WHEN AND WHY IS THE RUBBERSTAMP OF THE EUROPEAN UNION INSUFFICIENT? - CAVEATS TO SYSTEMS ON THE ROAD TOWARDS THE EUROPEAN UNION

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UDK: 341.174(4)EU
339.923:061.1>(4)EU
Izvorni znanstveni rad
Primljeno: studeni 2012.

Due to the principle of subsidiarity, European Union law is inherently incomplete. Hence, neither the transposition of the acquis communautaire, nor the law or impetuses coming from Brussels is a panacea to numerous real-life legal, economic or political problems not being focused upon by the Union. This is often forgotten not just by countries approaching the Union but also by the Member

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This paper served as a basis for my presentation at the international conference '*Economy and Democracy*' at the Inter-University Center Dubrovnik, Croatia, 17 – 24 September 2011 (http://www.iuc.hr/course-details-print.php?id=681) co-organized by CEU, IUC and the Faculty of Law, University of Zagreb. The author would like to express his deepest thankfulness for the comments and suggestions on this paper by the participants of the Dubrovnik conference, in particular Professors Biljana Đuričin, Stefan Messmann and Đorđe Gardašević, assistant Mišo Mudrić, doctoral candidate Patricia Živković, as well as to all the co-authors of the three books – each uniquely devoted to CEE – co-edited by Prof. Stefan Messmann and myself, *Investing in South Eastern Europe – Foreign Direct Investment in the Stability Pact Countries* (European University Press, 2005), *The Case Law of Central and Eastern Europe – Leasing, Piercing the Corporate Veil and the Liability of Managers & Controlling Shareholders, Privatization, Takeovers and the Problems with Collateral Laws* (European University Press, 2007) and *The Case Law of Central and Eastern Europe – Enforcement of Contracts* (European University Press, 2010).

States. The article is a review of a number of such legal and economic challenges faced in particular by Central European and ex-Yugoslav successor states, from such new transplants as franchise through risks of the pyramid and Ponzi schemes from the realms of financial law.

Key words: EU law, financial law and financial risks, self-help repossession, franchise, transplantation

1. INTRODUCTION: WHY DOES IT MAKE SENSE TO GO BEYOND WHAT EU[1] LAW CONTAINS?

This article has not been written by a European Union skeptic. Quite to the contrary: hardly could any European country – even if geographically being located close to the periphery – be in the position to survive economically outside this supranational organization of the Old Continent, perhaps with the exception of oil and gas super-rich countries like Russia or Azerbaijan. This should not, however, pull the wool over our eyes not to see not just why Brussels is often justly criticized but rather what the limits of EU law are. This article's modest task is to deal with the repercussions of the latter through a number of living examples in particular of relevance to CEE countries.

The rarely admitted misunderstanding, expecting much more from EU law than what one is supposed to, is that with the transposition of the *acquis communautaire* all the latest-generation legal tools will become automatically part of the legal repository of the states aspiring to become Member States. EU law contributes to but is insufficient, for example, to boost economic growth by attracting foreign capital. While countries like Germany are capable to achieve that end without special legal arrangements forged for the sole benefit of foreigners; that may not be the case in less attractive countries where a privileged status and concessions must be ensured by way of *lex specialis*. Likewise, EU law does not guarantee that the recipient states' economies will be automatically protected from all risks potentially coming from across the borders. In fact, the closer a country comes to the EU, the more it is forced to become open and vulnerable to transborder (European and global) threats of all sorts. *Thirdly*, it needs to be recognized as well that a fierce regulatory competition is ongoing

[1] List of abbreviations: CEE - Central and Eastern Europe; DCFR - Draft Common Frame of Reference; EBRD - European Bank for Reconstruction and Development (London, UK); EU – European Union; SEC - Securities and Exchange Commission (US); UCC - Uniform Commercial Code (US); UK - United Kingdom; US - United States of America.

in Europe tolerated by the EU. *Finally,* of not less importance is that certain problems idiosyncratic to a single or only a few countries hardly could find their way to the agenda of the EU. This is especially so as it is primarily the economically and thus politically more leveraged Member States that are the driving motors of developments within the EU and who thus have more say in what will become regulated and what not. What follows will try to exemplify these points, too.

