatory principles found in the EU's regulatory framework</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>The Ministry of Public Affairs, Transport and Telecommunications is the central state</td>
<td>for communications, which promotes competition as the most efficient way to offer</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>administration body responsible for electronic communications and postal services</td>
<td>communications products and services while ensuring universal access.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>through its General Directorate of Posts and Telecommunications.</td>
<td>The market’s growth potential has attracted international investment into both the</td>
</tr>
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<td></td>
<td></td>
<td></td>
<td></td>
<td>incumbent and alternative operators.</td>
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<td></td>
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<td></td>
<td>Future network development is expected in order to support the growing popularity of</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td>broadband services.</td>
</tr>
<tr>
<td>Bosnia and</td>
<td>BH Telecom (Sarajevo)</td>
<td>- 90% ownership in the Federation government of Bosnia and Herzegovina</td>
<td>Republic Telecommunications Agency (RAK), which is a functionally independent non-</td>
<td></td>
</tr>
<tr>
<td>Herzegovina</td>
<td></td>
<td>- 50.10% ownership performed by the Federal Ministry of Transport and</td>
<td>profit institution established by the Law on Communications of 2002.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Hrvatske Telekomunikacije</td>
<td>- 65% in ownership of Telekom Srbsja, 20% traded on the national stock</td>
<td>The Council of Ministers of Bosnia and Herzegovina responsible for developing and</td>
<td></td>
</tr>
<tr>
<td>(Mostar)</td>
<td></td>
<td>exchange, 10% held by a pension fund and 5% by a restitution fund</td>
<td>adopting policies for communications, and for preparing secondary legislation.</td>
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<td></td>
<td>Telekom Srpske (Republic</td>
<td></td>
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<td></td>
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<tr>
<td></td>
<td>of Srpska)</td>
<td></td>
<td></td>
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<tr>
<td>Bulgaria</td>
<td>VIVACOM</td>
<td>- 65% in ownership of Viva Ventures Holding</td>
<td>The Communications Regulation Commission (CRC) is the regulatory independent authority</td>
<td>Over the past 10 years, the Government has undertaken major projects to upgrade the</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- 35% shares quoted on the stock exchange</td>
<td>established by the Law on Telecommunications in 2002.</td>
<td>existing telecommunications network and to increase the quality of services provided.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- the golden share property of the Bulgarian government through the</td>
<td></td>
<td>Member State of the European Union as of 1 January 2007.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Ministry of Transportation and Telecommunications, thus granting it a</td>
<td></td>
<td>New telecommunications law enacted in 2007 following membership in EU.</td>
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<tr>
<td></td>
<td></td>
<td>veto right</td>
<td></td>
<td>Competition is guaranteed in each segment of the telecommunications market, which</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td>leads to lower prices and higher quality of the services offered.</td>
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<td></td>
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<td></td>
<td></td>
<td>Secondary legislation is still needed to ensure implementation of important measures</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td>such as market analyses and access and interconnection.</td>
</tr>
<tr>
<td>Countries</td>
<td>National operator</td>
<td>Ownership</td>
<td>Regulatory authorities</td>
<td>Regulatory evolution</td>
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<td>----------------------------------------------------------------------------</td>
<td>------------------------------------------------------------------------------------------------------------</td>
<td>------------------------------------------------------------------------------------------</td>
</tr>
</tbody>
</table>
| Croatia         | Hrvatske Telekomunikacije (T-HT) | - 51% of the shares owned by the Deutsche Telekom AG  
- 7% held by Croatian War Veteran’s Fund  
- 32.5% share package through an IPO  
- 7% of shares owned by the former and present T-HT Group employees  
- 2.5% owned by the Croatian state | Croatian Post and Electronic Communications Agency (HA-KOM) established in July 2008 as an independent, autonomous and non-profit legal entity with public authority under the new Electronic Communications Act adopted in 2008.  
The Ministry of Sea, Transport and Infrastructure is the central state administration body responsible for electronic communications. | Liberalisation of the telecommunication industry is well on track. Measures have been taken to increase the level of transparency of the work of the regulator and improve the accessibility of relevant information to the public. |
| Macedonia       | Makeodonski Telekomunikacii | - 76.53% of the shares owned by the Magyar Telecom part of the international Deutsche Telekom Group  
- 34.81% owned by the Government plus one golden share  
- 10% owned by the Makedonski Telekom AD (Treasury Shares)  
- 1.88% owned by IFC  
- 2.31% owned by the other minority shareholders | Agency for Electronic Communications (AEC) is the independent regulatory body established under the new Law on Electronic Communications adopted in 2005.  
The Ministry of Transport and Communications is responsible for implementing the government policy and drafting legislation in the electronic communications sector, as well as preparing the national strategy for the development of electronic communications and information technology. | The telecommunications market has been liberalised and recent regulatory developments in the area of network access are improving prospects for competition, as evident by increasing uptake of wholesale offers. |
| Montenegro      | Crnogorski Telekom         | - 51% of the shares owned by the Magyar Telecom part of the international Deutsche Telekom Group  
- 23.47% of the shares owned by private investors and quoted on the stock exchange | Agency for Electronic Communications and Postal Affairs (Agentel) as an independent regulatory agency established in 2008.  
The Ministry of Maritime Affairs, Transport, and Telecommunications is the central state administration body responsible for the telecommunications sector. | Telecommunication industry has been liberalised and legislation introduced by adopting regulatory principles found in the EU’s regulatory framework for communications, which promotes competition as the most efficient way to offer communications products and services while ensuring universal access. |
| Romania         | RomTelecom                 | - 54.01% owned by the Greek incumbent operator (OTE)  
- 45.99% owned by the Romanian state | National Authority for Administration and Regulation in Communications (NAARC) performing regulatory tasks.  
Implementation of EU Directives has opened the telecoms market to competition and implemented a regulatory framework designed to foster fair competition. |
<table>
<thead>
<tr>
<th>Countries</th>
<th>National operator</th>
<th>Ownership</th>
<th>Regulatory authorities</th>
<th>Regulatory evolution</th>
</tr>
</thead>
</table>
| Serbia    | Telekom Srbija   | - 80% of the shares and a 'golden share' owned by the state  
- 20% owned by the Greek incumbent operator (OTE) | Republic Telecommunications Agency (RATEL) established under the Telecommunications Law as of 2003 is implementing the national telecommunications development strategy and the regulatory framework for telecommunications.  
The Ministry of Telecommunications and Information Society is the central state administration body responsible for telecommunications, postal services and information society. | Total telecom market revenue is expanding although growth is not uniform, with the Internet and mobile markets recording the strongest growth, a trend that is set to continue due to increasing broadband and mobile take up and usage.  
The new Law on Electronic Communications (44/2010) supersedes the previous Law on Telecommunications from 2003. The major novelties introduced with the new Law are the establishment of a general authorization regime, re-naming of the RATEL into the Republic Agency for Electronic Telecommunications |
| Slovenia  | Telekom Slovenije d.d. | - 52.54% owned by the Republic of Slovenia  
- 14.25% by Slov. Odskodninska družba Investment fund  
- 10.49% by individual shareholders  
- 5.59% by Resident legal entities  
- 6.21% by Kapitalska družba  
- 2.25% by Investment companies  
- 3.19% by Foreign legal entities  
- 1.77% by Kapitalska družba – PPS  
- 1.63% by mutual funds  
- 0.96% by banks  
- 0.46% by Telekom Slovenia (Treasury Shares)  
- 0.23% by other funds  
- 0.13% by brokerages  
- 0.17% by insurance companies  
- 0.12% by foreign individual shareholders | Agency for Postal and Electronic Communications (APEK) established in 2001 in order to arrange and supervise the operation of the telecommunications market.  
In the telecommunications sector, the country has in place all the necessary institutions for the implementation of the acquis. |
| Turkey    | Türk Telekom     | - 30% ownership by the State plus one golden share controlled by the Ministry of Transport  
- 55% owned by the consortium led by Oger Telecom  
- 15% traded at the Istanbul Stock Exchange | Telecommunications Authority (TA) established under the new Law on Electronic Communications as of 2008.  
The Ministry of Transport defines the state policies and strategies for the telecommunications sector. | The telecoms market has been mostly liberalised with a number of alternative operators and a majority stake in incumbent fixed-line operator Türk Telekom privatised. The telecoms regulatory framework has been amended to conform to the EU’s regulatory framework for communications. |
3.1 Institutional framework

The main consideration while applying the competition and telecommunications rules should be put on the institutional side. The establishment of an independent regulator is a cornerstone of the EU regulations for telecommunications. The basic requirement is set out in the Framework Directive\(^{21}\), which requires certain regulatory tasks, such as the granting of individual authorisations, to be carried out by bodies that are legally distinct and functionally independent from activities that are associated with ownership or control of services and networks.

It is common practice across the EU to establish a regulatory authority that is also independent of the ministry. The reasons for this are:

- to create some distance between policy creation and policy execution. The ministry is responsible for policy and primary legislation. The NRA is responsible for the day-to-day functioning of the law. The ministry can provide guidance and set objectives, but normally cannot instruct the NRA in any specific case;
- that such separation of powers reduces the likelihood of regulatory decisions being made on the basis of political favors;
- to increase confidence among market participants of a level playing field by insulating the NRA against political changes;
- that the Ministry is often involved with the ownership of the incumbent operator. There is no requirement in the EU framework that Member States must privatize. Indeed, the requirement for the NRA to be legally distinct and functionally independent from activities associated with ownership is set out in recognition of the fact that such ownership is legitimate.\(^{22}\)

The NRAs need to effectively assume the role of arbiter in disputes between undertakings related to regulatory obligations and practices. This will contribute to the speedy development of the telecommunications sector itself as uncertainties will be removed without undue delay, and also regulatory oversight might be exercised ex post.

In South Eastern Europe, progress in market liberalisation has been slower than in the EU. Adoption of the EU telecommunications framework in this region is already regarded as a well-defined step towards an improved functioning of the telecommunications markets as well as being an essential part of the EU accession process. The progress that has been made in parts of the region in recent years in the telecommunications sector has been remarkable, given the legacy of relatively low investment and poor economic management from the past. All countries have established an independent regulatory authority, but there are still concerns in some of these countries about appeals and dispute resolution, where the authority of the regulators is weakened.

\(^{21}\) 2002/21/EC - Framework Directive Art. 3

3.2 Regulatory independence

The successful liberalisation of SEE countries’ telecommunications market has been accompanied by the establishment of an adequate regulatory environment. Towards this direction and under the framework of the telecommunications acquis communautaire, the majority of SEE governments have proceeded in the establishment of independent National Regulatory Authorities (NRAs). The role of NRAs, along with the relevant Ministry, is to implement the best policy practices and support the development of a credible regulatory regime, which will boost investments in the telecommunications sector and promote public confidence in the telecommunications market through transparent regulatory and licensing processes.23

A question has been raised regarding the level of introduced independent sector regulation in SEE countries, and what its contribution to a more effective market will be. Establishment of independent NRAs in these countries has been done with one of the main focuses being to create conditions for market investment that will ensure consumers can buy and producers can sell under fair, transparent and non-discriminatory terms. Regulatory bodies must intervene to prevent this behaviour preferably before it occurs, for example, by formally designating the dominant operators (using established competition principles) and then applying obligations to supply services on open, fair, and non-discriminatory terms. Therefore, regulatory bodies have to make decisions in applying competition principles and setting obligations that are proportionate to the foreseen market conditions. Regulatory independence has been advanced in most of the region firstly by separating the defined responsibilities of the government from the responsibilities of the sector regulator.

Governments in SEE countries retain the overall responsibility for sector policy (for example, market liberalisation, privatisation, consumer protection and universal service). This leaves the sector regulatory bodies with the day-to-day task of implementing policy through independent action in the market. On the other side, the national competition authorities operational in all these countries must work in full co-operation with sector regulators to ensure that the full force in competition law is carried through to the telecommunications sector consistently, as well as its own sector-specific laws.

3.3 Competitive safeguards and consumer issues

The contribution of competition law to the liberalization of the telecommunications sector is conceived as a safeguard of effective competition in a dynamic competitive environment. The table below provides a summary overview of the implementation status of competitive safeguards in the SEE countries.

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Table 2 – Overview of competitive safeguards

<table>
<thead>
<tr>
<th></th>
<th>Albania</th>
<th>Bosnia and Herzegovina</th>
<th>Bulgaria</th>
<th>Croatia</th>
<th>Macedonia</th>
<th>Montenegro</th>
<th>Romania</th>
<th>Serbia</th>
<th>Slovenia</th>
<th>Turkey</th>
</tr>
</thead>
<tbody>
<tr>
<td>Carrier selection (CS)/pre-selection (CPS)</td>
<td>x</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>x</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Fixed number portability</td>
<td>x</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
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<td>✓</td>
</tr>
<tr>
<td>Mobile number portability</td>
<td>✓</td>
<td>x</td>
<td>✓</td>
<td>✓</td>
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<td>✓</td>
<td>✓</td>
<td>✓</td>
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<tr>
<td>Fixed Reference Interconnection Offer (RIO)</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
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<tr>
<td>Reference Unbundling Offer (RUO)</td>
<td>x</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
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<td>✓</td>
<td>✓</td>
<td>x</td>
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<td>✓</td>
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<tr>
<td>Wholesale broadband access (WBA)</td>
<td>x</td>
<td>x</td>
<td>✓</td>
<td>✓</td>
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<tr>
<td>Wholesale line rental (WLR)</td>
<td>x</td>
<td>x</td>
<td>✓</td>
<td>✓</td>
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<td>✓</td>
<td>✓</td>
<td>x</td>
<td>✓</td>
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</tr>
<tr>
<td>Mobile Reference Interconnection Offer (RIO)</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
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<td>✓</td>
<td>✓</td>
<td>x</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>National roaming</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
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<td>✓</td>
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<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Mobile Virtual Network Operator (MVNO)/SP access</td>
<td>✓</td>
<td>✓</td>
<td>x</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>x</td>
<td>x</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>

Legend: implemented ✓ not implemented: x

Source: Cullen International, Report 1 – Supply of services in monitoring regulatory and market developments for electronic communications and information society services in Enlargement Countries 2011–2013, November 2011, p. 13; 24; 39; 55; 67; 82; 97; 120; 129

Referring to the competitive safeguards on operators after they have entered the market in the EU, there is a requirement on all countries to carry out market reviews that define sub-markets, assess competitiveness (using competition law principles) and decide on appropriate and proportional market remedies where market dominance is found. Competitive safeguards are those measures that are intended to protect new entrants against the anti-competitive practices of incumbent operator(s) with significant market power. Throughout the SEE region, progress has been made with implementing EU-like market reviews, with SMP designation mechanisms and reference interconnection offers implemented within the region. Carrier selection, carrier pre-selection and number portability are being implemented. The telecommunications sector is one where technology has produced significant consumer and economic benefits in the last ten years, and will continue for the foreseeable future. The important trend in SEE countries is to adopt EU regulatory methods, so that the benefits of liberalised telecommunications markets in terms of investment, competitiveness, consumer choice and value for money can be felt even outside EU membership.

4. Non-discriminative competition rules in the telecommunications sector in SEE countries

The role of regulation is to try to ensure that appropriate conditions exist for the attraction of investment, innovation and fair competition in the market. Therefore, in sectors such as telecommu-
communications, liberalisation cannot immediately lead to so-called deregulation but must first go through a transition period of re-regulation, to protect competition and consumers. By contrast, the primary function of competition law is to deter anti-competitive activity and provide enforcement remedies, as well as private compensatory recourse, to bring such an activity to an end. Inevitably, regulation and competition law overlap and to an extent regulatory bodies become quasi-competition authorities.

Liberalization of the telecommunications market in SEE countries aims at the promotion of competition in the provision of telecommunications networks and services. Competition policy does not directly influence the competitiveness of the market players. However, by promoting competition as a market process, it urges competitors to innovate and perform efficiently and, ultimately, to provide consumers with a fair share of the resulting benefits.

All competition laws in SEE countries in their provisions prohibit anticompetitive practices that include monopolistic behaviour of telecommunications operators, thereby protecting the rights and interests of users, customers and consumers of services. Respectively, they prohibit “Any express or tacit agreements between undertakings or associations of undertakings and any partnership decisions or concerted practices which have as their object or may have as their effect the restriction, prevention or distortion of competition in the market or on a part of it; as well as abuse of a dominant position held by one or more undertakings on the market or on a substantial part of it”.

5. Protecting consumers’ rights in telecommunications sector in SEE countries

Possible measures that may be taken to protect the rights of consumers is a matter of relativity. Expectations of each consumer differ. What should be remembered is that one of the basic principles of competition law is to protect consumers’ rights. The EU Commission and the NCAs in member countries are organizations which are responsible for ensuring a healthy implementation of competition in the telecommunications sector, just like it is in all other sectors. In other words, even though NRAs on telecommunication are vested with regulatory missions, the organizations that will be in charge of supervising competition violations are competition authorities in the end. Competition authorities fulfill their duties upon their own initiative or complaints they receive from parties.

Consumer interests are best enhanced through effective competition, which will deliver lower prices, improved choice and better quality. However, there is a continuing role for the governments in SEE countries to ensure that consumer interests are protected in this sector.

The Framework Directive (Art. 20) sets out a requirement for NRAs to issue binding decisions to resolve commercial disputes that arise from the regulatory framework. The Universal Service Directive (Art. 24) sets out a requirement for transparent, simple and inexpensive out-of-court procedures for disputes that involve consumers, but does not specify that this is a responsibility of the NRA.

The telecommunications market is characterized by rapid technological changes and changes in business practices that have brought particular problems for consumers. Communication products - mobile telephony, television and the Internet - are converging. The industry is subject to rapid


technological change, from both a provider and user perspective. These changes have raised important policy issues as a number of supply-side behaviors, sometimes interacting with consumer decision-making short cuts, have reduced competition. The industry practice of product bundling has some consumer benefits in terms of convenience, but bundling generally introduces barriers to competition, particularly price competition. There are contractual issues, including confusing and unfair terms, long contractual periods and exit penalties, all of which act as impediments to effective competition. Additionally, there are technical problems of interoperability of both software and hardware, which tend to lock consumers into particular products from particular suppliers.

In terms of policy, the issues the NRAs in SEE countries shall consider important are as follows:
- Bundling and product complexity – the need to allow for simpler consumer choice and open standards allowing for interoperability.
- The provision of better information, consumer advice, and consumer education.
- Simplification of switching.
- Standardization of contract terms, business conduct rules and avenues of consumer redress.

6. Intensified relations and strengthened cooperation between competition authorities and consumer associations in the telecommunication sector in SEE countries

Since the telecommunication sector is a dynamic, continuously developing sector which is open to technological innovations and directly addressing consumers, it is closely connected to the protection of consumer rights. If the objective of competition policy is to keep the competition level in the market as high as possible, the reflection of this policy to consumers should be in the form of lower prices, wider range of products and better access to technological innovations. Naturally, all technological developments experienced in the sector will, in the first stage, lower the charges and then direct companies to provide new services to consumers in the competition environment as they appear.

The best way to protect consumer rights in the telecommunication sector is to establish productive relations between competition authorities and consumer associations. Protection of consumer associations as “economic agents” by the NCAs will constitute the most important step in this matter. Thus, consumers will be able to enhance their capacities of shifting in the market and benefit from the results of competition. It should be remembered that consumers are among the most important structural elements. In other words, ensuring proper functioning of the market will also enable consumers to make their best choice among what is offered.

The European Commission expects much from consumers and consumer associations with respect to the protection of consumer rights. Consumer protection associations, thanks to their knowledge and experience on the functions of the market, provide data to the Commission via unofficial contacts. In addition, they are entitled to be a party to lawsuits as far as they are concerned.

Referring to SEE countries, the development of consumer associations should be supported within the frame of protecting the rights of consumers and, on the other hand, the competition environment needs to be strengthened by way of taking necessary measures to ensure that the market functions at a high level of capacity.

Competition policy and competition law do not directly influence the competitiveness of market players. However, by promoting competition as a market process they stimulate competitors to innovate and reap the benefits of their improved efficiency and, ultimately, to provide consumers with a fair share of the resulting benefits. Telecommunication NRAs and the NCAs are supposed to seriously handle these assertions. NCAs might also play an active role in constraining the trend of over-regulation resulting from the application of sector-specific regulation by NRAs, by providing advice on the interpretation of competition law notions and their application to the concrete facts of a particular case.

7. Conclusion

The European Union will have to continue the practice of regulating specific sectors. In this respect special consideration should be put on various network sectors in different Member States and their traditional approaches. Over the last 15 years, the European Commission has been progressively opening network industries to competition. Network industries encompass economic sectors that operate on the basis of network infrastructures, such as telecommunications, electricity, gas and rail networks. The efficiency of sector-specific regulation and opening of network industries, in this case the sector of telecommunications, created competitive markets within the European Union, as well on the national markets of the acceding and candidate countries in the SEE region, which certainly will increase economic welfare, contribute to allocative efficiency and thus benefit consumer welfare.

As the above analyses of sector-specific and competition protection regimes in SEE countries has shown, it will not be dramatic to phase out regulation of the telecommunication sector, as inappropriate sector-specific regulation can inflict more harm than good and inhibits investment, while competition law is in a position to prevent or correct market failures. This conclusion, however, is premised on the need to carefully formulate and prioritize policy objectives in the telecommunication sector and to provide detailed guidance to business on the regulatory constraints to certain types of market behavior.

In all SEE countries, restructuring the telecommunications sector was a major goal in micro-economic reform. The privatisation and market liberalisation of telecommunications services in the EU has been important for all SEE countries. Arrangements oriented to liberalisation are not enough to open market competition. The success of privatisation programs depends on competition. It is agreed that the competitive market is the best way of realising privatisation in this sector. Both privatisation and liberalisation policies are required in an effective regulatory policy.

In applying competition rules to the telecommunications sector, further progress should be made in SEE countries to increase the expertise and the understanding of the NCAs and NRAs, especially in the direction that NCAs shall limit the ‘regulatory’ role in their decision-making practice only to those instances where the sector-specific regulation does not provide for a remedy to a competition problem, or where regulatory intervention has failed to produce the desired results. In this respect, duplication of remedies will be avoided and regulation, as a combination of sector-specific and competition law intervention, will be proportional.

In order to eliminate the risk of regulatory evasion, complementarity between sector-specific regulation and competition law enforcement is needed. The interface follows several patterns in that respect:

- Competition law addresses market failures that are inappropriately dealt with under sector-specific regulation.
- Competition law seeks to remedy anti-competitive practices that escape from the provisions of sector-specific regulation.
- NCAs and NRAs jointly interfere to correct one and the same market failure by their respective means.
- Competition law seeks to pre-empt sector-specific regulation by imposing regulatory forms of remedies.
- Sector-specific regulation attempts to remedy a problem that cannot be dealt with under competition law.
- Competition law provides concepts and a methodological tool kit for sector-specific analyses.

As a conclusion, better coherence between regulatory and competition law remedies is likely to increase the success of achieving their regulatory aims. Effective inter-institutional cooperation is a prerequisite to the attainment of this result. Still, there is certainly a strong need to apply general competition rules alongside sector-specific regulation. For the time being, the dualism of competition rules and sector-specific regulation continues to significantly shape the regulation of the telecommunications sector in SEE countries.

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PART FIVE
CONTRACT LAW
CASE LAW AS A TRIGGER OF CISG UNIFORM GLOBAL ERA (CUGE)

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Abstract

Accomplishing the CISG Uniform Global Era (CUGE) assumes three requisite phases of development must arise. First, the enactment of a common lingua franca, a common or uniform text that can apply in the international community. Second, the use of interpretative aids such as case law, prevailing based on autonomous interpretation and therefore, creation of international precedent. Third, an international tribunal must be created to supervise the adoption and uniform application and interpretation of the CISG. While a new lingua franca, a prerequisite for uniformity in application of the CISG is evident, the study of jurisprudence and surrounding case law is rendered difficult due to both conflicting court decisions and views of its role as a legal authority. Finally, the most problematic pillar of CISG uniform global era is creation of an international tribunal, of which establishment is just an optimistic projection.

Key words: Lingua franca, CISG, uniformity, CISG International Tribunal, International precedent.

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CASE LAW AS A TRIGGER OF CISG UNIFORM GLOBAL ERA (CUGE)

Elimination of the potential conflicts of various interpretations of international uniform texts of the different national courts present the most challenging and actual tasks for legal doctrine, judges and other interpreters of international provisions. Naturally, the aim of unification of law is to facilitate international trade of goods and to resolve problems rooted in the conflicts of law through the establishment of equal norms for all actors from different states. However, the successful unification of international sales law cannot be accomplished simply through the adoption and ratification of the uniform text of the United Nations Convention of Contracts for International Sales of Goods. On the contrary, we often witness the problem that the provisions of international laws are not uniformly interpreted nor applied in different countries and by different judges. It is, thus, necessary to uniformly apply these international norms because effective, substantive uniformity, creating CISG uniform global era (CUGE) directly depends on the possibility of applying such rules in different countries. The analysis of this problem has shown that the ideal of reaching substantive uniformity can be established when lingua franca, a supervising tribunal and, therefore, strong case law are met. As the formation of the tribunal has been rejected as a costly and non-feasible solution, aside from lingua franca case law is the leading light and a basis for the completion of the idea of uniformity in the area of international sales law.

1. The CISG Uniform Global Era (CUGE)

In 1929 Prof. E. Rabel had for the first time in the modern legal doctrine of international sales law introduced the concept of uniformity, firstly interpreted to mean adoption of uniform texts or provisions of law. This led the UNIDROIT to subsequently unsuccessfully attempt enactment of two Hague Conventions on sales law in 1963. Uniformity in textual law was finally achieved by the international community in 1980 when CISG was enacted. As time passed, members of the international community discovered that uniform texts did not mean uniform interpretation by different courts in diverse countries. The concept of uniformity has thus evolved to not only mean textual uniformity but uniformity in application. Hence, the successful unification of international sales law directly depends on the possibility of applying such rules in different countries. The substantial issue is how to achieve uniform interpretation, and to define mechanisms for such a thing.

Analysis of past and current processes, problems and methods of achieving goals of uniformity has shown that accomplishing the CISG Uniform Global Era (CUGE), as mentioned, assumes that three elements or requisite phases of development must arise: First, the enactment of a common

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1 Bridge, Michael. “Uniformity and Diversity in the Law of International Sale”. 15 Pace International Law Review (2003), p. 55-89. See also UNCITRAL defines uniformity as that which removes barriers in international trade and UNIDROIT seeks to harmonize and co-ordinate national private laws and to prepare for int’l adoption of uniform rules of private law.


lingua franca, a common or uniform text that can apply in the international community. Second, the use of interpretative aids such as case law (creation of international precedent), legal doctrine and travaux préparatoires as guides to uniformly interpret the CISG. Third, an international tribunal must be created to supervise the adoption and uniform application and interpretation of the CISG.

1.1 Prerequisite for New Uniform Global Area - A New Lingua Franca

Prerequisite towards approaching uniformity in interpreting the CISG is a new lingua franca. Because the CISG is an international norm created by an international body separate and independent from each of the constituent members, its terms, concepts and principles must be interpreted autonomously from traditional meanings ascribed to these within national legal systems. Instead, the terms of the CISG should be interpreted based on the context within which it was created and within the Four Corners of the Convention. Domestic laws interpreting the same terms used within the CISG must be disregarded since different nations have different legal systems and legal experiences. To garner support from members of the ratifying body, the drafters of the CISG used terms and neutral language that were not meant to be rooted in any specific domestic legal system. Therefore, there is no possibility, despite the established common lingua franca of the CISG, that different ratifying states will uniformly interpret its provisions.

1.2. Creation of the International Precedent in Sales Law

The status of the decision of the court has traditionally been determined differently in the two major legal world systems – common law and civil law. The possibility of the courts to create a law (judge made law) has been broadly incorporated into the doctrine of the common law. The doctrine of the obligatory effect and power of the court decision is inherently related to the USA and United Kingdom legal systems. Precedent in these legal systems refers to a decision of the higher court that has mandatory authority on lower courts when deciding on the same or similar facts, within that particular system. Although the particular decision is binding on the parties in dispute, the general legal principles and doctrines explained in the decision binds lower courts on the same given set of facts and issues. The part of the decision that is considered binding on lower courts is called ratio decidendi.

On the other hand, in civil law systems court decisions do not have binding authority. In fact, the Courts in civil law jurisdictions tend to give greater credence to legislative enactments and statutes as sources of law. Albeit some crucial concepts of civil law countries, such as objective liability, have been inaugurated by the courts, decision of the court never became a formal source of law. Furthermore, in the French civil law system, for instance, Article 5 of the Code Civil forbids courts from creating new principles of law not defined under statute. Although case law may have persuasive authority, it is not binding in the face of conflicting or contrary statute. For example, in Montenegrin law, as a part of its civil law system, court decisions are treated differently according to two conflicting theories: First, the theory of absolute negation under which court decisions are not treated as sources of law; and second, the theory of court decision as an interpretative source of law. However, the prevailing attitude among courts in Montenegro towards legal precedents is

5 For example, the CISG concept of fundamental breach has different interpretations under common law (U.K.) and civil law (Switzerland). Despite the fact that the CISG concept of fundamental breach was created through combining elements of U.K. theory on warranty and condition as well as Switzerland’s theory on tort liability, the CISG fundamental breach was intended as an international legal concept distinct from the two legal systems that served as a basis for its definition.

that court decisions may possibly be de facto, but not formal, sources of law. However, there is a new light into this long-standing policy, not only in Montenegro but in all civil law countries. \(^7\) Namely, the development of private and public international law has generated the new developing trend of case law becoming the most decisive legal source of interpretation in private and public areas of law with international components. \(^8\)

Creation and contemplation of the international precedent in the specific area of international sales law, the character and role of international legal precedent in both common and civil law traditions, should be analyzed. Even accepted as de facto and de iure sources of law, there are serious impediments to accomplishing uniformity in interpreting the CISG and creating international stare decisis. \(^9\)

The initial reluctance of national courts to adopt or use foreign court decisions interpreting the CISG due to perceived lack of access to these foreign decisions is currently being remedied. The problem has been ameliorated by the creation of databases containing CISG decisions from different countries. \(^10\) The continuous and steady increase in the number of CISG decisions is clear when one compares the 550 or so CISG decisions published by Will in 1999, to over 2500 cases listed on the Pace Law website in 2012. \(^11\) In fact, today there are three related electronic databases in existence: CISG PACE LAW, UNCITRAL database - CLOUT and UNIDROIT database- UNILEX. \(^12\)

Furthermore, it is already a widespread attitude that judges prefer to apply local court decisions, a phenomenon known as “chauvinisme judiciaire”\(^13\). Namely, the unwillingness of some judges to consider foreign jurisprudence is often due to mistrust and an uneasy awareness of their lack of familiarity with foreign systems of law. Additionally, uniformity in application of CISG is made even more complicated by the fact that CISG is interpreted by different institutions all over the world, with due regard to the legal systems in which they belong. To ensure uniformity in the application of the CISG, a deciding tribunal in one country or jurisdiction must take into consideration the way it is interpreted in other countries. \(^14\)

1.3. Establishment of an Institution For Unified Practicing Of Uniform Laws

Due to the diversity of approaches of various national courts, case law is not predictable. As already mentioned, aside from the chauvinisme judiciaire reason there are several more reasons for the current state of the interpreting community. Namely, even when analyzing the cases decided by

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\(^7\) Popović, Dragoljub. op.cit. p.117.


\(^10\) Germany: 211; Canada 133; Switzerland 95; Hong Kong 86; USA 83; France 59; China 64; Russia 50; Italy 25. The Netherlands 18; Croatia 16; Hungary 15; Singapore 12; Chile and Denmark 10; Zimbabwe, Egypt, ICC and Belarus 9; Mexico 5; UK 5; Korea and The Philippines 4; Finland, Luxembourg, Sweden 1. Although Montenegro has been a signatory to CISG since its adoption, only one case involving CISG has been decided by a national commercial court. For more details see: http://cisgw3.law.pace.edu/cases/070220mo.html.

\(^11\) The great majority of cases are in central Europe - in countries that had over a decade of satisfactory experience with the predecessor to the CISG, the 1964 Hague Convention that provided uniform rules for international sales.

\(^12\) Promotion of ways and means of ensuring a uniform interpretation and application of UNCITRAL legal texts, A/CN.9/748, United Nations General Assembly. 20 April 2012. para 15-17. p. 5.


\(^14\) Kritzer, Albert H. Guide to Practical Applications of the United Nations Convention on Contracts for the International Sale of Goods. p. 108-109: “as a matter of principle and common sense, courts should, at least, consider the jurisprudence developed by foreign courts applying the CISG”. Felemagas explains that the development of a stable system of case law on the CISG and the “careful consideration of this jurisprudence by later courts” are essential to the uniform interpretation of the CISG.
The first, the last and most problematic and controversial prerequisite for achieving substantive uniformity is the establishment of an international tribunal, formed with the purpose of creating consistent and uniform case law through the uniform application of CISG. To ensure uniformity in the application of the CISG, a deciding tribunal in one country or jurisdiction must take into consideration the way it is interpreted in other countries. Felemegas explains that the development of a stable system of case law on the CISG and the "careful consideration of this jurisprudence by later courts" are essential to the uniform interpretation of the CISG. He also notes that since the CISG cannot undergo speedy legislative amendments, the "importance of case law in understanding international sales law is all the greater." Kritzer argues that "as a matter of principle and common sense, courts should, at least, consider the jurisprudence developed by foreign courts applying the CISG." Thus, a judge faced with interpreting any specific provision of the CISG that has already been interpreted autonomously by another court in a Contracting State should consider that foreign court's decision. The decisions of that foreign court must be given merely persuasive value instead of binding force by a current tribunal deciding similar facts and issues. The current state of international law and the legal context surrounding the CISG supports only the idea of case law as having persuasive value, hence the creation of an international CISG tribunal in the future should have the same functioning model.

2. The Creation Of International Precedent Within The Context Of Three Pillar Structure Of CUGE On The Example Of Fundamental Breach

The creation of CUGE, as already explained, assumes the coexistence of three elements. As the first one lingua franca is undoubtedly present, the other two are very problematic and mutually conditional. A theoretically perfect construction serving the accomplishment of uniformity in interpreting different concepts of CISG assumes the existence of a coordinating and monitoring institution. However, as for now, the establishment of a tribunal for uniform interpretation seems an unrealistic idea, hence the accomplishment of uniform interpretation is left in the hands of the direct interpreters - judges. In this connection, and in relation to the argument that judges are not trained to apply or interpret CISG law and that they have a strong common preference to apply the law of their own country, this author, in combating such an argument, insists upon the role of the legal doctrine to establish the theoretical structure which can be directly applied in a concrete case.

On the example of the vaguest and most controversial concept of fundamental breach, the author elaborates the method of creating the second solid pillar of CUGE case law, taking into consideration the fact that establishment of a tribunal has been turned down. The same could be conducted and suggested for other respective CISG concepts such as damages, the concept of conformity of the goods or avoidance of the contract.

15 Popović, Dragoljub. op.cit. p.78-83.
2.1. Diverging Approaches To The Fundamental Breach

At this stage of the CUGE development, in the situation where the creation of a CISG tribunal seems a non-feasible idea, the tendencies and work done by legal doctrine and its worldwide representatives have been assessed as a magnificent move towards the accomplishment of uniformity. A number of international sales law writers have been analyzing current case law, trying to define the common denominator among the criteria of judges all over the world when interpreting different concepts of the CISG text.\(^{19}\)

Analysis of existing case law and scholarly work illustrates the different factors used by courts to determine the different types of breach of contract, as well as factors that can be considered to determine whether or not the breach is fundamental for the purpose of the CISG.\(^{20}\) This assessment of the analyzed cases has proven theoretical findings examined in Koch's research, related to the factors relevant for the determination of the fundamental breach. In fact, Koch's work, based on the courts' legal ratio, have provided for the seven approaches that have been used to determine whether a breach is fundamental: Strict Performance Approach; Economic Loss Approach; Frustration of the Purpose of the Contract Approach; Remedy-oriented Approach; Anticipatory breach Approach; Approach of the Future Performance; and Offer to cure Approach.

The primary approach that applies whenever contracting parties explicitly or indirectly agree that in case of breach of certain obligations specified in the contract the other party may terminate the contract is known as the *Strict Performance Approach*. In accordance with the principles of *pacta sunt servanda* and *bona fides*, it is necessary to initially try to use this approach. For example, in the case of *Italdecor S.a.s. v. Yiu’s Industries (H.K.) Ltd.*,\(^{21}\) the Italian buyer and a Hong Kong seller concluded a contract for the sale of knitted goods, which included a clause precisely defining the conditions for delivery and payment. The Court held that since the seller had failed to deliver the goods at the date fixed by the contract as required by Art. 33 CISG, the buyer was entitled to declare the contract avoided on the ground of Arts. 45(1) and 49(1) CISG, and that the cancellation of the purchase order sent by the buyer was equivalent to a notice of avoidance under Art. 26 CISG. The Court considered that, given the concise text of the delivery clause, the precise observance by the seller of the date for delivery was of fundamental importance to the buyer, who expected to receive the goods in time for the holiday season, as it had made apparent to the seller even after the conclusion of the contract.

In the Serbian case T – 13/05 of the Foreign Trade Arbitration Court attached to the Serbian Chamber of Commerce of 5 January 2007, the arbitrator rejected the plaintiff’s request for the substitute delivery of goods. The Court judged that the fundamental breach was not constituted taking into consideration the fact that only 18% of delivery was not conforming with the terms specified into the contract.\(^{22}\) In addition to that case, a Portuguese seller and a French buyer entered into a contract for the sale of a stock of pressure cookers to be distributed in a French chain of supermarkets.\(^{23}\) After delivery, some of the cookers showed a defect that made their use dangerous. As a result, both the buyer and the distributor brought an action against the seller claiming, respective-

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\(^{19}\) This author has extensively written in the research area of determining the concept of Fundamental breach, so that the brief discussion of application of the findings will be present herein.


\(^{21}\) Case Number 790 Corte di Appello di Milano of Italy decided on 20 March 1998. The text of the decision is available at http://cisgw3.law.pace.edu/cases/980320i3.html


ly, termination of contract and damages. The appellate Court found the existence of fundamental breach since the number of the defective pressure cookers was substantial, amounting to almost one-third of the total number. Moreover, although the seller had alleged that the defective items had a different reference number, this was not evident from the invoices, where they were referred to by the same number. Nor did the seller provide for another way to identify the defective items. Partial termination was therefore not admissible. In both cases the court in determining fundamental breach of contract and the possibility of terminating the contract considered the total contract value and the losses suffered: 1) considering the size of non-conforming delivery or, 2) determining the amount of expenses needed to redress the consequences of the infringement. This approach is called The Approach Of Economic Loss.