It is absolutely clear that the dimensions of the *acquis* are prohibitive, to say the least. It is neither easy to determine its confines, nor not to get lost in it. The euphoria coupled with ignorance of the true dimensions of EU law and the enormous task of comprehending and adequately transposing the *acquis* then may easily divert the attention of decision-makers from the crucial fact: satisfying the expectations of Brussels by getting a rubberstamp on a new law is a solution only to some of the problems.

The EU, however, should not be blamed for the misconception(s) only: the partial and fragmented nature of EU law should logically follow from its very basic principles.[2] In case of states with a limited number of lawyers speaking foreign languages and hence being capable of dealing with the next to insurmountable task of understanding and adequately transposing EU law, inadvertent disregard of what is not directly required by Brussels is almost guaranteed. Time pressure, lack of resources and human capacities obviously take the toll, too. The question is whether this predicament is taken adequate note of and reacted upon; starting with but not limited to adequate responses in legal education.

2. THE ARGUMENT EXEMPLIFIED

2.1. The risks inherent to the nature of EU law-making

This paper would not be complete without a cursory glance at the way laws are made in the EU. These inherently create gaps or room for maneuvering. At

[2] Suffice to mention the diverging opinions on one of the basic principles of EU, the principle of subsidiarity, the present formulation of which (Article 5(3) of the Treaty on European Union in the consolidated version following the Treaty of Lisbon [in force since 1 December 2009]) states: "Under the principle of subsidiarity, in areas which do not fall within its exclusive competence, the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level."

least, three such inherent features should be mentioned: 1) slow law-making and regulatory reaction, 2) the lack of consensus on numerous pivotal issues, and 3) the impact of Continental European system thinking.

2.1.1. Cumbersome law-making and the Lamfalussy process

The EU is an idiosyncratic supranational organization: it is neither a federation, nor a unitary lookalike of a municipal system. Its law-making regime must therefore also be unique. The end-result, quite cumbersome and slow processes, is a fact that always should be reckoned with as a form of limitation. Obviously, the tempo of regulatory reactions need not be the same with respect to all economic and social phenomena. Yet some fields are more exposed to changes than others. The world of finance – the amalgam of banking, capital market and securities regulation – may be the best example of the point made.

As demonstrated by the 2008 global financial crisis, in this domain changes occur not just with unprecedented speed but their results tend to have increasingly wider reaching and deeper going negative effects. Today, due to globalization and the resulting interconnectedness of markets, crises will hardly bypass any system unscathed. Moreover, this branch of law is more featured by 'the drive to innovate' than others, in particular the traditional legal disciplines typically enshrined into hard-to-change, deemed-to-be-gapless codes. As a consequence of these constant challenges it is an open issue how to speed up the regulatory reaction in the world of finances having in mind not just the recurring crises of varying magnitude but also that law-making eventually should be a democratic process in which the regulating executive should remain subject to some form of checks and balances. One must admit though that the frequent amendment of laws and regulations in the world of finance *per se* has become a problem of its own in the EU by now. Hudson has therefore rightly pointed to the unprecedented epistemological problems inherent to financial regulation, though it is not hard to conclude on the basis of the above that systemic risk has become a 'known' problem yet with 'unknown' and presumably changing content.[3]

[3] Hudson exploited the quite known aphorism of former US Defense Secretary, Donald Rumsfeld, to explain this feature of financial law. In brief: regulators face three types of risks – the 'known knowns', the 'known unknowns' and the most dangerous ones the 'unknown unknowns'; or "the risks which no one has yet been able to anticipate or to quantify." See Alastair Hudson, *The Law of Finance* (Sweet & Maxwell, 2009), at 831.

The EU's major project, launched in 1999 yet still ongoing, aimed at the creation of a single market in financial services – *the Financial Services Action Plan (the FSAP)* – itself per definition is an incomplete agenda because it did not aim to regulate the entire universe of finances. Yet even this, obviously important goal, has faced serious obstacles in the implementation process and could not be said to have been a complete success.[4] The constant revamping of the related EU legislation is the best proof of the uncertainties. This fact alone should already be telling, yet presumably due to the complexity of the domain, such additional gaps remain, which the national regulators could, neither foresee, nor properly remedy. In other words, it would not be erroneous to brand the EU-cum-national regulatory system as an 'open end' one heavily exposed to systemic risk. The level of exposure, moreover, hardly will abate as demonstrated by the ongoing sovereign-debt crisis in Europe.

It should not be a surprise then that the EU's recipe for dealing with fast-changing conditions in the world of finance was thought to be through speeding up the law making process and through that also the regulatory reaction time. This was to be achieved by creation of two new regulatory bodies outside the already then relied on comitology committees[5] and creating of a more

[4] The European Commission's FSAP Evaluation (Part I) from 2010 itself admitted that: "The political pressure to complete the Action Plan meant that timeframes were largely respected; the new approach to the preparation of legislation introduced under the Lamfalussy process brought significant improvements in terms of consultation, institutional co-operation, and (potentially) greater flexibility to respond to market events and there is a general appreciation of the quality of the measures finally introduced, which in many cases were much broader in scope than that originally set out in the Action Plan. However, the Financial Services Action Plan presented some very specific difficulties. These largely centre on the fact that, because it was so extensive, it was a challenge to balance the requirement for high quality legislation with the tight demands on timing. This applies to the various stages in the preparation of the actions, from consultation with stakeholders and inter-institutional negotiations to transposition and implementation in the Member States. In addition, the FSAP did not address all policy areas that go towards making up a truly single market in financial services." *Ibid.*, at 33 (http://ec.europa.eu/internal_market/finances/docs/actionplan/index/070124_part1_en.pdf; last visited on 10 November 2012).

[5] The two new bodies – to operate outside the comitology procedures – were the European Securities Regulators Committee (CESR) and the European Securities Committee (ESC) to regulate securities markets on an EU-wide basis. The first body was in 2011 renamed to ESMA – European Securities Markets Authority (http://www.esma.europa.eu) by Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Su-

flexible law-making process – as formulated by the *Final Report of the Committee of Wise Men on the Regulation of European Securities Markets* led by Alexandre Lamfalussy. With a degree of simplification, the main idea was that each novel challenge brought about by a newer financial crisis, or financial innovation, is to be addressed by more swiftly passed laws with the involvement of powerful committees of national experts ('comitology committees').[6]

In Europe, where the main lawmaker, at least in principle, is still the 'legislature' such philosophy seeing the *panacea* to all pathological phenomena in the world of finances in the 'legislator' is understandable. The 2008 financial crisis is the living proof, however, that this paradigm suffers from serious defects as the EU system with its complicated web of institutions was not in the position to immunize Europe from the calamity set into rolling by the collapse of the US sub-prime housing market. In fact, the comitology procedure had been expanded to other areas in the meantime virtually uncontrollably (e.g. import tariffs) what triggered eventually a backlash in the form of renewal of the control powers of the European Parliament and especially of the Commission during the last few years.[7]

pervisory Authority (European Securities and Markets Authority). While ESMA is an independent agency, the ESC is run by the Commission, though it fulfils both comitology and advisory functions (http://ec.europa.eu/internal_market/securities/esc/index_en.htm). ESMA seems to be destined to become an EU-level independent regulatory agency, though at the moment rather coordinates the work of other European Supervisory Agencies in the fields of banking (EBA), insurance and occupational pensions (EIOPA). The text of the Final Report is available electronically at http://ec.europa.eu/internal_market/securities/docs/lamfalussy/wisemen/final-report-wise-men_en.pdf; last visited on 10 November 2012.