In the third case submitted before the French Supreme Court, an Italian seller delivered Italian wine, which did not conform to the French wine law with respect to the sugar added to it. The French Supreme Court found a fundamental breach on the grounds that the wine was not merchantable in France. The courts have examined the intended purpose of the contract and its frustration, hence they used the Frustration of the Purpose of the Contract Approach. Applying this approach, courts start from the premise that the buyer asked for delivery of specific goods for specific and determined reasons. Thus, the buyer’s inability to use the goods in a way stipulated by the contract constitutes a fundamental breach of contract. In that case, it is not relevant to assess whether the breach is full or partial non-performance, whether there has been delay in delivery, or whether there was delivery of other goods not specified under the contract. If the purpose of the contract is no longer feasible or economically viable due to the breach, then the breach is fundamental. However, the party must prove that consequences of the breach are of such a nature that she/he suffered damage that essentially deprived her/him of what was reasonably to be expected from the contract.

In the fifth case of this analysis, a Dutch seller and a German buyer concluded several contracts for the sale of cobalt sulphate with specific technical qualities. The buyer declared the contracts avoided on the following grounds: the delivered cobalt was of a lower quality than that agreed to under the contracts; the cobalt was produced in South Africa and not in the UK as indicated in the contracts; and the seller had delivered non-conforming certificates of origin and quality. The seller denied the buyer’s right to avoid and brought suit to recover the purchase price. The Supreme Court held that the buyer had not validly avoided the contracts and awarded the seller the full price. This is the famous Cobalt-sulfate case. This Remedy-Oriented Approach was inaugurated by the German Supreme Court in 1993. According to the Court, in the system of the Convention the remedy of avoidance for non-conformity of the goods represents the last resort in respect to the other remedies available to the buyer. The fact that the buyer might be forced to resell the goods at a lower price is not to be considered in itself an unreasonable difficulty. The Court denied existence of fundamental breach in the case at hand, because the buyer should at least have proved unreasonable difficulties in trading the goods in Germany. This method determines whether it is reasonable for the buyer to retain the goods or to use them, and to claim damages for the loss suffered which occurred as a result of injury. Under this approach, only if it is clear that the injured party cannot compensate the damage or successfully request a price reduction, it is possible to resort to termination as an ultima ratio remedy. However, this approach is limited in its scope since it only applies in case of non-conformity of goods, while in case of other types of injury this approach cannot be used. In the fifth herein analyzed case, the Hamburg Court of Appeals found that the seller committed a fundamental breach. Namely, the seller asked for additional time from the buyer, with the explanation that

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26 See more on Germany 3 April 1996 Supreme Court (Cobalt-sulphate case) at: http://cisgw3.law.pace.edu/cases/960403g1.html
he needs it for negotiation with the supplier to ask for the delivery or termination of the contract. Therefore, after not having been able to deliver the goods within the stipulated time, such declaration of the seller constituted a fundamental breach since it remained uncertain for the buyer if and when the seller would fulfill his obligation to deliver the goods. In this famous Iron–molybdenum case the court used the Anticipatory Breach Approach.\(^{27}\) The court found that where, prior to the date for performance of the contract, one party produces uncertainty regarding the future fulfillment of the obligation, the other party has the right to protect itself from future breach of the contract.

A Swiss buyer had placed an order with an Italian seller requesting that the goods be delivered within the next 10 to 15 days. Almost two months later, the seller, after asking the buyer to confirm its order, specified the purchase price and assured the buyer that all the goods would be dispatched within a week. Two months after that, the buyer had not yet received the goods. The buyer then sent the seller a notice canceling the order and demanding a refund of the price. After receiving this notice the seller delivered part of the goods. The buyer refused to accept the late and short delivery and, as the seller did not refund the purchase price, commenced legal action, claiming avoidance of the contract for breach by the seller and asked for a refund of the purchase price with interest and damages. The Italian court found that there was a fundamental breach on the grounds that, two months after ordering and paying the price, the buyer was still waiting for two thirds of the goods.\(^{28}\) In this case, the court applied the Approach of the Future Performance (to successive deliveries), questioning termination of contract in relation to: a) failure to perform one obligation, while other parts of the contract remain in force, b) future performances and c) to the whole contract.\(^{29}\)

In the case of a contract for delivery of goods in installments, if one party's failure to perform with respect to any installment gives the other party reasonable grounds to conclude that a fundamental breach will occur with respect to future installments, the other party may declare the contract avoided for the future (Art. 73(2) CISG).

In the seventh case covering the Franco-Portuguese dispute, a French company sold a second-hand metallic hangar to a Portuguese buyer, with the purchase price including the cost of dismantling and delivery. After the buyer’s refusal to pay the last installment of the price on the grounds that the dismantled metal elements were defective, the court found that a certain quantity of the goods were not fit to be exactly reassembled, a fact expressly made known to the seller. Since that defect related to only part of the hangar and concerned metal elements which could be repaired, the court held, however, that it did not constitute a fundamental breach justifying avoidance of the contract pursuant to article 49(1)(a). In this case, the court applied the Offer to cure Approach. Considering offers to cure the defect of goods is not explicitly provided as part of the definition of the concept of fundamental breach. This approach is limited in its application to cases where the following conditions are cumulatively met: 1) when the injuring party can cure the failure (without unreasonable delay and without causing the buyer unreasonable inconvenience or uncertainty of reimbursement), 2) when a party who fails to perform an obligation subsequently offers fulfillment and 3) when cure of the defect would prevent the damaged party from being substantially deprived of what he expected under the contract.

Analysis of case law has shown that there are a variety of different schemes and elements in existence, and that different courts have been evaluating current methods of interpretation and proposing the adoption of a more consolidated and coherent approach in defining the concept of

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\(^{27}\) See more on Germany 28 February 1997 Appellate Court Hamburg (Iron–molybdenum case) http://cisgw3.law.pace.edu/cases/970228g1.html

\(^{28}\) See Pretura circondariale di Parma, sez.di Fidenza; 77/89; 24 November 1989; Foliopack Ag v. Daniplast S.p.A. The text of the decision is available at http://cisgw3.law.pace.edu/cases/891124i3.html

fundamental breach under CISG. Formation of the one complex and all-involving uniform approach, instead of applying the existing seven approaches that pertain to particular types of breaches and national legislations, will contribute to achieving the goals of the Convention – uniformity in application - which today is the most pressing aim in the sphere of the international sale of goods. By defining one unique approach that applies to all types of breach of international sales contracts, we will contribute to the accomplishment of this aim. The Consolidated Approach should also contribute to the effectiveness of courts and aid in the prevention of contradictory and inconsistent results.

### 2.2. Combining Diverging Approaches into a Hybrid Approach

Legal doctrine strongly advocates for the necessity of creating one comprehensive approach which could cover all herein factual and legal situations, and reduce the diversity within the legal construing area. The method of generating a new all-encompassing approach basically can be expressed through co-existence of two elements prescribing particular requirements. Accordingly, only when both elements are cumulatively fulfilled the court would have basis to claim existence of fundamental breach, and to award the right of avoidance or substitute delivery. The first element *Purpose Driven Test* applies whenever the purpose of the contract is frustrated. The second element *Interest Driven Test* considers the interests of the aggrieved party by examining whether the aggrieved party needs the remedy of avoidance or substitute delivery – as opposed to damages or price reduction – in determining fundamental breach. The complexity and coherency of such a dual-structured approach makes it universally applicable and all-encompassing. Furthermore, the acceptance of the newly proposed *Hybrid Approach* may lead to legal certainty and uniformity of a higher rank.

The author tries to prove that analysis of the elements of different approaches will enhance the possibility of the courts to more uniformly interpret their approaches, and therefore somewhat ensure legal certainty and prevent insecurity among the contractual parties. Due to the different interpretations of the concepts of CISG on contracts by diverse courts and countries, international sales law has been plagued by legal uncertainty and insecurity. The plethora of current global legal practice makes it impossible for the contracting parties to foresee and determine what will occur and what consequences will be produced, thus to contribute to the legal certainty and predictability of legal trade.

### 3. Conclusion

The CISG Uniform Global Era (CUGE) will be achieved when the international community has established three pillars required for the uniformity of application of international norms such as the CISG. In order to have a strong and consistent CISG case, the creation of an international tribunal that has jurisdiction over disputes arising under the CISG seems a necessary requirement. A centralized judicial institution could facilitate uniformity of court decisions on CISG-related disputes by supervising the uniform application and interpretation of the CISG. However, as for now the creation of an effective international tribunal that ensures uniformity of interpretation among members of the global community will be a long and tenuous process, which has not yet been initiated. In the presence of strong political will, financial support and conscious effort on the part of the international community, hopefully it will be plausible in the future, but this is presently not the case.

Due to limited financial resources and the lack of administrative support and human resources, creation of this international tribunal is currently not feasible. Thus, the drafters of the CISG
assumed that CISG will be interpreted by domestic courts and not by an international tribunal, and therefore, the legal doctrine has to provide the model for how to overcome this issue. Therefore, instead of having a tribunal as the pillar of CUGE, as the comforting scenario, different academics have proposed a variety of structures and instruments by which uniformity of application might be achieved. These methods are mainly based on interpretative common lingua franca and autonomous interpretation, all for the purpose of achieving international precedent of CISG. As for now, despite the existence of common lingua franca of the CISG, very rich legal doctrine and travaux préparatoires, existing interpretations of the CISG provisions are different and thus they generate inconsistent and non-coherent case law. The most relevant CUGE is international case law, which is rendered difficult due to both conflicting court decisions and views of its role as a legal authority. To counteract the possibility of national legal systems resorting to domestic legal interpretations, development of a jurisprudence of international trade has been strongly advocated. Different courts and tribunals applying the CISG must follow the intentions of its drafters, and follow the international character of the CISG as well as its goal of uniformity, emphasizing the need for an international discussion among all international business actors.
AN APPROACH TO RESEARCH OF FRANCHISE AGREEMENTS:
METHODOLOGY, ECONOMY AND COMPARATIVE LAW REVISITED

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Abstract

The article revisits a previous research of the author, i.e., his doctoral dissertation titled “Comparative Legal Aspects of Franchise Agreements”. Thus, the conclusions presented therein serve as a base for the current article. On the other hand, the article refers to the said conclusions only substantially, as its primary role is to revisit the approaches utilized for reaching the said results, and not to go into details on specific matters covered during the research. The article embodies the manner of employing legal and broader social methodology during the research, structurally developed and explained. Gradually, the article revisits the author’s previous research by examining the impact of different methodological approaches of social sciences and their role in achieving a research that is perceived as complete. Consequently, the functional features of the article refer to methodological matters which could, according to the author, serve as a model for the research of other legal phenomenon in the field of social sciences.

Key words: approaches, competition law, contract law, franchise agreements, franchising, methodology

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AN APPROACH TO RESEARCH OF FRANCHISE AGREEMENTS: METHODOLOGY, ECONOMY AND COMPARATIVE LAW REVISITED

1. Setting the fundament; or establishing the legal functionality of a social phenomenon

1.1. Subject matter and methodological approaches distinguished

When one decides to take upon the obligation to research a certain topic in the field of social sciences, one must be concrete, on one hand, and also try to give the topic its needed broadness. This certainly seems contradictory, yet it is inherent to the dialectical features of social sciences. Every phenomenon in the social milieu can be approached from different aspects, considering that only by broadening the variety of aspects from which one views the said phenomenon can a complete notion of the phenomenon be achieved. Therefore, determining the focus of the research is only the first step that should be undertaken. Further, one has to establish the dominant aspects of the analysis, or the topic will be diluted. By determining the dominant aspects, one tackles with very specific issues and problems concerning the subject matter of the research. The subject matter, therefore, is primarily focused on a certain area in the field of social sciences. On the other hand, with the end of achieving the needed broadness of the research, the approaches to the subject matter should be numerous.

Bearing in mind this position, the basic difference between the subject matter of the research and the methodology used arises. The problem is certainly focused in one area in the field of social sciences, yet the methodological aspects vary so one can not only give answers to concrete problems but can also determine the numerous interactions of the subject matter (the given social phenomenon) with other social processes (the social phenomenon from other social areas). Starting with this position, franchise agreements can serve as the given phenomenon in the field of legal science. This article serves the purpose of illustrating how a particular research of a given legal phenomenon can be carried from the outset to the end. As the subject matter of the research is primarily of a legal nature, so is the main approach undertaken legal in its substance. Nevertheless, various methodological approaches have been utilized with the objective of establishing not only the place of a given (legal) phenomenon in the field of social sciences (and processes), but also determining the interactions of the said legal phenomenon with other social processes that are subject matter of other social sciences and, therefore, other methodological approaches apply.

Where franchise agreements are concerned, the comparative legal aspects of the said phenomenon seem the most appropriate in terms of a general approach. Then, one would have to establish the structural framework for developing the subject matter of the research, while not only covering the issues that strictly belong to the field of contract law, but also the issues relating to franchising as a business activity, issues relating to competition aspects of franchising and franchise agreements, issues relating to franchise agreements in the light of international private law, issues relating to international franchising and international franchise agreements and, finally, issues concerning the prospects of franchising as a model of business organization and the prospects of legal regulation of franchising and franchise agreements. From this short structural overview, one can
establish the phases of analysis of a given legal phenomenon and also determine the different methodological approaches applied. The text that follows examines in more detail the concrete issues and problems faced, sticking to the developed and implemented structure and gradually explaining the different methodological approaches, as they arise.

It is an established practice when writing about social processes that one must first determine the working hypothesis of the research, by giving basic notes on the fundamentals of the used terminology, methodology and structure of the research, and by setting up the framework system of presenting the research. As for franchise agreements, the (working) hypothesis relates to the notion that franchise agreements currently enjoy autonomy as an institute of contract law, between the diffused and fragmented legislation on one hand and the creative and often only palliative effect of usages and practices on the other hand: regarding the said situation as satisfactory in the sense that prospectively there is not a need to undertake legislative steps but only a uniform activity of regulation, with the result of clear extraction of the institute from franchising.

1.2. General and special methodology explained

The working hypothesis should be further developed in the structural framework of the research, with each of its parts giving regard to the relevant aspect of the analysis. Generally, basic methodological issues should be primarily overviewed, by giving basic notions of particular methods applied and conclusions developed. Bearing in mind the dominant legal nature of franchise agreements, legal methodology seems the most appropriate one. On the other hand, when striving for a more complete presentation of the legal phenomenon, methods of related social sciences must also be applied.

Where legal methodology is concerned, one must first stress that franchise agreements are frequently classified and deduced as in-nominate agreements. The so called in-nominate character of franchise agreements directly induces the dominant use of the comparative legal method. Such an approach is dictated with the aim of establishing the basic tendencies that are present in legal sources thorough different legal systems and, more generally, through different legal traditions. When utilizing the comparative method, one is almost inevitably directed to the functional method of comparative research (Zweigert, 1972). The functional methodology, of course, has its shortcomings but, nevertheless, offers the possibility of determining the general tendencies of legal development. Therefore, one should strive not only to provide an overview or just restate the legal regulation of franchise agreements, and franchising generally, as is done in literature (Zeidman, 1990; Abell, 1991a, 1991b), but also to give the general contours of rules and guiding principles regarding franchise agreements. This supports the objective of not just conveying the black letter rules but also the functioning of those rules in practice (Pound, 1910) as much as possible, given the limited accessibility of information.

Legal methodology of comparative law, or the dominant utilization of the functional method, tends to disregard the particularities of a given legal system (Rosen, 2003). Therefore, one must also explore the alternative methodological approaches to comparative law, as are the approaches of legal transplants (Watson, 1993) and legal formants (Sacco, 1991a, 1991b). Those approaches may be found very useful when one determines not only the perceived functionality of legal regulation present in other systems but also when appraising the factors influencing the application of certain rules in (domestic) practice. Further, the mentioned in-nominate character of franchise agreements inevitably initiates the debate of formulating appropriate legal rules for their regulation. Therefore, one of the most important approaches is that of formulating (model) rules for future regulation. Most notable on European soil is the undertaking of formulation of the Principles of European Law
on Commercial Agency, Franchise and Distribution Contracts (PEL CAFDC) (Hesselink et al., 2006), as a part of the academic Draft Common Frame of Reference (DCFR) (Study Group on a European Civil Code, and Research Group on EC Private Law (Acquis Group), 2009). This approach is part of the more general methodological approach of defining and drafting common rules, as is the case of the Principles of European Law (Lando and Beale, 2000; Lando et al, 2003). One the other hand, there is the common core approach (Bussani and Mattei, 1997-1998) which offers the extraction of guiding principles that can serve not only as prerequisites for possible future regulation, but also as a very conceivable pinpoint for scientific argumentation.

All those approaches, in one way or the other, are actually complementary to the functional method, rather than taking its place. The functional methodology remains as a valued approach, yet some of its aspects are corrected and the methodology itself is being restructured and supplemented (Michaels, 2006). The supplementation of the functional approach extends not only to the recognition of differences and finesses of a particular legal system, but also to the recognition of cultural and anthropological factors (Legrand, 2003). All the activities for restructuring the functional method of comparative law are ultimately resultant from the need for a fundamental and substantial comparative research (Legrand, 1999). The legal methodology, therefore, must be supplemented with the methodological approaches of other social sciences (economy, sociology, psychology, etc.).

Legal rules, particularly in the field of private law, build upon actual (economic) processes and reflect their content. Bearing this in mind, one should strive to apply the methodological approach which would be appropriate considering all the particularities of the problem at hand. Franchise agreements prove as a viable terrain for the utilization of different approaches, which would finally lead to a (relatively) complete research in the field of social sciences. Nevertheless, it remains that the personal sense of the individual researcher on the issue at hand can sometimes be the decisive one (Zweigert and Kötz, 1998). One must strive, nevertheless, to achieve acceptable (if not ultimately successful) research results. Franchise agreements, as it was stated, prove rather suitable for applying different approaches. The text that follows illustrates some of the approaches undertaken and the results achieved, with the objective of making the methodological issues more applicable.

2. Determining the substantive sources of law

2.1. The economic base

The legal phenomenon is determined by its societal bases. In other words, the things that actually happen in life initiate the need for a legal reaction, considering the regulatory functions of law. This may be disputed in the area of public law but is precisely to the point when private law is concerned. Further, when one discusses the legal regulation of transactions, this bears the character of an actual axiom. Therefore, if one wishes to carry out a rather complete analysis of a phenomenon that is legal in its nature, one should not only consider legal matters but also the factors and processes that influence and determine the contours of the particular legal phenomenon. Bearing in mind the research at hand, and considering the methodological fundamentals established, the determination of the substantive source of law follows.

Franchising is the fundament of franchise agreements. Considering the primary legal nature of the research, presentations referring to economical fundamentals should be general and introductory, as to serve as a basis for further and more detailed analyses in different methodological frameworks. When a lawyer offers economic arguments, they are necessarily given in rudimentary form, as much as the analysis of available literature allows one. As to the legal analysis, it should be set in terms of extracting franchise agreements from franchising, as a separate business activity, by defin-
ing the notion and the legal nature of franchise agreements and, finally, by outlining the sources of law regulating franchise agreements and franchising, in a broader sense. Following this approach, the general distinction between the formal sources of law (i.e., the rules regulating franchise agreements identified in different sources of law) and the substantive sources of law (i.e., the economic activity of establishing and managing vertically integrated networks by utilization of the franchise package, known as franchising) is inevitable.

Franchising is a particular model of carrying out a given business activity. Moreover, franchising is a specific activity in terms of a mode of formation of unified networks of conducting business on the basis of a legal instrument called granting a franchise. The venture of franchising covers the entire sequence of activities for establishing and managing franchise networks. This activity, as a totality of different processes and undertakings, comprises the notion of franchising which is, in its substance, an entrepreneurial activity (Hoy and Shane, 1998). As such, franchising is primarily an economic phenomenon. Finally, franchising is a framework model, which itself incorporates all conceivable ways of performing all conceivable business activities. Hence, in general terms, it does not matter which kind of business is being franchised, neither the manner in which the specific business is performed.

As a business activity, franchising is understood as one of the modalities of the so called vertical integration, such as are, for example, the modalities of distribution, commercial agency and company-owned units. Many networks, however, do not function as purely franchised, but in combination with the existence of a franchisor’s own units in the network. Thus, the plural or hybrid form occurs (Brickley and Dark, 1987; Shane, 1996). Therefore, the determining of the proportion or the percentage of participation of company-owned and franchised units is one of the fundamental questions of the science of network management. Actually, in practice, franchising acts as a system in which one undertaking, which has developed a perceived functional and successful model of performing some kind of business activity, codifies the said model and shares it with other undertakings for remuneration. By the sharing of the developed format, other undertakings are included in the system comprised of the developer of the business format (the franchisor) and the undertakings that acquire its content (the franchisees). On the other hand, following different economic incentives, franchisors actually also operate their units, which coexist with the units of the franchisees. In a few words, this is how the so called plural form occurs.

Economically speaking, franchising is a form of distribution of goods and services. Therefore, the general economic approach does not consider only the aspects of entrepreneurship, but also the aspects of network management and marketing. Furthermore, the network form of organization requires broader evaluation of franchising: from sociological and cultural standpoints (Stanworth and Curran, 1999). As an economic model, franchising is a consequence of the so called globalization of economic relations. The activity of franchising enables the implementation of the cloning method of performing a particular business activity in the independent business venture of the franchisee (Stanworth and al., 2001). Bearing this in mind, the franchisee owns its own business, while the franchisor owns the network of uniform business ventures owned by the franchisees. In such a franchised network a redistribution of immaterial assets between the franchisor and its franchisees occurs (Windsperger, 2002).

Thus defined, the economic role, significance and functions of franchising can be viewed from its positive aspects in comparison to its negative aspects. Adopting a one-sided view is, of course, quite unrealistic. Like any model of doing business, or every model for performing the distribution of goods and services, franchising has its good and bad sides. Hence, the question is not how to achieve the ideal model, but how to achieve a functional model, taking into account the interests of participants in the relationship and the broader social interest. The latter is very important and
should not be stressed only as a matter of floccules, because achieving the ultimate unification of the ways of conducting business activities leads to a substantially black and white world, no matter how brilliant its colors are.

Thus explained, franchising is the substantive source of law for latter formulation of legal rules for the regulation not only of franchise agreements, but other aspects of operating franchising activities in general. Economically, franchising is not just a model of doing business but also a method of organization of distribution networks. Such notions on franchising dictate further considerations of the prospects of franchising and its legal regulation. It seems, on the other hand, that such an analysis can be undertaken after all other aspects are covered. Finally, one should establish one's own attitude towards statistical figures on the impact of franchising. This is a point of personal determination, as it should be the result of the more general outlook that numbers are somewhat scarce as a source of knowledge. The view herein accepted is that, at least when the researcher is a lawyer, one should maximally refrain from stating statistics, mostly because of the belief that the lack of franchising, *ipso facto*, does not entail a smaller number of business ventures and a growing number of unemployed persons.

2.1. The legal upgrade

Before attempting to extract franchise agreement from franchising as a business activity, the types of franchising should be determined. This can also be considered as a basis for determining the types of franchise agreements. According to the results of research on this matter, the division of franchising into certain types does not bear a particular significance, especially because the activities that are frequently (and falsely) covered by the notion of franchising are the activities of classical distribution, licensing, or even technology transfer. What may be regarded as proper franchising is solely business format franchising. Only business format franchising substantially influences the manner of performing a certain business activity in the undertaking of the franchisees, as it strives to completely cover every aspect of the activity which is being franchised. Other similar economical forms of distribution are, therefore, covered by different legal frameworks.

The latter, *mutatis mutandis*, applies to franchise agreements. Under the category of franchise agreements, to be precise one cannot submit anything more or anything less than granting the manner of performing a particular business activity. Whether this activity involves the sale of goods or the provision of services is not essential for the qualification of a certain relationship as a franchise. Hence, different notions of franchise agreements would hinder their economic fundamentals, as a deviation from what is their substantive source.

Otherwise, while composing the definition of the franchise agreement, different sources of information should be covered: the definitions in comparative jurisdictions, in ethical codes of franchise associations, in judicial and arbitral practice and in theory, respectively. Thus, common elements of all these notions should be extracted and, taking into account the results of the research, a single definition of franchise agreements should be proposed. Before proposing an integrated definition of franchise agreements, one should also analyze their legal nature. This approach proves to be extremely important, bearing in mind that franchise agreements are quite unjustifiably assorted with distribution agreements and/or license agreements. Franchising is distinctive from distribution, as it does not involve the supply of goods for resale. Licensing, on the other hand, covers the granting of certain intellectual property rights and the franchise package, in certain cases, does not need to be comprised of intellectual property rights. If franchising is a form of licensing, then the object of license would be the model of doing business (Mendelsohn, 2004).
When one considers those facts, one realizes the existence of serious and chronic flaws in determining the (in-) nominate character of franchise agreements and their (non-) autonomous legal nature. Franchise agreements, therefore, should be considered as a type of nominate contracts, because there are relatively standardized rules governing their content. There are, in fact, a number of sources governing the rights and obligations of contracting parties, such as the field of usages and on the grounds of established practices. Those legal sources, however more fluid, are not necessarily less relevant than legislation. Therefore, the approaches of classical civil (contract) law prove to be less adequate than those of commercial law. Following this line of reasoning, and in the context of the legal nature of franchise agreements, they should be considered to be a form of autonomous contract, especially when one considers their commercial character.

After determining their essential elements, the integral definition of franchise agreements should be derived, bearing the features of the economic core of franchise agreements. Therefore, the franchise contract is an agreement concluded between the franchisor and the franchisee, as independent entities, by which the franchisor grants to the franchisee, for consideration, the manner of conducting a business activity in order to achieve a reasonable level of uniformity of the activity and performs a reasonable degree of supervision and control over the manner of conducting the business activity of the franchisee. Such a broad definition is considered bearing in mind that a definition of a new and modern contractual relation should not only restate the classical elements of main obligations, but should also include some distinctive elements which would serve as a clarification of the main obligations of contracting parties. This may seem unorthodox but it serves to provide clear separation of franchise agreements from other similar contractual relations.

The legal upgrade of an economic phenomenon, naturally, covers the issue of legal sources of comparative, domestic, international, and European law governing franchise agreements. Generally speaking, the notion that franchise agreements are not covered by legislation is erroneous. Comparatively, there is a significantly higher regulation of franchise agreements than is the case with other modern agreements. Formal approaches differ, from special legislation (United States of America) to incorporation in civil codes (Russian Federation). Substantial approaches differ also, from regulation of disclosure aspects to regulation of relationship aspects. In any case, special emphasis should be put on the role of trade usages and established trade practices as a basis for the (subsequent) consideration of lex mercatoria as a source of so called franchise law. In any case, the possible perception that there is a so called franchise law, both in terms of a special legal branch and in terms of a specific legal science, proves to be completely unjustified, given that the many peculiarities of franchising and franchise agreements, by themselves, do not supply sufficient arguments in this direction.

3. General contract law theory on the creation of a binding agreement

3.1. The involvement of comparative contract law

The determination of substantive sources of law also dictates the origination of legal rules regulating franchising and franchise agreements, in terms of a general legal framework. On the other hand, considering the stated subject matter of the research, the legal aspect must be focused on contract law matters, in a comparative perspective. Here also, different approaches could be perceived. Those approaches would differ considering whether one utilizes the classical contract law approach or decides to follow the commercial law approach. As fundamental contract law issues are being considered at this point, the previous proves to be more effective, not only because of its systematic advantages, but also because of the fragmentary and casuistic features of the latter.
The classical approach seems more appropriate also following the different regulatory schemes in comparative law.

Classical contract law, at the risk of going into many details, provides for a distinction between the initial creation of the franchise agreement and its effects, as a preliminary step of the research. This approach proves effective when the initial occurrence of the agreement, and its qualification as a franchise, are concerned. The classical approach acknowledges that the contract can produce unimpeded legal consequences not only if it occurs, but it must also be a valid one (Перић, 1912). In this manner, one establishes the issue preliminary to the effects of the agreement. Following general contract theory, a further distinction should be made between general conditions for creation of contracts (parties, legal fact, object and cause) and the particular ones (as is the case with form). While analyzing all of the conditions mentioned, the impact of the condition, as on the initial occurrence of the agreement and on its validity, has to be considered.

3.2. Applicable outcomes from the creation and validity of an agreement

In terms of the parties (the franchisor and the franchisee), it is indisputable that at least the franchisor, considering that franchising is a form of entrepreneurship (Kaufmann and Dant, 1999), must be an entrepreneur. On the other hand, the fact that the franchisor is not registered as a trader, ipso facto, should not trigger automatic nullity of the franchise agreement; depending on the legal system, this fact could lead to possible administrative or misdemeanor liability. However, the general lack of subjectivity, as a rule, will result in nullity of the franchise agreement. When one determines the position of the franchisee, the question of his operation as an entrepreneur is disputed in literature (Torikka, 2011). However, at least in legal terms, the franchisee should act as a trader and cannot be, under any circumstances, considered as a consumer. As for the need of registration of the franchisor to performing the activity of franchising, the answer may vary from one legal system to another. As a rule, the valid occurrence of the contract may be brought into question only in systems where the ultra vires theory is accepted. In other systems, the contract shall be considered valid and the franchisor may be subject to administrative or misdemeanor liability.

As in any contractual relation, the concurrence of wills is the legal fact that creates it. When the concurrence of wills is concerned, the valid occurrence of a franchise agreement would be, in principle, jeopardized only in situations of misunderstanding (between the parties). The validity, but not the initial occurrence, of the agreement would be put into question in cases of nonperformance of a franchisor’s obligations to provide the necessary pre-contractual information to the potential franchisee. Therefore, if the conditions provided by applicable law are met, the appropriate remedies can be invoked; in principle, the contract could be avoided because of a faulty communication of will (van Erp, 1998). This concept is mostly the result of statutory interference, i.e., the rules of special legislation relating to pre-contractual duties of the franchisor for disclosure of relevant information. Comparatively speaking, most legislators have enacted disclosure and not relationship legislation where franchise agreements are concerned.

However, existence of the concurrence of wills could be discussed also from the aspect of completeness of the offer to conclude the contract. Here, classical contract law coincides with special rules on pre-contractual disclosure. To be exact, if the offer to enter into a franchise agreement is incomplete in the sense that it does not contain all the elements prescribed by statute, then the communication of will is rendered as unsuitable, i.e., legally irrelevant. The acceptance, even if it fully matches the offer, will not lead to perfection of an agreement because the coordination of wills is lacking. Hence, a divergence of remedies in the case of avoidance and nullity of agreement occurs. To be exact, non-compliance with statutory provisions regarding pre-contractual disclosure, which
serve to protect inexperienced franchisees from entering an unfamiliar contractual relationship, can result in public law remedies depending on the legal system. In terms of private law remedies, one should consider the standard rules of formation of contracts which determine the elements of the offer.

Issues prove to be relatively clear when it comes to form in systems where statutory formality of franchise agreements is prescribed. The form, although not a general condition for initial occurrence of an agreement, should be analyzed in relation to the concurrence of wills, following the consensual approach to formality in the field of contract law. Statutory formality, depending on the legal system, will usually be *ad solemnitatem*. Failure to adhere to statutory form will result in nullity of the contract. In systems where franchise agreements are informal (as is often the case in common law systems) there is the question of possible application of the classical concept of statute of frauds. Finally, in other systems where franchise agreements are informal, mostly because of the lack of statutory regulation, their formality can be derived from the agreement of the parties, trade usages, and even established practices.

The field of franchise research would be incomplete if one did not refer to the issue of standard agreements. In practice, franchisors generally conclude franchise agreements on “take it or leave it” terms. The researches of the power in distributive channels (Iyer and Villas-Boas, 2003) therefore serve as very useful for determining the actual function of adhesion agreements. Inequalities in bargaining power, therefore, prove as a suitable premise for establishing special rules even when commercial matters are concerned. This also reiterates the debate on the relatively essential effects of the distinction between commercial, civil, and consumer agreements (Hesselink, 2010).

In view of the subject matter, the notion that the contents of the franchise package should (legally speaking) be set widely as to cover the granting of any manner of conducting any kind of business activity proves to be functionally most adequate. This conclusion follows the notion that only business format franchising can be considered as the legitimate and fully deployable form of franchising in current economic and legal surroundings. The elements that, however, the franchise package must contain are those relating to communication of know-how and providing assistance and training (Bueno Díaz, 2008). This argument is developed for the reason that the lack of these elements would prevent the initial qualification of a franchise agreement as such. The same would apply to situations when there is not the provision of a uniform system, but would not apply to licensing of intellectual property rights given that the latter is not the only way of achieving uniformity since other distinctive signs may be involved.

Finally, as to the cause, the same arguments as in the case of the subject matter could be applied. Normally, this is relevant for those legal systems that recognize the cause as an institute of contract law, in its objective meaning. At this point, however, those arguments would apply only if the purpose of the contract, which the parties had perceived at the time of its conclusion, is to match the content of the rights and obligations under a franchise agreement. Otherwise, we switch to the ground of the subject matter of the contract. Thus, the lack of provisions for communication of know-how and for providing assistance and training would quash the cause on the side of the franchisee. Also, the lack of provision of supervision and control would quash the cause on the side of the franchisor and on the side of the franchisee. Licensing of intellectual property, however, would not affect the cause of the agreements, if the uniformity of the system is ensured by other means.
4. General contract law theory on the effects of a binding agreement

4.1. Closing the comparative contract law circle

After one establishes that the agreement has validly occurred, the contract law approach continues with the effects of the agreements. Such an analysis, if one follows the commercial law approach, would involve the central issues related to franchise agreements, i.e., the issues relating to content, duration and cessation of franchise agreements, and also to some post-contractual matters. In substance, such an analysis should also utilize the approaches of comparative contract law. The relevance of some classical contract law notions also remains, particularly considering the fundamental elements of the agreement and the distinction between objectively and subjectively essential elements. In any case, the comparative contract law analysis, whether perceived from classical or from commercial law approaches, is finalized when one also considers the issues on effects of the agreements and such an analysis, for the purposes of purely legal analysis of a contractual relationship, could be considered as more or less complete.

4.2. Applicable outcomes from the effects of an agreement

Regarding the contents of franchise agreements, an identification of the main obligations of each of the contracting parties seems appropriate. The comparative law approach induces the determination of the main obligations of the parties following the results from insights in particular legal systems, whatever the source of law is. Employment of the functional method of comparative law, therefore, seems the only viable approach. When analyzing the main obligations, commercial law methodology is customary. On the other hand, classical contract law approaches are most suitable when deciding on the qualification of some of the (main) obligations as objectively necessary, while others only as subjectively necessary elements of franchise agreements. Naturally, given the correlative nature of transactions, what is a duty for one party is an entitlement for the other; however, bearing in mind the qualification of the distinctive character of the obligations, the focus is on the latter. To address the rights, although it is usual in commercial law approaches, is rather tautological. In any case, during the analysis of the content of franchise agreements, or their effect generally, the inclusion of general principles of good faith and cooperation should be implied (Croonen, 2008).

As far as the obligations of the franchisor are concerned, the obligations of initial assistance in setting the business, of training and assistance, of grant of rights and know-how, of effective control and of proper supply are identified. The latter should not be considered as a necessary element of the franchise agreement, for the simple reason that business format franchising, as a rule, does not involve the supply of goods for resale. However, the franchisee is often obliged to procure inputs or equipment from the franchisor or from an approved supplier with the aim of achieving uniformity and proper functioning of the franchised model of operation of the particular franchised business activity. When this is the case, there is an obligation for proper supply as a subjectively necessary element of the franchise agreement.

All other obligations of the franchisor should be considered as essential for a contractual relationship to qualify as a franchise; i.e., without the existence of elements of initial assistance in establishing the business, of training and assistance and the grant of rights and know-how, it could not approach a successful cloning of the manner of operating the business venture itself. Liability for non-performance, therefore, seems not to be the appropriate remedy. Also, effective control should be considered as an essential obligation of the franchisor. That is to say, it is one thing to argue that the franchisee has a legal interest to be controlled, while it is something else to enforce this obliga-
tion against the franchisor. Therefore, the existence of such an obligation, at least as a legal power, should be treated as an essential element of franchise agreements. This approach, it is believed, not only straightens the notion of franchise agreements but also reflects the economic functions of franchising.

As far as the obligations of the franchisee are concerned, the obligations related to the initial (up-front) fees payment, the periodic (royalty) fees payment, promotion and advertising, the submission to supervision and control and to exclusive purchasing are identified. The obligations for payment of the two charges do not have to exist cumulatively so the contract may be qualified as a franchise. It is necessary, of course, for an onerous obligation to exist; the elements of which, more or less, will be qualified according to the features of the principle of equivalence. Payments for promotional activities and the performance of promotional activities need not be regarded as objectively necessary elements of a franchise agreement, as they may be included in the franchise fees. Also, in practice, promotional and advertising activities can be undertaken solely by the franchisor (Mendelsohn, 2004).

Then again, subjecting the franchisee to supervision and control is considered an essential condition for the existence of a contractual obligation that could qualify as a franchise. Without the existence of the obligation of the franchisee to be subject to supervision and control, the uniform manner of conducting the franchised business venture itself would be under question, and not only the extent of its success. Therefore, even if the specific franchisee is the best imagined one, this obligation must stand as a legal power. It is very important, on the other hand, to determine the elements of the franchise package that are the core elements and those that are peripheral when enforcing the obligation of the franchisee to be subject to supervision and control (Kaufmann and Eroglu, 1998). The standardization of the manner in which the franchised business activity is undertaken is certainly a conditio sine qua non of franchising, but when such an element exist in the agreement, the assessment of the enforcement of the obligation should be carried out not only by legal means. Finally, as for the obligation of the franchisee for exclusive purchase, mutatis mutandis, the same arguments relative to the franchisor’s obligation for proper supply actually apply.