6 As defined by the Glossary of the EU (http://europa.eu/legislation_summaries/glossary/index_en.htm): "The committees are forums for discussion, consist of representatives from Member States and are chaired by the Commission. They enable the Commission to establish dialogue with national administrations before adopting implementing measures. The Commission ensures that measures reflect as far as possible the situation in each of the countries concerned." The number of comitology committees changes from time to time. Albeit now four types of such committees are known – advisory, management, regulatory and (since 2006) regulatory with scrutiny – they are powerful as they can block Commission action and refer the case for decision to the Council (except the advisory committee). To increase the transparency of their work publicly accessible 'Comitology Register' was established (see http://ec.europa.eu/transparency/regcomitology/index.cfm).

7 The reform was introduced by the Lisbon Treaty (signed on 13 December 2007, entered into force on the 1 December 2009 – consolidated version of the Treaties available electronically at http://bookshop.europa.eu/is-bin/INTERSHOP.enfinity/

Another problem to be borne in mind is that notwithstanding the increased centralization of financial regulation in Europe, the Member States' regulatory systems still significantly differ from one another. This is so not just because of the differences in the features of financial laws, the varying levels of the rule of law and the multitude of legal cultures, but in particular the expertise and the general attention given to financial law on local levels. The systems aspiring for EU membership are even farther in this process and law school curricula hardly deal with the myriad challenges of the sort surfacing virtually on a daily basis. The more fundamental problem is that the unwritten yet almost generally subscribed to conventional wisdom of legal education focusing on courts serving justice and resolving disputes according to which "a court will deal with the novelty once it emerges by pointing to a section in a code" does not work in finances. *Ex post* resolution of an investment dispute, to illustrate the essence, ending in few years after the calamities had annulled the investments of an investor would hardly reinstall the trust in the capital markets and generally in the legal system as well.

The lesson for emerging systems in particular - not having had sufficient experiences with such sophisticated fields as finances - is that the protection may, but must not arrive in time from Brussels. It would pay to invest and focus on financial education also of lawyers, and develop a tailor-made regulatory protection for one's own country – a system that would be naturally compatible with the one envisaged by the EU. This should not be a problem given

WFS/EU-Bookshop-Site/en_GB/-/EUR/ViewPublication-Start?PublicationKey=QC3209190). In fact, two changes of relevance should be mentioned here. The *first* changed the comitology procedure by increasing the powers of the European Parliament and especially the Commission (i.e., decrease of the powers of the comitology committees). The *second* decreased the powers of the Member States through changing the rules on the votes needed for blocking the Commission proposal from simple to qualified majority – what is very hard to get. This was the outcome of the eternal struggle the EU is suffering from: the fear for democracy safeguards versus the need for more efficient law making and faster responses to contemporary challenges. For our purposes, however, it suffices to state that the law making procedures have remained as complex as they had been prior to the Lisbon Treaty. Now, however, the Commission has powers to pass 'delegated non-legislative acts' (Article 290 of the Lisbon Treaty) or 'implementing acts' (Article 291 of the Lisbon Treaty). The problem is that the distinction between the two is not clear at the moment, what has prompted Member States to raise their concerns on the implementation of these provisions of the Lisbon Treaty. See, e.g., http://www.euractiv.com/en/future-eu/eu-lawyers-struggle-new-comitology-rules-news-502310; last visited on 10 November 2012.

that minimum harmonization is the standard followed normally in the EU. Getting inspiration from sources beyond Europe, hence, is what wise systems should do. The good in the bad is that because of the 2008 global financial crisis Europe is now also more willing to take a look at the experiences of the US or of others in this particular complex domain, though there is still a lot to be done to get to the desired level of trans-Atlantic cooperation known, for example, in the context of competition law.

2.1.2. Financial risks exemplified: swaps, local governments, pyramid and Ponzi schemes

Merely two pathological financial phenomena need to be mentioned here to show not just that the increasingly complex, often-changing EU regulations aimed at dealing with local and transborder financial risks are far from being perfect but rather to highlight that even the countries that are only knocking on the doors of EU are exposed: the unfortunate encounter of municipalities with interest rate swaps and the many multicolored cases of pyramid and Ponzi schemes in CEE. The naïve yet very much present thinking of CEE systems that the fact that they are only at the beginning of the development of deeper capital markets makes them immune from crises and other threats – is simply mistaken.