The question of the duration of franchise agreements is complex, taking into account their specific content and their character of long-lasting relationships. Thus, there are peculiarities in terms of expiration and renewal of the agreement, in terms of the transfer of the franchise, in terms of the relationships with third persons, regarding interpretation and filling the gaps in the agreement and in respect of modifications of the contents of the agreement. The special rules relating to expiration and renewal of the agreement and the transfer of the franchise are due to the need to decrease the dangers of opportunistic behavior by the franchisor. The rules concerning vicarious liability are due to the fact that the franchisor has the right to supervise and control the manner of effectuating the franchised business activity, while the rules for interpretation, filling the gaps and modification of the contract are due to the long-lasting character of the agreement and its incompleteness (due to complexity). Truth be told, all those specificities are not inherent in franchise agreements only, but are rather relevant to all long-lasting contractual relations and should be treated as such.

When considering some of the manners of cessation of franchise agreements, one can again reach the conclusion that, as was the case with renewal or transfer, the existence of special rules serves to avoid the conceivable opportunistic behavior of the franchisor. Typical examples can be found in the existence of special rules for good cause termination of franchise agreements (McLaughlin and Jacobs, 1987), the unconscionability of clauses for at-will termination (Williams, 1999), and special rules for withdrawal from the agreement as a form of cancellation in a certain cooling off period. The long-lasting character of franchise agreements also dictates the relevance of impossibility of performance and force majeure as means of cessation of the agreement, the impact
of bankruptcy of parties on the legal fate of the agreement and the contractual liability for damages due to failure to perform.

Finally, the regulation of post-contractual relations between the parties of franchise agreements is rather specific, because the cessation of the contract, regardless of how the contract ceased to exist, can lead to specific post-contractual obligations on the part of the franchisor and the part of the franchisee. Some of these obligations may be the result of statutory imperatives, while others are the result of enforcing contractual provisions. Most important on the side of the franchisor is the obligation for repurchase of supplies and equipment and for indemnification for goodwill, while on the side the franchisee is the obligation for non-competition, in principle associated with the obligations of secrecy and confidentiality.

It could be said that the issues relating to the creation and the effects of franchise agreements, from a comparative angle, give a relatively complete picture of their life cycle. The utilization of the comparative legal method gives also the opportunity to establish that all of the stated peculiarities are sufficient for treatment of franchise agreements as autonomous. Moreover, following identification of the elements of franchise agreements not only in terms of their content but also in terms of duration, cessation and post-contractual relations, the qualification of franchise agreements as nominate also proves adequate. Also, it can be inferred that comparative legislation and practice is primarily focused on the amortization of the risk of opportunistic behavior of the franchisor, i.e., that the large portion of legal rules serve a protective function, besides the basic function of legal certainty.

5. Illegality from a non-contract law aspect: competition law issues

5.1. The involvement of public law and the desire for a more complete social research

After exhaustion of the comparative contract law approaches undertaken on the subject matter covered, one would usually proceed to closing of the research. A complete research, on the other hand, induces a broader analysis of certain rules that do not directly cover contract law issues, but nevertheless influence the existence and effects of agreements. Historically speaking, competition issues have more and more effective influence on contract matters. Those influences are concerned with the legality of agreements, by employing non-contract law means for assessing and, ultimately, putting an end to an agreement. Therefore, competition law approaches concern public law interference in private law matters. Competition law approaches, by themselves, emanate hybrid methodological features. Although the legal bases of public law scrutinization of private law matters remain, economic argumentation has a significant role. This role is apparent not only by implementing economic arguments when applying competition law rules, but also when formulating policy approaches to market behavior and building the legal science of competition law. Finally, under competition law scrutinization are not only franchise agreements, as contractual relations, but also the economic activity of franchising as a whole.

5.2. Fixing the system and its contractual form

Following insights in economic literature and combining those findings with the legal approach to the legality of contractual arrangements, a general finding emerges that franchising, as an organizational form, does not actually solve the problems of centralized networks because it implies the existence of externalities, so these externalities are dealt with by imposing vertical restraints on competition. Economically speaking, franchising is employed to solve certain externalities and
stimulation problems which impede the efficient functioning of centralized networks of distribution. During the functioning of those networks, externalities like moral hazard, shirking, etc., occur. Therefore, undertakings employ decentralized forms of networks, as is the case in franchising (Rubin, 1978). Nevertheless, franchising itself involves externalities, at this level as a decentralized network. Vertical restraints, as contractual mechanisms, are imposed (by franchisors) in order to eliminate or just amortize the existing externalities of the system (Lipczynski, Wilson and Goddard, 2005). Hence it can be said that franchising itself is not as superior as one would claim, because its alleged amortization of externalities and stimulation problems, ultimately, are due to vertical restraints on competition and not to franchising itself.

When examining competition law issues, it should be noted that franchising is influenced by antitrust issues or, to be more specific, by vertical restraint matters. Issues concerning abuse of dominant position, concentrations, state aid and unfair competition may arise, but those problems are rarely so specific (putting aside unfair competition matters) in the sense that they involve the need for development of particular rules concerning franchising. Vertical restraints on territories, prices, inputs, consumers, etc., serve to solve franchising problems and there are evidences that they do (Brickley, 1999). The targets of vertical restraints are, quite understandably, franchisees. Problems like double marginalization, free riding, hold-up, etc., resulting from the decentralization process determine the content and the effect of contractual terms imposed on franchisees. In practice, stimulation problems and externalities of centralized networks may be solved by making employees owners, such that franchisees act as independent market actors. On the next level, because the plurality of franchisees induces more (different or even the same) problems, they are directly (e.g., by price fixing) or indirectly (e.g., by exclusive territories) bound by vertical restraints. On the other hand, one often turns a blind eye to the fact that franchisees pay for what they get from franchisors. Therefore, it seems to be inappropriate to treat vertical restraints as a means of amortization of externalities and problems of stimulation, when their purpose is to solve the problems on the side of the franchisee rather than the problems on the side of the franchisor.

5.3. Legal argumentation introduced

Those considerations naturally address the need of determining the legal attitude towards vertical restraints of competition. If one accepts the economic reasoning, then the Chicago school attitude that presupposes per se legality of vertical restraints would be employed (Bork, 1965, 1966; Posner, 1981). Historically, on the other hand certain vertical restraints have been dealt with under the per se illegality concept, while others are appraised within the rule of reason approach. As time passes, in European competition law and under U.S. competition law, the view shifts towards the rule of reason approach with presumed legality. Currently, in the United States even minimal price fixing falls under the rule of reason, while European competition law still condemns certain vertical restraints as hardcore and therefore automatically illegal, although recent attitudes turn to greater latitude of minimum price fixing in the field of franchising.

Legally speaking, the view that certain vertical restraints should be per se illegal should not be considered as incorrect. Such would certainly be those that fix prices or other charges. On the other hand, vertical restraints which amortize free riding problems faced by other franchisees in the system and which ultimately hurt the reputation of the entire network and the franchisor can have a proper grasp and can be treated under the regime of the rule of reason concept. In substance, the question is not whether vertical restraints are simply positive or negative. Further, there is a clearly defined direction in literature that warns of the possibility of abuse of vertical restraints in order to increase profitability and hurt the interests of competitors and members of the network (Cann Jr,
1987; Rey and Stiglitz, 1995). This literature, truth be told, is rarer than the sometimes apologetic literature for the usefulness of vertical restraints. The latter especially because vertical restraints are often justified by solely schematic economic criteria, without giving consideration to the wider social viability of vertical restraints and their long-term repercussions.

In other words, of utmost importance is not the restraint, but the context in which it is used and the purpose it needs to achieve, in the sense that the boundary between vertical restraints that increase competition and those that impede it is uncertain. It is true that in evaluation of certain vertical restraints one must take into account the specific circumstances prevailing in the particular market, i.e., its competitiveness, both in terms of upstream production markets and in terms of downstream distribution markets. However, this should not develop into a micro-analysis of the particular vertical restraint. When placing too much emphasis on economic analysis one may lose consideration that the sanctioning of certain vertical restraints has its own legal political purposes, such as preventive action and teleological assessment of the totality of use of particular vertical restraints.

The bottom line is that, legally speaking, the question is not the benefit from a particular vertical restraint, which is an economic issue, but the likelihood of harm from certain vertical restraints. The law is focused on the formation and enforcement of mechanisms for protection of rights and interests of all stakeholders: franchisors, franchisees, their competitors, consumers, and society as a whole. Considering the possibility that vertical restraints can cause serious shifts in competition and the need of competition law to be more focused on the impact of vertical restrictions on inter-brand competition, and not only on intra-brand competition, and also the need of an effective system of enforcement of competition law, it seems appropriate to accept the approach of treating vertical restraints as presumably illegal, even in a rule of reason context. However, this mechanism may prove to be inapplicable to large markets so the methodology of group exemptions to certain market thresholds is proven as reasonable, with certain vertical restraints remaining illegal as hardcore restrictions, while for those that do not fall under the system of block exemption due to market shares or because of hardcore restrictions, it would be needed to be proven by the entity that imposes them that they possess procompetitive effects that outweigh their anticompetitive effects.

6. Returning to contract law, but broadening the horizons

6.1. When the comparative becomes international

Bearing in mind that agreements frequently contain a foreign element, something that is very common when franchise agreements are concerned, there is a need for utilization of international private law approaches during the research. The subject matter remains contract law bound but it seems appropriate to analyze international issues after competition issues, as the methodology shifts significantly when international private law is concerned. In other words, the methodology of competition law can be construed as closer to comparative contract law methodology, as concerns the illegality of an agreement, notwithstanding the predominance of public law aspects. International private law issues, on the other hand, have a greater impact on the so called globalization of international franchising and, therefore, such a structural approach can be justified. It is rather clear that international private law methodology observes substantive legal issues and procedural legal issues also. Therefore, general procedural law methodology, in a prevailing international context, should also be utilized.
6.2. **Substantive and procedural conflicts resolved**

Regarding substantive legal aspects, it is quite clear that issues regarding the determination of applicable law should be discussed. Certainly, the principle of autonomy of the will is primary in the sense that franchise agreements are subject to the law chosen by the parties. On the other hand, overriding mandatory provisions must be taken into account as a limitation of the principle of autonomy of the will. Overriding mandatory provisions have a rather importing grasp when issues regarding pre-contractual disclosure are concerned, and the franchised business is carried in a certain country. More problems arise when arbitration is involved. In a rather atypical manner, the emphasis is placed on overriding mandatory provisions of *lex fori*, notwithstanding whether the dispute is resolved before a state court or an arbitration body. In the latter situation, such a standpoint is accepted because arguments are introduced for rejecting the so called theory of delocalization of arbitration (Paulsson, 1981), and because of the belief that arbitration should be bound to the legal system of the country of its seat, i.e., *lex loci arbitri*.

Also, the question of applicability of *lex mercatoria* as a source of law should be given slightly more attention. This problem should be examined from the aspect of the treatment of *lex mercatoria* as any other source of law, in the sense that its rules would apply as law within the notion of sources of law determined by *lex fori*, i.e., by *lex loci arbitri* (Goode, 1997). As for the conflict of law rules in the absence of a choice made by the parties, specifics exist in terms of determining the party that is to perform the characteristic obligation, in view of doubts about the treatment of obligations of the franchisor as characteristic. European private international law, for those reasons, regulates particular conflict of laws rules for franchise agreements.

Primarily, procedural legal aspects should be focused on determining the modalities of resolving disputes arising from franchise agreements, the merits of the dispute and the claims that can be raised. An emphasis should be placed on the analysis of the rules relating to civil court (in principle, contentious) procedure, to arbitration procedure, and to the process of mediation. When civil court litigation is concerned, the issues that cover the determination of the competent forum and the questions that cover the issues of recognition and enforcement of foreign judgments should be addressed. As for the modality of arbitral resolution of disputes, the arbitrability of the subject matter of the dispute, especially when the franchise package contains intellectual property rights, is rather relevant. Furthermore, the question of the arbitration agreement arises, especially in terms of the applicable law, as a prerequisite for the recognition and enforcement of foreign (and domestic) arbitral awards. Finally, the issues on mediation should be discussed, with a clear indication that it is not a procedure, but a process.

Discussions on private international law issues provide for a general conclusion that the issue is more than complex, and that it must be subjected to a more profound analysis. There is a great need for reassessment of some of the dominant views in literature and in practice on the legal nature of arbitration proceedings. It seems that more classical, both substantial and procedural, approaches serve the matter better than proposed alternative means. A three level analysis could serve as guidance for further research. The first level would involve the identification of general rules of international private law and their contextual consideration with other legal branches. The second level would involve the specification of identified general rules to the field of franchise agreements, taking into account their particularities, both in the substantive (e.g., choice of franchisors law) and in the procedural field (e.g., enforcement of arbitration clauses). The third level, which could be set as the preliminary point of analysis, would involve the determination of the existence and the need of recognizing special rules applicable only to franchise agreements, or even only to all long-lasting contractual relations.
7. Expansion, regulation and perspectives: economical, legal and political issues

7.1. Penetrating foreign markets

Finally, the discussion of international and prospective aspects of franchising and franchise agreements seems appropriate. Such presentations would serve towards a better understanding of the legal consequences of concluding franchise agreements containing a foreign element. On the other hand, the scope of this approach is considerably wider than the scope of the international private law approach, both because it covers aspects of franchising as an economic activity and because of the efforts to lay down the prospective aspects of franchising and legal regulation of franchise agreements. The idea should be, principally, through the introduction of international franchising and its contractual forms, to lay down the foundation for discussion of future directions and developments of the economic activity and its legal framework. The methodology employed, therefore, must be rather mixed, as all other approaches should be respectively implemented on a broader social scale.

The notion of international franchising and its contractual frameworks represents franchising in its true global light, by highlighting its features, advantages, and the effects it produces. The manner in which one is performing a particular activity, to be precise, is perhaps best seen when one tries to implement the model in another country, as this is the best manner for perceiving the skills of the franchisor. It is indisputable that international franchising is one of the best examples of so called globalization, because franchising contributes to the uniform conduct of certain business activities. When this uniform operation is extended to other countries, it is clear that franchising leads to acculturation of business philosophies that are dominant in the country of the franchisor. Long-term consequences of this could entail the loss of specific business approaches that are used locally, which cannot be simply dismissed as dysfunctional or inferior, just because they are local.

Thus, one of the essential observations on international franchising is the need to devote greater attention to specific local circumstances, in a broader socio-economic framework (Shane, 1994). This undeniably results with the need to adapt the business format when the franchisor decides to penetrate foreign markets; hence, pilot operations are more than welcomed. The bottom line is that international franchising is one of the most effective models of the processes of so called globalization on the economic playing field. Perhaps for the latter, there are few studies that explicitly explore and process the impact and role of franchising in the globalization of economic relations. The specificity of the role of franchising is that, at least for the time being, franchising works on a micro level so its effects are even unnoticeable, considering that most of the literature clearly focuses on the role of global institutions, organizations, associations and companies. Franchising, on the other hand, performs its function at one of the most important levels, and that is the way business is done.

The modalities of penetration in foreign markets certainly vary (Konigsberg, 2008). However, for the purposes of clarity and a systematic approach, the forms of direct franchising, joint venture franchising and master franchising can be distinguished. Selecting any of those modalities depends on the available human and financial resources of the franchisor (Alon and McKee, 1999), while each of the models provides an opportunity for different levels of control and for achieving different levels of profit. Different modes of franchisors’ penetration in foreign markets, or various forms of international franchising denote different sub-types of international franchise agreements. Moreover, each sub-type has its specific features that must be taken into consideration when drafting its content. Thus, e.g., intervention of the franchisor in the sub-franchise relationship can be secured only if one includes a provision for this outcome in the sub-franchise agreement: for the simple reason that
taking such a commitment by the sub-franchisor in the master franchise agreement will not be enforceable towards the sub-franchisee. Also, the possible dependence of the development or master franchise agreement from the joint venture agreement must be provided for in those agreements and not in the joint venture agreement.

7.2. Durability of franchising and justification of statutory involvement

The fact that international franchising is thriving does not halt the debate on the durability of franchising as a model of business organization. One encounters serious discussions through the literature on development, future and prospective aspects of franchising, generally. Certainly, the prospective aspects of franchising result, mutatis mutandis, in the need for setting prospective aspects on the existence and the regulation of franchise agreements. Regarding the problem of so-called ownership redirection (Oxenfeldt and Kelly, 1968-1969; Hunt, 1973), one would certainly mention actualization of the aspect of public policy. Moreover, one must not lose sight of the fact that franchising is treated as a way to raise capital. This in itself, and given the position of socio-economic relations, should not be treated as a kind of inadequacy. What is interesting, however, is that the approach itself is pompous. Also, one must not lose account of the integration of franchisors through mergers and acquisitions.

In principle, one cannot claim that there is some kind of conspiracy theory between franchisors that, once they take advantage of franchising by penetrating unfamiliar markets, they will benefit from the gained experience by achieving a higher level of self-managed units, leaving franchisees high and dry. On the other hand, the need for long-term observation of perspectives and consequences of franchising remains, especially from the ideological angle, because the pursuit of unification may be the case even when scarcity of resources on the side of the franchisor is not involved. In this sense, the ideological background is rather, pro et contra, pertinent. In practice, the plural form dominates the market. Nevertheless, there are evidences from economic literature that suggest actual ownership redirection, particularly when multi-unit and development franchising is concerned (Kaufmann and Dant, 1996), although agency theory generally denies it (Caves and Murphy II, 1976).

As for the perspectives of legal regulation of franchising, comparative experiences reveal either only fragmentary or even non-existent regulation. In any case, the U.S. experience demonstrates that regulation is primarily aimed at protecting franchisees, as a result of opportunistic behavior of franchisors. On the other hand, regulation of franchising in many other legal systems is more the result of a fad than of a real need for formulation of appropriate rules that will intercede actual economic relations, so the participants would be brought into approximate contractual positions and one would create preconditions for achieving the principle of formal equality of parties to the relationship.

Taking all this into account, one develops the belief that legal regulation of franchising is unnecessary and undesirable, except in the form of uniform international rules. Such an argumentation stands from the angle that the concept of franchising is still under formulation and clarification, and because there are reasonable sources of law located in trade usages and established trade practices. It is believed, therefore, that uncritical regulation will lead to greater harm than benefit for franchising as a business. However, this does suggest that franchising should not be subject to any regulation. Application of the general theory of obligations and contracts certainly remains as perhaps the most important. Also, the regulation of disclosure aspects can be justified. Finally, there are some fields of general regulation to be covered, in terms of contracts of vertical integration and long-term
contractual relationships in general. In any case, this is ultimately connected with the necessity of the existence of a sound theoretical basis of competition law.

8. Closing the circle; or can there be a complete social sciences research?

It is rather clear that, after all previous analyses, one should address the problems raised at the outset of the research, naturally after the summation of all previous argumentations and conclusions. The starting hypothesis should be put to the test, as to its confirmation, denial or modification. In methodological terms, the final step of any research should serve towards a dialectical networking of methodological approaches employed. In other words, the closing of a research should go further in testing an overreaching social restatement of the problem. Summarized conclusions from previous stages of the research, therefore, should be utilized and dialectical methodology should be conceived for testing of the fundamentals set.

After summarizing the findings of a research and the analysis conducted during previous stages, the concluding observations of the given research must return to the starting hypothesis. When there is a primary legal analysis of an economic phenomenon, it seems that the initial hypothesis should not include remarks to prospective aspects of, in this case, franchising as a business activity. Two reasons determine such a standing. First, the subject matter of the research is defined in terms of the comparative legal aspects of franchise agreements. The topic, therefore, is primarily legal. One cannot afford to include economic aspects in the hypothesis, as this would transcend the subject matter of research by raising questions to which a lawyer cannot give fully satisfactory answers. Second, it nevertheless seems necessary to hammer out the economic aspects of franchising, as long as the volume of available literature allows and as far as a lawyer can interpret it. False representations, therefore, are not excluded. On the other hand, this coincides with methodological approaches accepted.

The analysis of franchising as an economic phenomenon should be considered as appropriate, as it allows the individual researcher to plunge into what is called a substantive source of law. Law has its own methodology, because law is still a normative system. As such, the system of law (like any other system, in fact) is limited. Law, always, is a set of norms. Nevertheless, this approach by no means necessitates that law is to be analyzed by legal means only. The normative method, thus, is just one of the methods of legal research. One must therefore maintain that one should clearly distinguish between what is the subject matter of a presentation and what is its methodology: something that seems a forgotten rule of research. Accordingly, the analysis in question has the legal regulation of franchising as a subject matter, and the methodology used, among other things, includes economic analysis. How, otherwise, could one understand the meaning of a legal norm? How, without the identification of the substantive sources, would one comprehend the law itself? How, otherwise, could legal policy function? Analyses of this type are rather limited, as is the law itself.

Thus, a researcher should allow himself to approach the analysis of the institute with some use of broader social methodology, to simply realize what determines the necessity for development of franchising and its sense, and so to determine whether it entails and requires legal regulation. It is believed that the research carried justifies the initial hypothesis. To be exact, in the current moment of development of socio-economic relations, franchising enjoys not only independence as an entrepreneurial activity but also as an instrument of dominance of the so called globalization. Franchising performs its function as a global phenomenon and as a tool of globalization at one of the most important levels: the way business is done. This position of franchising spills over into the level of the legal position of franchise agreements, so the hypothesis set and developed seems to be
proven. On the other hand, viability of the anticipated position on the transitory features of franchising may affect the change in justification of the hypothesis, but this is already beyond the scope of the research.

REFERENCES
CAVEAT VENDITOR: ROMAN WIND IN THE SAILS OF MODERN PROTECTION OF BUYERS IN SERBIAN LAW

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Abstract

In this article the author seeks to show a strong contribution of Roman law to the development of modern Serbian consumer law. In this context, the development of the seller's liability is analyzed from the classical law to the Justinian law. Arguing with prevailing attitudes in jurisprudence that Roman law adopted the principle cavea emptor, the author offers a new, original view of the contribution of Roman jurisprudence, embodied in the principle caveat venditor. It is intended to emphasize, by pointing to the seller's obligations to publicly point out any defects and guarantee their accuracy (dicta et promissa), to the Aedile remedies actio redhibitoria and actio quanti minoris, and the extended effects of actio empi, that the law of Justinian led to the objectified seller's liability, the contribution of Roman solutions to modern views on consumer protection. As an illustrative example of the influence of classical Roman law on modern Serbian legislation regarding the protection of buyers, the author analyzes the Serbian Civil Code of 1844 and the Yugoslav Law of Obligations of 1978. By a comparative analysis he seeks to draw a clear line that connects the achievements of Roman jurisprudence with solutions to these legal documents, by which the author expresses his thesis that certain Roman solutions are the foundation of European private law.

Key words: Buyer's protection. - Dicta et promissa. - Actio redhibitoria. - Actio quanti minoris. - Serbian Civil Code. - The Law of Obligations.

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CAVEAT VENDITOR: ROMAN WIND IN THE SAILS OF MODERN PROTECTION OF BUYERS IN SERBIAN LAW

1. Introduction

Contract of sale is one of the most important contracts in both the Roman and modern legal systems. First of all, it was the main instrument of economic transactions in the first law-governed communities. Later, the principles developed in the field of this contract became the basis for the development of other instruments of legal transactions. Subsequently, the mechanisms were perfected and they contributed to the transformation of various elements of the contract of sale. That is why this institution has almost always been in the middle of the evolution of private legal systems and therefore it has, from a research standpoint, the most prominent position compared to other obligation agreements. Under Roman law, the importance of the contract is emphasized by its place in the construction of the basic principles of contract law – consensualism, bona fides, the equivalence of welfare of parties and contractual liability. It was very widely used throughout Roman history from ancient times until the Justinian law.

Contract of sale (emptio-venditio),\(^1\) in classical Roman law, bearing in mind the majority of definitions\(^2\), is a consensual contract in *bonae fidei* by which one party (seller, venditor) undertakes to permanently leave an object (*merx*)\(^3\) to the other party (buyer, emtor) i.e. to surrender it for peaceful (uninterrupted) possession,\(^4\) and the latter is bound to pay him for that a certain amount of money as the price (*pretium*).\(^5\)

Unlike in pre-classical law, sale in classical law is completely consensual and has only obligation effects. The contract itself does not transfer to the buyer the ownership right, so that the

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1 Although the Latin name of this contract points to the possibility of it being translated as “purchase and sale”, as it points to the possibility of two mutual obligations, i.e. two separate formulae, the names of this contract in foreign languages point to the possibility that maybe a more suitable name would be “sale” (English – “*sale*”, German – “*Kauf*”, French – “*vente*”, Italian – “*vendita*”, Russian “купля”). The Law of Obligations also uses the term, contract of sale, and therefore in this article we shall use the terms of the domestic legislator.

2 *Emptio et venditio contrahitur, cum de pretio convenenerit, quamvis nondum pretium numeratum sit, ac ne arra quidem data fuerit* - Gai. Inst, 3, 139.


5 The definition de lega lata is very similar, with the difference that the seller’s obligation is to transfer ownership to buyer: By a sales contract the seller undertakes to transfer to the buyer the right of ownership over the sold thing and to deliver it to him and the buyer undertakes to pay the price in money and take over the thing – Article 454, paragraph 1, Law of Obligations, Official Gazette of FR Yugoslavia, No. 31/93.
agreement on important elements of this contract is only the legal grounds (*causa*) for the transfer of money or things, in other words: the legal basis for the delivery.6

It is thought that in those days the principle prevailed that each contracting party itself had to care about their interests and that it was the duty of buyers to inform themselves about everything what would impact their decision.7 At the same time it seems that civil lawyers tended to somewhat arbitrarily minimize the contributions of classical Roman law in this area, often noting that in Rome the dominant principle of *caveat emptor* put the buyer at a disadvantage in the contract, and that it was his duty to check the thing carefully and be informed about its potential shortcomings, since what he bought “was in his view.” However, we believe that this is only one of several examples where the issue is not traced back to its source, and where Roman law is prematurely evaluated and assessed with a mark it does not deserve. We believe that the role of Roman law is just the opposite: it is the foundation of modern buyer protection, a wind in the sails of this modern institute that is developing dynamically. Therefore, we want to offer a different perspective on the emergence and development of the seller’s obligations under the contract of sale, as the fundamental institute of buyer protection today.

2. Roman law: Dispelling misconceptions

The principle *caveat emptor*, which governed the rules on sale in all early legal systems,8 is, seemingly, to some extent opposed to the intent of a Roman legislator to protect buyers from fraudulent acts of sellers. The requirement that “buyer beware,” i.e. take care of what to buy, is not, it seems, in contrast with the intention to properly protect the buyer. Rather, the intention of Roman jurisprudence was to establish conditions under which they would give the buyer the right to protection.

This maxim, in fact, expresses the situation where the benefits of the contract of sale are expressed in the presence of both parties.

The buyer at the time the contract is concluded has the object of purchase “before his eyes” so that it can be expected of him to examine that object in detail and assess its value before the contract is concluded.9

Although the development of reactive customer protection due to hidden physical defects of things was one of the major achievements of Roman jurisprudence in relation to the contract of sale, it cannot be denied that the regulation of the position of buyer and seller began with the principle of *caveat emptor*.

6 Agreement has no real legal effect, since by the agreement on purchase and sale and agreement about the thing as a whole the real right is not transferred and no real right is established, but both for the seller and buyer the obligatory duty arises to transfer the obligatory thing to the other, i.e. purchase price, Horvat, Marjan. Rimsko pravo II. Zagreb, 1954, 87. In the legal doctrine it is a well-known position that the mere transfer of thing and price is done by a special act, i.e. tradition, and that this is not an obligation (which is a feature of real contracts) but constitutes the fulfillment of an obligation, regardless whether it is an instant or loan sale. Contrary to this Roman doctrine, some modern European civil codes adopted a contrary opinion: French and Italian civil codes foresee that by the mere conclusion of a sales contract ownership is acquired over the thing by the buyer, even without its transfer.


8 Roman law was not the earliest to develop a customer care implied in the contract of sale. Codex Hammurabi gave the buyer of the slave with epilepsy the right to terminate the contract if the cancellation request was presented within one month from the time of sale, while in classical Greece, the same right was given to the buyer for every disease that the seller failed to reveal before the conclusion of the contract. See more in the Nicholas, Barry. An Introduction to Roman Law. Oxford, 1962, 181 ff.

In the pre-classical period contracts of sale of movable property looked like a cash-and-carry arrangement, and therefore the buyer could be protected only from the obvious deficiencies of things, reviewing the available goods before approving the conclusion of the contract.\(^{10}\)

The biggest risk for the buyer remained the frequent situation of common hidden faults, which he even after careful checking could not detect.

Thus, according to Atiyah, there are cases in which various household items are brought to the forum which buyers can evaluate just by looking, and make decisions about them based on intuition. Once they finish bargaining and determine the purchase price, buyers can then be in a position to carry the thing home with latent defects.\(^{11}\) The maxim *ius vigilantibus scriptum*, which seems to be consistent with the above principle and describes the character of Antique law, gives to customers, as long as they can see and evaluate what they buy, the right to protect their own interests, and alone try to reduce the purchase price for the item that they suspect is defective. In the Roman law the basis for contract annulment in case of *metus* is that duress must be serious. There was a rule that “praetor does not protect cowards”. A similar parallel exists in the institute *caveat emptor*: the law should not protect careless and inobservant buyers as according to the Chinese proverb “who has no eyes for watching, has eyes for crying”.

The strict, but apparently common sense of this principle is that the buyer under the new circumstances calls for physical flaws and may try, now retrospectively, to return to negotiations on the initial conditions of contract.

Even if it turns out that the item sold is physically defective, it is always very difficult to prove that the defect existed at the time of concluding the contract or at the time of handing things over.\(^{12}\)

According to the rule *caveat emptor*, the buyer is obliged, after having reviewed the item, to pay the price for it, if deadlines are not defined, immediately after the conclusion of the contract.

His obligation is in fact *dare* as he is obliged to transfer ownership of money to the seller. For delay in payment rates, the buyer has an obligation to pay interest to the seller on the price for the entire period from the conclusion of contract to the payment of rates.

Back during the Law of the Twelve Tablets, there was a mechanism for the emergence of the explicit obligations of the seller to guarantee the quality of the things that are the subject of the sales contract. However, this mechanism implies the use of stipulations, by which the buyer actually stipulated the promised quality of product by the seller.

In case he does not take a thing at all, or does not take it in time according to the contract, and paid the price, the buyer is obliged to reimburse the seller for any damage suffered by him. That is what Florentino’s fragment from the *Digest* relates to:

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\text{“Si nominatim morbus exceptus non sit, tali tamen morbus sit, qui omnibus potuit apparente..., eius nomine non teneri Caecilius ait, perinde ac si nominatim morbus exceptus fuisse: ad eos enim morbos vitiaque pertinere editum aedilium probandum est, quae quis ignoravit vel ignovere potuit.”}^{13}
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\(^{11}\) Literally applying the *caveat emptor* maxim, we would say that the buyer in this case could more feel as embarrassed and outwitted due to his lack of attention, than he could ask for protection because he was cheated, Atiyah, Patrick. The Rise and Fall of Freedom of Contract. Oxford: Clarendon Press, 1979, 179.

\(^{12}\) Often it seems likely that a physical disability or deterioration has arisen even after the surrender of things. For this reason, respecting the Roman solutions, a modern law may prescribe very short time limits for the statute of limitations which shall commence to run, not from the moment the buyer discovered (or could detect) a defect, but from the moment of transfer of objects or its delivery; see more Leser, Hans G. Der Rücktritt vom Vertrag, Abwicklungsverhältnis und Gestaltungsbeugnisse bei Leistungsstörungen. Tübingen, 1975, 177 and further.

\(^{13}\) D. 21. 1. 14. 10. (Ulpianus libro primo ad editum aedilium curulum).
It may be noted that this text insists on the increased attention of buyer when buying things and does not protect the careless and thoughtless buyers. It is the buyer who, in examining the goods (in this case: slaves), did not realize that the slave was a woman and not a man, that the slave's eyes were gouged out or that he has a large and dangerous scar on his face, and thus the buyer deceived himself and lost his right to legal action against the seller.14

Early Roman law on the basis of consensus introduced terms of delivery and payment of things as part of the sales contract. However, such a contract in the beginning contained no warranties or conditions of the thing's quality. On this basis, any seller's statement about the quality of products during negotiations with the buyer about the price did not have any effect.

However, problems arose in situations of hidden physical defects of products, or situations where the buyer, despite a careful review of things, could not reveal their hidden flaws. Classical Roman law, because of this issue with frequent cases in practice, began to shift the perception from the demands that the “buyer beware” (caveat emptor) to require that the “seller beware” (caveat venditor). This was a revolutionary idea, a model according to which later modern legal systems would act.

Development of customer care in terms of an implied warranty for latent defects of things which even the seller did not have to know, was the result of actions of Curule Aediles and their edicts dedicated to the sale of slaves and cattle in markets.

Probably since the times of Cicero15, Curule Aediles sought to sanction the fraudulent behavior of sellers of slaves and hauling cattle16 with the then known appropriate sanction actions that were available to buyers. It is the actio redhibitoria for breach of contract that could be raised within two months, or within six months if the stipulation was concluded, and the actio quanti minoris for the proportional reduction in rates, within six months or one year if the stipulation was concluded.

Aediles foresaw that in the streets and markets, where they had jurisdiction, the sellers of slaves or animals must at the time of sale stipulate any special physical defects of things, and state by the stipulation that there were no other defects than those reported.

Both parties had a very clearly expressed opportunity to expand the scope of protection of the buyer’s rights even beyond those set by Curule Aediles. This could be accomplished through the dictum in venditone in the informal or by stipulations in formal variants. The seller by using these means could also guarantee that the slave had no defects other than those presented publicly, or even had some special qualities, important for the buyer in certain situations (for example, the claim that a slave is an excellent cook).17

A comprehensive term for all these guarantees, either formally or informally given, is the dicta promissave (dicta et promissa).18 Curule Aedile of course adopted and accepted their obligation and opportunity to bring financial accountability to the seller.

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16 There are two parts of Curule Aediles’ Edict: one refers to the sales of slaves and the other to the sale of cattle. Buckland claims that the Edict at first referred to only the sale of slaves and that it was later expanded to the sale of cattle, Buckland, William. A Text – Book of Roman law from Augustus to Justinian. Cambridge, 1921, 491, while Zulueta seems to treat development of two parts of Edict as simultaneous, it later expanded to cattle (pecora), de Zulueta, Francis. The Roman Law of Sale. Oxford: Clarendon Press, 1945, 50.
17 D.21.1.18.1 (Gaius libro primo ad edictum aedilium curulum).
18 D.21.1.19.2 (Ulpianus libro primo ad edictum aedilium curulum).
The term *dicta et promissa* is not easy to explain, and it is even less easy to draw a clear line of demarcation between the two. It is particularly interesting to determine in which cases *dicta et promissa* bears the responsibility of the seller, or where the benign boasting stops and where the seller’s *dolus* starts. It is natural, namely, that each vendor strives to better present his product, to boast of it, and in the eyes of the customer make it seem like quality. In these circumstances it is primarily important to determine at what point that boasting goes from good faith to *dolus* behavior, which determines the appropriate scope of protection for the buyer.

As far as bragging remains at a general level and does not exceed the usual exaggeration of the already known boastful seller, no reasonable buyer will take such a declaration seriously:

> “Ea quae commendandi causa in venditionibus dicuntur, si palam appareant venditorem non obligant, veluti si dicat servum speciosum, domum bene aedificatam: at si dixerit hominem litteratum vel artificem, praestare debet: nam hoc ipso pluris vendit”

It seems that Curule Aedile had no reason to intervene in this case. Thus, one can see that the seller’s statements that the slave is handsome or good looking or a horse is strong are of a general nature and do not constitute a base for protecting the buyer. However, the situation is quite different if we move from general to specific terrain: the seller’s statement that the slave is *litteratus* (literate or highly educated) or a highly skilled craftsman is already a proposition that can influence the decision of the buyer. Such statements, particularly if they are false or with *dolus*, are typical bases of buyers’ protection.

If such valid, and therefore binding, statements were given with seller’s *dolus* (he knew that he emphasized qualities that do not exist or deliberately hushed latent defects), the buyer can use *actio empti* (since the sales contract is *bonae fidei*) which always can be raised in case of *dolus*. Although not tied to any deadlines, its deficiency is primarily to be seen in the buyer’s obligation to prove seller’s *dolus*, which, in general, was not at all easy. Deficiency of this action was a major problem in protecting buyers’ rights, which is addressed in the further development of Roman law. According to the Digest, there is no seller’s responsibility for the sale of an already worn suit that he presented as new, unless it is proven that the seller acted in *dolus*.

This situation was simply not for legal action, and remains out of reach of the civil rights and rights of Curule Aediles.

In order for force sellers to promise necessary quality of products and guarantee the absence of defects that are not announced, Aediles at first intended to regulate the responsibility of sellers only in terms of expressed promises. However, the results were not entirely satisfactory. It is possible that some rash buyers overlooked or ignored the requirement that the seller undertakes stipulations. This could happen because of the need of efficiency of the contract itself, and many daily sales would be burdened by this formalism. Curule Aediles, being mindful of these practical situations, expanded the seller’s responsibility in the Edict to cases where the seller did not know for a fact anything about hidden defects, even in the absence of a seller’s explicit acceptance to take on

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19 Kaser believes that the term “dictum” implies a unilateral guarantee of the seller, while the term “promissum” indicates bilateralism of legal work, Kaser, M. 404. However, Arangio - Ruiz disagrees with this and believes that this distinction is completely unnecessary and does not exist in classical law, but that both terms are treated uniquely, without separation of different meanings, Arangio - Ruiz, V. 358. Peters and Perozzi, apparently accepting the position of Arangio-Ruiz, consider that dicta promissave applies only to the dicta in mancipio; see Peters, Frank. Die Rücktrittsvorbehalte des römischen Kaufrechts. München, 1973, 187, S. Perozzi, Silvio. Le obbligazioni romane. Bologna, 1903, 85, while Watson denies this, believing that such an interpretation is contrary to the fragment from the Digest (D.21.2.69.3) and thought it would be better to interpret this term in the sense that it refers to the contractual terms, to the additional agreements (pacta adiecta), and not to informal guarantees stated during the negotiations on the conclusion of the contract, Watson, A. 89.

20 D.18.1.43 (Florentinus libro octavo institutionum).

21 D.18.1.45 (Marcianus libro quarto regularum).
that responsibility. Thus, it was possible that chronologically earlier obligations of sellers to provide stipulation recoiled before the provisions of the Edict, which provided for the seller’s responsibility even in the absence of stipulation.