The *first,* still unfolding problem is related to the financing of various local governmental units and their reliance on such complex financial innovations as interest rate swaps.[8] The country, the municipalities of which were trapped by these recently was Italy, where 525 Italian local authorities entered into almost 1,000 interest rate swaps with an aggregate value of Euro 35bn in the period between 2001 and 2008. This was possible based on a 2001 constitutional amendment allowing municipalities and regions resort to international capital markets to solve their financing problems.[9] The municipalities have

[8] Swap is a "[f]inancial transaction between two parties, usually involving an intermediary or dealer, in which payments or rates are exchanged over a specified period and according to specified conditions." (Quoted from the Black's Law Dictionary). Interest rate swaps are complex derivatives with more sub-variants (e.g., fixed-for-floating rate, same or different currency; floating-for-floating swap, same or different currencies). Interest rate swaps are used to hedge against adverse interest changes or by speculators to exploit the arbitrage opportunities they offer.

[9] See, e.g., Rachel Sanderson, Guy Dinmare and Gillian Tett, *An Exposed Position,* Financial Times, 9 March 2010, at 8.

hastily subscribed these derivatives without properly understanding how they work and what risks are inherent to them. The problem had become known due to the default of the city of Taranto in 2006 and had exacerbated afterwards due to the global financial crisis.

In the same vein, the City of Milan charged four international banks with fraud for "misrepresenting [...] the financial benefits of the debt restructuring" – i.e., bond issue coupled with swaps – and for not being "transparent in explaining the terms and conditions of the swaps agreement" as a result of what the "city incurred €56m of hidden costs ... on top of the fees."[10]

The interesting point is that the unfortunate encounter of municipalities with interest rate swaps was resolved in the UK already in the 1990s, where the judgment in the case *Westdeutsche Landesbank v Islington* [*1996, A.C. 669*] brought to an end the local municipal derivatives market. In the case, the contracts were declared void *ab initio* because in the court's opinion the municipalities did not have capacity to conclude such agreements (*ultra vires*).[11] As some CEE municipalities have also begun to turn to international capital markets to raise financing for their needs, it remains to be seen what the prospect of those deals will be; or worse, time might show which of them has fallen the pray of the same errors as their Italian or UK brethren.

Ponzi and pyramid schemes[12] are the other handy examples, though perhaps more of relevance to genuinely early phase emerging markets. In fact, the post-1990 history of CEE is full with illustrative cases, starting with the collapse of the entire economy of Albania in 1996[13] triggered by omnipre-

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10 Vincent Boland, *Milan Swaps Case Puts Banks in the Hot Seat,* Financial Times, 19 March 2010, at 25. The four international banks charged with fraud were Deutsche Bank AG, JPMorgan Chase & Co., UBS AG and Hypo Real Estate Holding AG's Depfa Bank Plc.

11 See Hudson, *op. cit.* (fn. 3), at 1191 – 93.

12 These two pathological financial phenomena are similar, yet not the same. In CEE, the pyramid schemes are known and are typically prohibited and criminalized. The designation 'Ponzi' scheme is less known in Europe. For example, the German naming is *Schneeballsystem* (roughly: avalanche or snowball system). The Black's Law Dictionary defines pyramid schemes as "property-distribution scheme[s] in which a participant pays for the chance to receive compensation for introducing new persons to the scheme, as well as for when those new persons themselves introduce participants." As opposed to that a Ponzi scheme is "a fraudulent investment scheme in which money contributed by later investors generates artificially high dividends for the original investors, whose example attracts even larger investment."

13 See Chris Jarvis, *The Rise and Fall of the Pyramid Schemes in Albania,* IMF Staff Papers, vol. 47, No. 1 (2000); Arnisa Gorezi and Evgjeni Bashari, *Enforcement of Contracts*

sent and government-linked pyramid schemes, continuing with the Hungarian real property investment cooperatives[14], the Romanian *Caritas*[15], the Russian *MMM*[16], the Serbian *Dafiment Bank*, the Slovakian *BMG/Horizon*[17] and many others.[18] Even though the US SEC has put investigation of Ponzi schemes a top priority[19] after the Madoff scandal[20], no such shift in priorities seems to have ensued in Europe, even though the Madoff scandal did not leave Europe unscathed either. Put simply, Ponzis are lurking at emerging financial systems (both in and out of EU), are real threats to the trust of the so much needed investors (local and international), and yet hardly will anything from EU law properly warn or protect fledgling systems from this type of financial pathology.