By the time of Justinian, one resorted to the gradual expansion of responsibilities and the use of appropriate charges to the sale of land and all kinds of goods.22 The limited scope of the buyer’s protection, determined by Aediles’ edict, even if it was gradually extended to the time of Justinian, has a definite significance consisting of the following:

First, the edict was initially applied only to sales in the squares and markets in the jurisdiction of Aediles, and when its field of application was extended, the contract of sale became subject to these changes, while the implied warranty was not applicable to other contracts. Commercially important transactions, which were subsumed under a contract of sale, such as the sale of generic goods from an indeterminate mass (mainly sales contracts of future delivery)23 that are apparently formed by stipulations, assumed the responsibility of the seller only and always for express guaranteed terms of delivery and could not be expanded in terms of objectified responsibility of the seller.

Second, the implied warranties were applied only to latent defects of things because there was a presumption embodied in the principle of *caveat emptor* that the buyer at the market sale was able to protect himself against obvious defects by closely examining the goods before buying. The view that the buyer must be responsible for careful examination of the things he buys was so established that even an express warranty was interpreted, if possible, as not applying to the apparent disadvantages of things.

Third, redhibitory action due to violations of implied warranties imposed by the Aediles was limited to the loss of value due to the defects of goods. Lost profit for the defective goods was not covered by Aedile legal means, though these were clearly available for other breaches of contract by the seller (e.g. non-delivery or late delivery of goods).

Finally, from the very beginning the implied warranties for a buyer’s protection have been limited to special periods. Aediles’ edict restricted the buyer regarding the time period in which he could raise the *actio redhibitoria* and *actio quanti minoris*.

The imposition of restrictions was a significant departure from the general rules of Roman civil law until the time of Dominate, when the limits were fixed by objective standards to thirty years.24

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22 In general, scientists are cautious regarding the possibility of extending activities of these charges before Justinian. In this sense Zulueta: “extension may be made prior to Justinian’s codification”; see de Zulueta, F. 49; Nicholas: “a fully completed expansion of Justinian”; see Nicholas, B. 182; Buckland: “only it is clear that the texts in Digest refer to all types of sales, including sales of the land”; see Buckland W. 492 – 493; Rogerson: “the extension in the classical Roman law beyond the squares is controlled by Aediles, but probably not more than the sale of slaves and animals”; see Rogerson, A. “Implied Warranty Against Latent Defect in Roman and English Law”, Studies in the Roman Law of Sale Dedicated to the Memory of Francis de Zulueta, Oxford, 1959, 117. However, there are opposing views, for example Onorev’s, who argues that the *actio empti* took Aedile remedies in the classical period see Honoré, Tony. “The History of the Aedilian Actions from Roman to Roman-Dutch Law.” Studies in the Roman Law of Sale Dedicated to the Memory of Francis de Zulueta, Oxford 1966, 143-144.

23 Of course, the sales contract could have regulated also certain situations of sale of a future product and this should be differentiated from the sale of future delivery of product.

24 In 424 Theodosius established a general period of limitation of thirty years for all the charges that were considered permanent. This is still the basic period of limitation for all the modern civil codices of Western Europe, Buckland, W. 689.
Therefore, the process based on the explicit promise of quality based on the stipulation was not subject to any limitation period, or at least the period of thirty years.\footnote{At least until the time of Justinian, the general cause of the buyer’s raising charges in sales contracts (actio empti) included also Aedile remedies. Because of this, the restrictions of Aedile lawsuits, could have applied by analogy to requests guarantees in actio empti. Remedy of the buyer, provided by correctly concluded stipulations, however, did not work outside the jurisdiction of Curule Aediles and therefore, obviously, has never succumbed to the short time limit, Jolowicz, H. F. and Nicholas, B. Historical Introduction to the Study of Roman Law. Cambridge, 1972, 332.}

Some special legal actions, created by praetor activity, were also provided by short periods of time constraints which have almost always been a one-year period (\textit{annus utilis}), while other complaints were ongoing. There are Roman lawyers who claim that praetorian claims, subject to a one-year limit, were penal, as opposed to civilian, which were permanent and referred only to the disputed matter.\footnote{Romac, Ante. trans. Paulus Sententiae. Zagreb, 1989, 116.}

In contrast, the Roman jurists might simply not have believed that all sellers who acted in good faith promised even minimum quality of products, because the circumstances of each sale are quite different.\footnote{Diversity of cases prevented the establishment of universal forms, such as those in stipulations for eviction, de Zulueta, F. 47.} Thus, they regulated the issue of quality products directly through Aediles’ edict, although their first intention was to preserve the illusion of harmony to the responsibilities of the parties, requiring the seller \textit{stipulati duplae} for the appropriate quality.

However, the image of the buyer’s protection is not complete. It is notable that the \textit{actio de modo agri} may be raised against the seller, who claimed that the area of land is larger than actual. Remedies of Curule Aediles \textit{actio redhibitoria} and \textit{actio quanti minoris} were valid, at least in the classical law for the sale of cattle and slaves, and were limited only to market activities.

On the other hand, the \textit{actio empti} had a very wide field of application, but again with one important restriction: the requirement was to prove the seller’s \textit{dolus}, which sometimes was not at all easy. In order to secure the buyer on a large scale, it was only possible to require from the seller an expressed warranty (\textit{dicta et promissa}) for the quality of goods they sell. Without such a guarantee to which the seller is not always obliged, the protection of the buyer is still far from perfect.

Research is relatively new of the prevalent view that classical Roman law never succeeded in moving from this point and that the foregoing, in fact, is the ultimate reach of classical Roman jurisprudence, which was successfully complemented by the Justinian law.\footnote{So Betti thinks that the only thing that a buyer may do in classical law is the alternation of Aedile lawsuits or insisting upon \textit{dicta et promissa} in certain cases, Betti, Emilio. “Gefahrtragung bei zweiseitig verpflichtenden Verträgen.” Zeitschrift der Savigny Stiftung für Rechtsgeschichte 82, 1965, 455. Pernice states that the changes did not occur until the time of Justinian, that therefore the Aedile rules at the time applied to all the cases of sale and that the seller is liable even without concluding stipulation by which he guarantees the quality of product, and judgment due to \textit{action redhibitoria} is \textit{in duplum}, Pernice, Alfred. Römisches Privatrecht im ersten Jahrhundert der Kaiserzeit. Weimar, 1873, 442. Horvat also states: “In Justinian law Aedile guarantee is present for purchasing all products, not only slaves and cattle as in the classical law.” Horvat, Marjan. Rimsko pravo. Zagreb, 1954, 94. Mackintosh is somewhat more careful, although himself on this line, stating that the rules changed gradually: from classical law, by the activity of Roman magistrates, Curule Aediles, to fully finalized change in the Justinian’s law. Mackintosh, James. The Roman law of sale. Edinburg, 1907, 389.}

These evaluations could potentially be subject to criticism. It seems that already in classical law an important, perhaps fundamental step was made which completed the protection of the buyer to the extent to which it would be hard to add anything. This step fully established a new principle, \textit{caveat venditor}, which established the seller’s objectified accountability underpinning all modern approaches to consumer rights.

In addition to this, to quote a Pomponius’ text from the Digest:

\begin{quote}
\textit{Si vas aliquod mihi vendideris et dixeris certam mensuram capere vel certum pondus habere, ex empto tecum agam, si minus praestes. Sed si vas mihi vendideris ita, ut adfirmares integrum, si id integrum non sit, etiam id, quod eo nomine perderim, praestalis mihi: si vero non id actu}
\end{quote}
sit, ut integrum praestes, dolum malum dumtaxat praestare te debere Labeo contra putat et illud solum observandum, ut, nisi in contrarium id actum sit, omnimundo integrum praestari debeat: et est verum quod in locates dolis praestandum Sabinum respondisse Minicius refert.29

Labeon’s position in this fragment about the safety of a vessel sold seemingly shows that the Roman traditional understanding assumes that the seller is liable only if he had an evil intent or knowledge that the vessel was not entirely functional. However, in this text Labeon does not insist on the explicit guarantee of dicta et promissa. The seller, according to him, does not have to give a guarantee that the vessel is suitable for use; on the contrary, if he wishes not to be responsible for malfunction of a vessel, he must specially exclude his financial obligation which, according to Julian,30 would be determined by the actio quanti minoris aestimatoria. Thus, it appears that the seller is generally responsible for all the flaws, even for the hidden ones which he did not even know existed. The only way to limit his liability was an explicit statement that he does not respond to a potential disadvantage.

However, it seems clear that instead of this Aedile remedy actio empti is used. This is confirmed by the text on the sale of clothes which turn out to be remade and not new,31 so in this case actio empti was openly used.

This is a clear indication of the direction in which the classical Roman law acted. Where other procedural means showed deficiencies in application or when proving buyer’s rights to protection, the classical Roman jurisprudence reacted in an elegant way, by using the clause ex fide bona to expand the effect of actio empti. Specifically with reference to this clause, the buyer did not have to prove any more dolus of the seller, but the process was completely reversed: the seller is the one who is obliged to exclude his liability, by expressly denying any shortcomings of things, whether visible or latent.

This is not all. The seller is now responsible even for those defects of which he was not aware, which objectified his responsibilities and placed the buyer in a much better position than before. This extension of the buyer’s protection was only possible with the help of actio empti and its “engine” - the clause “ex fide bona”.

This lawsuit can now consume all other remedies, even those that are obsolete over time, and may be used in a variety of situations, always with reference to bona fides. This expansion process has made it a means with “a broad spectrum.” All this was happening at the time of the classical Roman law, as some domestic Romanist asserted, who believed that classic law had already made

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29 D.19.1.6.4 (Pomponius libro nono ad Sabinum).
30 D.19.1.13 (Ipianus libro 32 ad edictum): “...aut enim, qui pees morbosum aut tiguum vitiosum vendidit, si quidem ignorans fecit, id tantum ex empto actione praestaturum, quanto minoris esser emptoris, si id ita esse scisis: si vero scis relict ut emptorem decepit, omia detrimenta, quae ex ea emiptione emptor trasiret, praestaturum ei: sive igitur aedes vitio tigni corrurent, aedium aestimationem, sive pecora contagione morosi pectoris periron quod interfuit idonea venisse erit praestandum”.
31 D.18 1. 45 (Marcianus libro quarto regularum).
a decisive effort to expand the seller’s responsibility and better protect the interests of the buyer.\textsuperscript{32} Some world-famous civil lawyers have maintained a similar position.\textsuperscript{33}

Already there has been a standard practice of adding explicit guarantees for the quality of the goods on sale, which will very quickly become common practice, not only in markets.\textsuperscript{34} In addition, Aedile policies offered very reasonable solutions that were heavily used by the learned lawyers in order to make the objective need for greater protection of the customer even expressive. Their balance was an important virtue: the responsibility of the seller, on the one hand, was extended due to \textit{actio empti}, and, on the other hand, the buyer was able to require full compensation (\textit{quod interest}). No less important is the fact that their field of application was mainly related to the physical flaws of things, even one latent and one for the existence of which the seller does not know. A special place in this system of protection of the buyer has the extension of \textit{actio empti} under clause \textit{ex fide bona}, which made it comprehensive and complete.

Grading of liability, and therefore the financial obligations of the seller also provided these remedies, as Julian witnesses.\textsuperscript{35} He clearly makes distinction between the negligent and good faith seller. The first is responsible for \textit{omnia detrimenta, quae ex ea emption emptor traxerit}, while the other is responsible for \textit{quanti minoris}.\textsuperscript{36}

It seems that the warranty for latent defects was actually implied in the contract of sale, even in situations where the seller, as we have seen, was unaware of the existence of these deficiencies, or if he acted in \textit{dolus}. This solution seems to be due to an extended function of \textit{actio empti}.

Justinian had really not much else to do. Classic law enabled him a paved path that he was only supposed to follow. Everything was there: the \textit{actio redhibitoria}, if the buyer’s intention was to terminate the contract, and \textit{actio quanti minoris aestimatoria}, if he wants to keep it in place with a proportionate refund, and the extended effect of \textit{actio empti} for all cases of latent defects, and even in certain cases that were resolved by Aedile means. One would perhaps expect Justinian to abolish Aedile means because the \textit{actio empti} “assumed” to a large extent their competence, but that did not happen. On the contrary, they were not only retained, but their competence and scope of application expanded beyond sales of slaves and cattle, to all cases of selling items. By this the classical Roman law actually managed to take a significant step towards the full protection of the buyer, then

\textsuperscript{32} When these changes occurred cannot be determined with certainty. It is hard to believe that classic law did not contribute anything to that and that the stipulation was required until Justinian. Therefore, the view is more probable that it is the work of classical jurists, Stojcic, Dragomir. \textit{Rimsko privatno pravo}. Belgrade, 1975, 263.

\textsuperscript{33} Kaser also insists that in classical law an energetic effort already existed to establish general financial obligations of the seller for latent physical defects, see Kaser, M. 409. This is corroborated by de Zulueta, who states that in times when forms of other charges were deemed obsolete they were considered covered with the \textit{actio empti}. Thus he explains that Justinian’s law will only confirm the intention of the classical jurisprudence of \textit{actio empti}. Also \textit{actio redhibitoria} which includes \textit{restitutio in integrum} within six months (\textit{tempus utile}) and \textit{actio quanti minoris} that must be raised within \textit{annis utilis}, ceded their place implicitly in classical law and already in Justinian explicitly to \textit{actio empti}, see de Zulueta, F. 48. In this sense also Roby, Henry J. \textit{Roman Private Law in the Times of Cicero} and of the Antonines. Cambridge, 1902, 222-223. Zimmermann confirmed this, quoting another fragment from the Digest (D.18.1.45 referring to the sale of clothes for which it turned out to be remade and not new, so that the buyer by raising the \textit{actio empti} may reduce the price), and expresses the opinion that the Aedile means operated “under the guise of” \textit{actio empti}, see Zimmermann, R. 321. Bechmann obviously was essentially on the same doctrinal line, believing that in time part-time remedies of Curule Aediles were accepted as \textit{jus civile}, because there was less justification for the consistent adherence to rules of \textit{caveat emptor}, see Bechmann, August. Der Kauf nach gemeinem Recht - Erster Teil: Geschichte des Kaufs im Römischen Recht, Weimar, 1876, 266. Zulueta sees these remedies as well-balanced with the \textit{actio empti} because they imposed extended liability to the seller and obtained status \textit{naturalia negotii}, de Zulueta, F. 51, while Zimmermann concludes that the \textit{actio redhibitoria} and \textit{actio quanti minoris}, by introducing “\textit{oportere ex fide bona}” for \textit{actio empti}; in fact not only expanded its field of activity, but largely contributed to protect consumer’s rights as a result of this action fully and expressively, see Zimmermann, R. 322.

\textsuperscript{34} Such practice shall become standard so that it will lose the status of \textit{accidentalia negotii} and obtain a new one - \textit{naturalia negotii}, Zimmermann, R. 321.

\textsuperscript{35} D.19.1.13. (\textit{Ulpianus libro 32 ad edictum}).

\textsuperscript{36} \textit{Ibid}.
the very nature of the sales, as a *bona fidei* contract, provided that the seller’s responsibility be more extensive and comprehensive but also to be established, in addition to part-time remedies, on the civil *actio empti*.

### 3. Modern protection of buyer’s rights in Serbian law: sailing under full sail in the Roman wind

We shall now analyze the contribution of classical Roman law to better protection of the buyer’s rights in modern Serbian law by examples of the Serbian Civil Code of 1844 and the Yugoslav Law of Obligations of 1978.

That the classical Roman concept of protection of the buyer’s rights due to factual flaws was actually extended to all things is testified in Article 651 of the Serbian Civil Code, which provides that, if a buyer purchases property in good condition, the seller must in the same condition surrender it as well.

It can be seen from this article that the seller guarantees to the buyer all those typical qualities of things and that, therefore, the buyer assumes it possesses the features that actually provide him an economic value, allowing the buyer to use it, given its nature and purpose. For these reasons, the buyer has offered such proper price. Otherwise, he would have offered a lower price or, perhaps, would not have engaged at all in negotiations with the seller.

It is notable that the Serbian Civil Code also recognizes the so called objectified seller’s responsibility for physical flaws of things, which, as has already been analyzed, developed from classical to Justinian law, because the seller guarantees and is in good standing, even if he does not express all the properties of the contracted thing or those which are usually implied. It seems that already in this case the Serbian Civil Code applied Roman solutions, however, this is far from being the only contribution of the classical Roman law to this Code.

The first requirement of protection is that the defect is such that the buyer could not see it. It is, therefore, a hidden, latent physical flaw that is known in Roman law. Otherwise, if the buyer was not careful when buying and did not notice the flaws that are visible, then he has no right of protection, which in essence corresponds with his commitment in Roman law to watch what he is buying.

37 The Civil Code for Serbia was passed in 1844. The main editor of this Code was Precanin – Jovan Hadzic, a learned jurist, to whom prince Milos, after an unsuccessful attempt to have the French Civil Code translated by Georgije Zachariades, entrusted this great job. Hadzic took as a base the Austrian Civil Code, which is one of the reasons why some legal historians and civil lawyers think that the Serbian Civil Code is just a translation of the Austrian Civil Code. However, it seems that it is not difficult to prove that the Serbian Civil Code had some autochthonous provisions that differ from its source. Here we shall not discuss well-known provisions about cooperative ownership, inheritance rights of female children and preemptive rights. The Serbian Civil Code also has some different solutions in comparison to the Austrian Civil Code referring to the protection of buyer’s rights.

38 “In other words, the seller is responsible to the buyer, if, contrary to this rule, defects appear on the thing, which reduce the value of the thing. This obligation of seller’s guarantee exists also in the Austrian Civil Code (Die Gewährleistung) and in the Code Civil (La garantie des défauts ou des vices); Perić, Zivojin. “About the obligation of protection in case of physical defects in sales contracts” Arhiv za pravne i društvene nauke, 1909, book 7, 90.

39 “For defects, that are obvious to everyone, no one is obliged to guarantee, unless it is stipulated in the contract that the thing has no defects” - § 556, Serbian Civil Code. An almost identical provision can be found in Article 928 of the Austrian Civil Code. However, this Article exhibits one single exception in which the buyer would be entitled to protection in case of visible defects, namely if the seller stipulates in the contract that the thing does not have any defects, whether visible or not. In this case, if a thing did have a visible defect, it is assumed that the buyer failed to notice it and that he offered such price. Therefore, he failed to notice the defects since he relied on the seller’s statement and did not take a careful look at the thing. This situation reminds us a lot of Roman *stipulatio duplae*, concluded by the seller’s additionally guaranteeing that the thing sold has no defects. Another question may be asked: what if the buyer, even with the seller’s guarantee, and without inspecting the thing, knows that it is defective? Here we start with a presumption that the buyer relied upon the seller’s guarantee and that he failed to inspect the thing, therefore the essentially visible defect remained unknown. But is it a presumption *iuris tantum* or presumption *iuris et de iure*? Judging by the Code, it seems that this presumption may not be overruled, and it is the buyer’s right to protection, in case of an additional seller’s guarantee, that is fully secured.
If the defect is invisible, in Roman law as well as in the Serbian and French, the seller is responsible for it, regardless of whether he knew of its existence or not.\(^{40}\)

The second condition for the buyer's protection is that such a thing has flaws i.e. it has no properties that are commonly assumed in such things.\(^{41}\)

However, in addition to the properties, some things may have unique properties which make them different and stand out in comparison to other things.\(^{42}\) In the absence of such properties, the buyer has no right of protection, unless it has been agreed that the thing has such a property, and the seller guarantees for it as well as for the usual features that come as a standard.\(^{43}\)

Articles 554 and 555 of the Serbian Civil Code refer to this second condition of protection as follows: Article 554 guarantees to the buyer the right to standard properties of things, while Article 555 guarantees protection in relation to the specific characteristics only if the seller specifically contracted these.

The third condition of protection concerns the scope of the flaw or lack of that thing. The flaw must be significant, it must fully or partially reduce the usefulness (l’ utilité) of the thing for the protection of the buyer to be activated.\(^{44}\) If only the aesthetic nature (l’agréement) of a thing is reduced, it cannot be assessed that a thing has a flaw.\(^{45}\)

The Serbian Civil Code also applies the so-defined concept of flaw, and here the quoted Article 554 of the Serbian Civil Code may apply, which insists that a thing by its very nature can be used.\(^{46}\) So, to the Serbian legislator usefulness is more important in relation to aesthetic appearance, which should be fully approved.

Finally, it is interesting to analyze the question whether a defect which reduces the usefulness of things is considered a sufficient basis for the customer’s right to protection.

German\(^{47}\) and Austrian law grant protection of buyers’ rights only if the flaw is significant, so that a slight impairment of things will not be taken into account.\(^{48}\) One should, however, be cautious: it seems that the intention of the German and of the Austrian legislator has not been to exclude the responsibility of the seller for slight flaws of things and thus exclude the application of actio quanti

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\(^{40}\) It is irrelevant whether he knew about the defect and was silent about it, or was unaware of it. That detail may only define the scope of buyer’s protection rights, and not question protection as such, Planiol, Marcel. Traité élémentaire de droit civil. Paris, 1886, 455. However, according to the Serbian Civil Code (Article 819) if the seller is silent about a defect of which he has been aware, and even claims to buyer that the thing does not have that defect, or that it has no defects, we may say that the seller acted in dolus and that the buyer’s scope of protection could be even wider.

\(^{41}\) For example, the buyer would not be entitled to protection against the seller of a desk because it does not have any secret drawers, since desks usually have no such drawers. However, if the desk has no drawers at all, the buyer acquires the right to protection since desks usually have drawers. The same applies to a horse which does not know circus tricks as horses usually do not know such tricks, but if a horse will not jar up the hill this is a basis for buyer’s protection as horses usually have that feature – examples according to Planiol, M. 460.

\(^{42}\) Example: a large chiming clock can play a melody at the outbreak of every hour. This is not a usual feature of a chiming clock (although it is understood that the outbreak of the hour is their common property).

\(^{43}\) Due to such special features of the clock, the buyer offered the contracted price which would not have been justified for a clock without these features. If the feature is missing, we cannot say that the clock has a defect from the general point of view: it has features that clocks generally have. But, according to the contract, the clock has a defect: it is not in accordance with the description of the clock as stipulated by the contract.

\(^{44}\) Article 1641 of the French Civil Code defines defects in this way.

\(^{45}\) Ibid.

\(^{46}\) Peric gives a good example for this case: “The purchased cow has no horns. Is that a defect which according to Article 554 of the Serbian Civil Code grants base to buyer for petition? Certainly not. A cow’s destiny is to give milk, a calf and possibly to tow. The fact that the cow has no horns does not obstruct any of these purposes.” Peric, Ž. 204.

\(^{47}\) That is: the German BGB before the “Schuldrechtsreform”.

\(^{48}\) „Eine unerhebliche Minderung des Wertes oder Tauglichkeit kommt nicht in Betracht“ – § 459, German Civil Code (previous version), § 922, Austrian Civil Code.
minoris. The following is possible: only such minor flaw that does not obstruct using things or substantially reduce its value in use can be ignored.\textsuperscript{49}

French law is stricter in reference to the seller. Napoleon's code accepts any defect of things, without distinguishing between significant and insignificant, as a basis for protection of the buyer's rights.\textsuperscript{50}

The Serbian Civil Code is of course closer to the Austrian understanding of this problem, so that it is clear from the Article 555 that the seller is liable if he would not state the particular flaw of a thing. From this we can clearly see that the buyer is not entitled to protection in the event of non-essential flaws of things, i.e. if these do not reduce their usefulness.

The fourth condition of protection, according to the Serbian Civil Code, is the condition that the defect should have existed at the time when the contract was concluded, which is, as has already been demonstrated, in accordance with the solution of classical Roman law.\textsuperscript{51} However, another situation is possible as well in which the buyer is entitled to protection even if the defect occurred after the delivery of the thing, namely if the cause that led to the existence or formation of defects existed in the period when the thing was owned by the seller, which is why he is responsible.\textsuperscript{52} Thus, the buyer is entitled to protection in certain situations even after delivery.\textsuperscript{53}

What is the contribution of the classical Roman law in terms of process remedies that are available to the buyer? It seems that modern laws, almost unchanged, accepted and incorporated the Roman legal solutions to their civil codes.

The Austrian Civil Code provides that, if the defect, for which there is a guarantee, is of a kind that it cannot be removed and obstructs the regular use of the thing, the buyer may demand cancellation of the contract completely. If what is missing (in measurement or weight) may be amended then he is entitled to the supplement but, in both cases, has the right to compensation of damages and, if the seller was acting with negligence, the right to compensation of lost profits.\textsuperscript{54}

It follows that the buyer is able to request termination of the contract if the flaw is such that a) it obstructs the regular use of thing, i.e. substantially reduces its value in use and b) if the defect cannot be remedied (for example, the purchased horse has a disease which prevents it from pulling up a hill, and the disease is incurable).

The petition of the Austrian law by which the buyer may request termination of the contract is analogous to the Roman redhibitory petition and is called Wandelklage.\textsuperscript{55}

\textsuperscript{49} For example, the buyer has purchased a horse that has all the characteristics stipulated in the contract but is restless when being groomed. It is true that this circumstance obstructs its upkeep and cleaning but it certainly neither questions the use of its features nor reduces them significantly. Besides, that circumstance may be removed if the horse is carefully treated.

\textsuperscript{50} § 1641, Code Civil.

\textsuperscript{51} However, one should not accept that creation of the defect after the conclusion of the contract and before the delivery of the thing to the buyer excludes the buyer's protection rights. The risk according to the Serbian Civil Code is not on the buyer, but is still on the seller until the thing is handed over (§ 285, Serbian Civil Code).

\textsuperscript{52} To give an example: a horse bought by a buyer, before being handed over to him, ate some poisonous plants, which negative effect the buyer did not notice until taking the horse to his stall.

\textsuperscript{53} It is different in French law: only defects created at the moment of the conclusion of the contract are considered a basis for the buyer's protection, while any other defect which appears after that moment is the buyer's responsibility, since according to French law the buyer becomes the owner of the thing by purchase and as of that moment he, not the seller, bears all the risks – in detail in Planiol, M. 455-457.

\textsuperscript{54} § 932, Austrian Civil Code.

\textsuperscript{55} The Austrian legislator adopted the Roman protection system that foresaw petition actio redhibitoria (judicium redhibitorium), see Coing, Helmut. Europäisches Privatrecht. München, 1989, 224. With the assistance of Wandelklage, the buyer, as in Roman law, succeeds to obtain termination of the agreement, having established that the defect which obstructed regular use may not be removed. Klauer, Irene. Die Europäisierung des Privatrechts. Baden-Baden, 1998, 77.
However, Austrian law in this case seeks to completely reinstate the buyer to the previous position, not tolerating any damage to the buyer.

Namely, if the buyer had only the right to terminate the contract and to receive a refund, he could still, at the seller’s fault, be further damaged. In this case, according to the stated article of the Austrian Civil Code, the buyer is entitled to compensation for damages if the seller was not negligent, or even with the possible compensation of lost profits if the seller was negligent (i.e. he knew about the invisible flaw of things and did not disclose it to the buyer, or even claimed that this flaw did not exist).

In the event that a defect is of such a nature that it can be partially removed, i.e. that it is a lack of quantity, measure or number, the buyer’s right to protection under this Article means that the seller has to make up the amount, measure or number of the contract. However, this does not prevent the buyer to compensate for any damages he suffered if the seller was not negligent, or loss of profit if he was negligent.

It is in this part of the quoted Article from the Austrian Civil Code that a significant difference arises between Roman and Austrian law, which determines the difference between Austrian law on one side, and German and French law on the other: classical Roman law allows the buyer the choice between redhibitory and estimatory lawsuit, regardless of whether the defect is avoidable or not. In both cases, these lawsuits are at the buyer’s disposal, and he will have to choose which path to take.

Both French and German laws provide identical solutions. According to the French Civil Code, the buyer can opt between the termination of the contract (la résolution de la vente) by lawsuit, which not only is the same as in Roman law, but also of the same name (l’action rédhibitoire) or proportional reduction of the price, again of the same name and function as in Roman law (l’action estimatoire). In both cases, the buyer is entitled to compensation of damages if the seller was negligent, and if he was not negligent, except the price refund, the seller must pay the buyer only costs for sale.

The German Civil Code also adopts in full the Roman solution: in the case of such defect for which the seller is responsible, the buyer may request contract termination (Rückgängigmachung des Kaufes oder Wandelung) or a proportional reduction in rates (Minderung). The buyer is entitled to use both of these lawsuits regardless of whether the defect is avoidable or not, just like in Roman and French law.

The sailing of modern protection of the rights of buyers under full sail of Roman law is particularly evident in the Law of Obligations, enacted in 1978, which seems to proceed almost in the same way as the Roman legislator of the classical period in relation to the rights of the buyer for physical defects of things. The seller is responsible for the physical defects of the object of purchase which existed at the time of delivery, regardless of whether he was aware of them, which

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56 If the parties cannot agree on how much to reduce the price, the experts shall decide about that, provided that the purchaser opts for proportional price reduction (lex experts) - § 1644. Code Civil
57 § 1645. Code Civil
58 § 1646. Code Civil
59 Before the “Schuldechtsreform”.
60 § 459. German Civil Code (previous version).
61 § 460. German Civil Code (previous version).
62 This code has been translated into English (The Law of Contracts and Torts, Jugoslovenski pregled, Belgrade, 1997.)
63 This Yugoslav law was largely the result of the efforts of Ph.D. Mihailo Konstantinovic, Professor at the School of Law in Belgrade. Prof. Konstantinovic transformed his long-term scientific and educational activity in a special way, through legal form by which his so called Skica za Zakon o obligacionim odnosima was created (hereinafter referred to as the “Skizze”).
64 Article 407, paragraph 4, Skizze, Article 478, paragraph 1, Law of Obligations.
corresponds to the solutions of Roman law. Such an implied, objective responsibility of the seller in Roman law was the result of extended operation of actio empti. The buyer is not required to prove negligence of the seller, that is, whether the latter was aware of the shortcomings of the thing or not. This change refers to the buyer. In classical law, he had to prove the seller’s dolus. That was not easy at all. In Justinian’s law the seller is responsible whether he was negligent or not, and whether he knew about the defect or not. In this way a system of buyer’s protection is initiated in the classical law.

The seller is responsible for the defect even if he did not know about its existence. The buyer does not have anything to prove. It seems that our legislator had a similar view regarding the protection of buyers’ rights.

The influence of Roman law is also evident in the context of analogous provisions of modern civil codes in Europe, which seem to have inspired our legislator. The same solution, namely, is provided by the Swiss Code of Obligations65 and the Code Civil.66

The seller is liable for those defects that arise after the transition of risk to the buyer, if these are the result of a cause that existed before.67

And regarding the definition of material defect, the Law of Obligations is in line with the Roman Curule Aediles’ edict, and the solutions of the mentioned codifications. A defect exists if the thing does not have the needed characteristics for its regular use or sale, if the thing does not have the necessary characteristics required for the particular purpose for which the buyer purchased it, and which was known to the seller or ought to have been known to him, if the thing has no properties or characteristics that are expressly or impliedly agreed or stipulated.68 In the Swiss Code of Obligations the standard is almost the same: the buyer is entitled to protection for contracted properties of things, for defects that physically or legally erode the thing’s value, or its intended usefulness, or reduce them significantly.69 The Napoleon Code also takes a similar view: the seller is responsible for the guarantee in connection with physical defects of things, for latent defects that make it unsuitable for intended use, or which interfere in its use so that the buyer would not have bought that thing at all, or would have given a lower price had he known about them.70

The Roman principle of caveat emptor finds its application in the Law of Obligations. It has been observed in a previous analysis that the range of this principle basically did not result in the detriment of the buyer. Neither was every buyer in a position that his rights were not protected, nor was the intention of Roman jurisprudence in general directed against the buyer’s rights. This principle, understandably, only does not protect the reckless and gullible buyers. Careful viewing of things by the buyer is a sufficient basis for claiming the right to protection under Roman law. Had the Roman law really established this principle in order to impede the buyer’s position, it seems that it, almost invariably, would not have existed in modern civil European codifications, or even in our Law of Obligations. So the buyer is not entitled to protection because of those defects that, at the time of the conclusion of the contract, were known to him or could not have remained unknown.71 The standard is defined as those defects that a careful person with average knowledge and experience of the same occupation and same profession as the buyer could easily discern when conventionally viewing things.72

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65 Seller is responsible for defects even if he was unaware of them, Article 197, paragraph 2, Swiss Code of Obligations.
66 § 1643. Code Civil.
67 Article 478, paragraph 2, Law of Obligations.
68 Article 479, paragraph 1-3, Law of Obligations.
69 Article 197, paragraph 1, Law of Obligations.
70 § 1641. Code Civil.
71 Article 408, paragraph 1, Skizze, Article 480, paragraph 1, Law of Obligations.
72 Article 408, paragraph 2, Skizze, Article 480, paragraph 2, Law of Obligations.
The inspiration for such a solution is found, it seems, not only in the ideas of Roman jurisprudence, but also in analyzed civil codifications. In the same way the buyer’s right to protection is waived, with the same standard being adopted by the Swiss Code of Obligations73 and the French Civil Code.74 This is yet another example that eloquently testifies to the contribution of Roman jurisprudence which, through the European codifications of civil law, has also served as the basis of our legal system.

Owing to this, the buyer is obliged to view the received thing as usual and notify the seller about visible defects within eight days, or immediately if the survey is performed in the presence of both parties.75 In commercial contracts notification must occur without delay.76

It is obvious that the legislator adopts short periods in which the buyer must notify the seller of the observed defects. Although this solution might be criticized, since the constant tendency is to extend the periods to inform the seller, it is in accordance with French law which adopted the so called bref délai, a single short period in which the buyer must give the seller notice of defects.77 As has been shown, Swiss law is similar, with the exception of cattle trade.78 However, such set time limits make sense if we assume that the defects are readily visible or detectable through careful examination of the average careful person. It seems that in this situation the buyer does not need more time, while, in the case of a hidden defect, even much longer time would not allow him to notify the seller in a timely fashion.

The Roman obligation of the seller to dicta et promissa, as an element of modern obligations of the seller to notify, is also contained in the Law: the seller is also liable for those defects which the buyer could have easily observed, if he stated that there are no defects or that the thing has certain properties and characteristics.79 This seller’s obligation already constituted by Curule Aediles in classical law hinted a tendency of Roman law to comprehensively protect the rights of the buyer. Preserved to this day, this commitment permeates modern European civil codes80 and is explicitly mentioned in the EU directives that are embedded in our legal system.

However, the buyer might not see some defects, no matter how carefully the examination was performed. These are the so called hidden, latent, redhibitory defects of things. These defects, as analyzed, were known in the Roman law of the classical period.

Curule Aediles’ edict in detail addressed the standard that describes these defects. At the same time, it provides the process remedies that are available to the buyer in these cases. The Law of Obligations governs this question modeled on Roman law and provides that, if the thing has a defect that could not be detected by conventional view (hidden defect), the buyer must notify the seller of the defect within eight days from the time it was discovered (a subjective term). Failing to do so within six months of delivery of the thing (objective time), the buyer loses the right to sue, unless the contract provides otherwise.81

It seems that the solutions envisaged in the Law of Obligations are more accurate and more convenient for the buyer than those provided by the Swiss Code of Obligations. Unlike Swiss law which, under the influence of the Zurich Code of Obligations, establishes very tight deadlines in

73 Article 200, paragraph 1-2, Swiss Code of Obligations.
74 § 1642. Code Civil.
75 Article 481, paragraphs 1-2, Law of Obligations.
76 Article 409, paragraph 1, Skizze, Article 481, paragraph 2, Law of Obligations.
77 § 1648. Code Civil.
78 Article 201, paragraph 1, Swiss Code of Obligations, Article 202, paragraph 1, Swiss Code of Obligations.
79 Article 408, paragraph 2, Skizze, Article 480, paragraph 3, Law of Obligations.
80 Article 200, paragraph 2, Swiss Code of Obligations.
81 Article 482, paragraph 1-2, Law of Obligations.
which the buyer must give notice (usually immediately), our law establishes an objective deadline of six months in which the buyer must at the latest give notice about the defect. It seems that the solution of the Yugoslav legislator is even closer to the original Roman solution which also determined an objective terms (6 months, one year), depending on whether the seller gave the stipulation about guarantees of the thing’s quality or not.

However, Swiss and Serbian law touch in terms of perceived dolus of seller. If, according to both the codes, the seller knew of the hidden defect of things or it could not have been unknown to him, and he was silent about that, the buyer will have the right to be protected even when he had not fulfilled his obligation to promptly review the thing, or when he failed to inform the seller within the set deadline of the existence of the flaw, or if the defects show after the expiry of six months.82

Finally, Aedile remedies are applied identically in the Law of Obligations:

“The buyer who timely informed the seller about the defect may:

1. Require the seller to remove the defect or to give him another thing without defects (fulfillment of the contract);
2. Require a price reduction;
3. Declare the contract terminated;

_in each of these cases, the buyer is entitled to compensation._”83

On the same line as Roman law and modern European codifications that adopted Roman solutions, the Law of Obligations seeks to enable the buyer to terminate the contract or to reduce the price, which is obviously a tendency that exists in process remedies introduced by the Roman Curule Aediles.

However, the question arises as to what the rights of the buyer are in the case of so called partial defects of things. Is the buyer in this case able to opt breach of contract? The Law of Obligations is very precise here. The buyer’s rights depend on the extent of the partial defect. If partial defects form an entity and the buyer has a legitimate interest to accept the whole contracted thing or the amount as a whole, he may request termination of the contract as a whole.84 Otherwise, he can terminate the contract only relating to the defective part or only regarding the part or quantity missing.85

Such solutions regarding the protection of buyer’s rights in modern Serbian law indicate strong correspondence with the achievements of classical Roman law. Though, perhaps one could run analytic proof of the existence of ideas about the embryo of modern consumer protection in Roman law, the choice was taken to restrict this study to those contributions of Roman jurisprudence which are undisputed. Moreover, solutions of classical Roman law, by medieval reception and by creating a ius commune primarily understood as a common way of legal opinion (communis oppinio doctorum), a common legal core of continental Europe, can serve as a beacon for unification and harmonizing European private law in general, which as we believe is a goal worth striving toward.

82 Article 203, Swiss Code of Obligations, Article 485, Law of Obligations.
83 Article 488, paragraph 1-2, Law of Obligations.
84 Article 492, paragraph 1, Law of Obligations.
85 Article 492, paragraph 2, Law of Obligations.
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