2.2. Lack of consensus and regulatory competition: the case of company law and corporate-governance

Contrary to the deficiencies due to the inherent nature of EU law-making, certain important legal issues have not become part of the *acquis* because no consensus could have been reached by the Member States on which model to follow in the past. As not being part of the *acquis* and as their regulation

in Albania – Overcoming Dilemmas in an Emerging Market, in: Stefan Messmann and Tibor Tajti (eds.), *The Case Law of Central & Eastern Europe: Enforcement of Contracts* (European University Press, 2009), at 52 – 57.

14 See Tibor Tajti, *Central European Contribution to the American Debate on the Definition of 'Security' or Why does the Definition of 'Security' Matter?: The Fiasco of the Hungarian Real Estate Investment Cooperatives, Pyramiding, and Why Emerging Markets should be Equipped to 'Act' rather than 'React'*, Transnational Law & Contemporary Problems, vol. 15, No. 1 (Fall 2005), at 111.

15 See Ileana M. Smeureanu and Florentin Giurgea, *Enforcement of Contracts in Romania*, in: Messmann and Tajti, *op. cit.* (fn. 13), fn. 1, at 680.

16 See Yuliya Guseva and Oleksiy Kononov, *Contract Enforcement in Russia: Positive Developments and Persistent Dilemmas*, in: *ibid.*, fn. 9, at 767.

17 See Anna Hergottova, *Enforcement of Contracts in the Czech Republic*, in: *ibid.*, fn. 4, at 142.

18 Pyramid schemes have not bypassed the Baltic States either. For the brief Lithuanian experiences see Lina Aleknaite, *Enforcement of Contracts in Lithuania*, in: *ibid.*, fn. 4, at 322.

19 See, e.g., Michael K. Lowman, *SEC Compliance Best Practices – Leading Lawyers on Working with the SEC, Structuring Effective Compliance, Programs, and Evaluating Securities Developments,* 2010 WL 894704 (ASPATORE) (2010), at 4.

20 For a description of the Madoff saga see David E.Y. Sarna, *History of Greed* (John Wiley & Sons, Inc., 2010), chapters 20 – 24.

is not mandatory, these are as a rule sidestepped in the transposition of EU law. One notable example from this realm is the clash of the one- versus the two-tier board structure corporate governance systems. The second is known by having besides the management board, also a supervisory board making thus two tiers of governance in (large) companies.[21] As quite a number of post-socialist countries have modeled themselves after German law[22] – including this solution – during the first years of the transition, the two tier system was a mandatory requirement imposed by local company laws. Unfortunately, it took quite a number of years to realize that this is a wrong approach that may scare off multinational corporations headquartered in common laws, or other systems knowing and being comfortably with a one-tier system only, to whom this pattern was completely foreign and hence not acceptable.[23]

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21 Laws vary from state to state. While the French system permits this system for public (open) companies, Germany and the Netherlands require the formation of supervisory boards.

22 In German law the two boards are – as Enriques, Hansmann, and Kraakman put it – "[a]lthough the supervisory and the management board are in a semi-hierarchical relationship in the two-tier structure, the management board may be the more powerful of the two in fact. The management board enjoys independent legal status. Under German law, for example, the supervisory board cannot oust the management board without cause, cannot make business decisions reserved to the management board, and – on certain matters – may even be overruled if a recalcitrant management board can obtain the support of a super-majority shareholder vote. In practice, a company's most influential single actor can be the chair of either its supervisory or its management board, depending upon ownership structure and the personalities involved." See Luca Enriques, Henry Hansmann and Reinier R. Kraakman, *Chapter 3: The Basic Governance Structure*, in: Reinier R. Kraakman, John Armour, Paul Davies, Luca Enriques, Henry Hansmann, Gerard Hertig, Klaus J. Hopt, Hideki Kanda and Edward B. Rock, *The Anatomy of Corporate Law – A Comparative and Functional Approach* (Oxford University Press, 2nd ed., 2009), at 57.

23 As per section 308 of the 2006 Hungarian Company Act – as the principal rule – the formation of supervisory boards became optional. Article 33 foresees the exceptions (i.e., cases when formation is mandatory), which are: *first,* the so-called open joint-stock companies (*nyilvánosanműködőrészvénytársaság*), unless they opt for a so-called 'board system', meaning that if their bylaws so provide, instead of [separate] managing and supervisory boards, a unified management system may exist consisting of a single board of directors (or management board); *secondly*, in case of closed joint-stock companies (*zártkörűenműködőrészvénytársaság*), if more than 5% of shareholders so decides; and *thirdly* if a special statute so provides (e.g., the national TV and other companies in case of which public interest requires that). According to the earlier 1997 Company Act the formation of supervisory boards was mandatory by joint-stock companies and limited liability companies with registered capital

Additionally, this model now co-exists[24] with the 'codetermination' (*Mitbestimmung*)[25] system that statutorily reserves places on the supervisory board to the representatives of the labor.The difference is therefore not just about some technical details but rather about fundamental policy choices as the German model rests on a social model presuming a significant level of 'co-operation' between employers and the labor.[26] With a degree of simplification, the essence of this philosophy is that while the German model accepts as natural that labor has a say in governance of corporations, to the one-tier model mixing of the roles is foreign (especially in its English and US versions).

As EU is divided on this issue, the leading legal systems tend to promote and recommend their models to others looking for tested solutions. To a great extent it was exactly the socialist past of CEE countries used to make the two-tier model the logical solution given the enhanced role afforded to labor by it. This logic, however, desires serious reconsiderations having the unhappy transitory experiences of many post-socialist countries in sight; especially the ex-Yugoslav jurisdictions where the imbedded reflections from the self-management version of socialism and the inherited strong position of labor unions (or non-unionized often only spontaneously organized employees) in many segments of the economy in fact prevent changes in any direction.

above 50 million Hungarian Forints; as well as by any company annually having on average more than 200 employees.

24 The two-tier system came into being already in the 19th century and not to accommodate the interests of the employees. First it was introduced by the 1861 General German Commercial Code (*Allgemeines Deutsches Handelsgesetzbuch*) as an option and was made mandatory only in 1870, however, only for joint-stock companies; in 1892 also for GmbHs. See Jean du Plessis and Otto Sandrock, *The German System of Supervisory Codetermination by Employees,* in: Jean du Plessis, Bernhard Grossfeln, Claus Luhermann, Ingo Saenger, Otto Sandrock, *German Corporate Governance in International & European Context* (Springer Verlag, 2007), at 119.

25 Two variants of employee participation are known: 1) management codetermination – denoting employee participation at supervisory board levels, and 2) social codetermination – encompassing all shop-floor level participation of employees in works councils, safety committees, productivity committees, and job classification committees. *Ibid.*, at 111 – 112.

26 Albeit some form of codetermination was introduced already in 1920 (abolished with the arrival of fascism in 1934), the present day system came into being because the British occupation authorities and the German trade unionists wanted to ensure "the nation would never again fall into the dictatorial pattern of the Third Reich." The idea was to make the cooperation of labor and management compulsory in the supervisory boards, also to ensure that the earlier strict class distinctions would not be created again. *Ibid.*, at 114.

The result in Serbia, for example, is a stalemate with huge number of (at least technically) bankrupt firms, high unemployment rates, high public indebtedness and remote chances of reorganization even for the otherwise healthy and promising enterprises.

Another disagreement relates to the differing approaches to legal capital: i.e., the continued importance legal capital plays in civilian legal systems versus its gradual discarding by common laws.[27] The tension remains alive to a great extent also because of the increased regulatory competition in the EU itself and a series of ECJ cases – starting with the 1999 Centros case.[28] The

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[27] Andreas Engert in *Life Without Legal Capital: Lessons from American Law* (downloadable from SSRN) warned that abandonment of the legal capital rules is to be resorted to carefully as the distributive function of these rules is in the US, for example, to a great extent achieved via bankruptcy law. In other words, while it is true that the Americans have given up much of the legal capital rules, other branches of law have taken over some of the functions – what would not be the natural result in Europe due to the radically different bankruptcy laws. Eilis Ferran, on the other hand, in the *Place for Creditor Protection on the Agenda for Modernisation of Company Law in the European Union* (ECGI – Law Working Paper No. 51/2005; downloadable from SSRN) questioned whether various contractual devices – i.e., covenants, security devices and other similar contractual arrangements – are proper substitutes for the protection of creditors because the legal capital rules "mimic what can be achieved through contractual bargaining. As such, legal capital rules can be seen as being helpful to the market because they provide a ready-made, off the rack, solution that reduces transaction costs." *Ibid.*, at 5.

[28] Only two cases will be mentioned here as a voluminous literature has developed around these issues in the mean-time, the *Centros* and the *Überseering* cases. The essential takeover of these, however, is that doing business in other parts of the EU by a company having a seat in one Member State is still not fully free. According to the judgment of the European Court of Justice of 9 March 1999*, Centros Ltd v Erhvervs- ogSelskabbstyrelsen, Case C-212/97, European court reports 1999. I-1459*, it is contrary to Articles 52 EC and 58 EC (now: Articles 43 and 48) – the freedom of establishment – for a Member State to refuse to register and thus allow the operation of a branch of a company (in the case: in Denmark) formed in accordance with the law of another Member State (in the case: UK) in which it has its registered office. After Centros set the ball rolling, a series of cases has further refined the issue. The ECJ judgment of 5 November 2002 in the case of *Überseering BV v Nordic Construction Company Baumangagement GmbH(NCC), Case 208/00, ECR 2002, I-09919*, proclaimed that albeit the real seat theory of companies is a restriction on the venerable EU principle of freedom of establishment and as such is, at least in principle, incompatible with EU law, nonetheless recognition of a foreign company established based on the law of another Member State requires recognition by the Member State in which it wants to do business. On the topic see, e.g., Eddy Wymeersch, *Centros: A Landmark Decision in European Company Law* (Financial Law

opinion on this particular issue is far from being settled in CEE either. Some have sided with the forceful criticism of the imposition of the capitalization rules in the EU by the 2nd Company Directive[29] coming largely from the other side of the Atlantic because they do not "facilitate entrepreneurship, business development, and the investment in high-risk, start-up companies that hold the best promise for future economic growth"[30], and have not just reduced the required registered capital but are thinking about abandoning it completely for some types of businesses.[31] Yet such a stance is rather the exception than the rule.

The point to be noted by *acquis*-recipient states is that, in fact, the nature of the company law and of the corporate governance system does matter to foreign investors planning to get established in prospective EU-Member States. To an American multinational understandably a two-tier system would be foreign (to say the least) and the mandatory imposition of such a rule could easily make it steer its investment ship towards a friendlier system. To the Swedish Ericsson, on the other hand, that would be more or less normal, if not an expectation. It would be worthwhile also to rethink whether the two-tier system is the best of all options to local businesses themselves.

At any event, a number of CEE countries have recognized the pivotal role a business-friendly company law plays and have entered into a regulatory competition, among others, by making the two-tier governance with the concomitant co-determination system optional. The competition has not ended

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Institute Working Paper 99-15, October 1999); Mathias M. Siems, *Convergence, Competition, Centros and Conflicts of Law: European Company Law in the 21st Century,* European Law Review, vol. 27 (2002, with postscript 2008) (downloadable from SSRN), at 47 – 59.

29 Second Council Directive 77/91/EEC of 13 December 1976 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent as amended (1992, 2006 and 2009). Consolidated version available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:1977L0091:20091022:EN:PDF; last visited 10 November 2012.

30 See Luca Enriques and Jonathan R. Macey, *Creditors versus Capital Formation: the Case against the European Legal Capital Rules*, Cornell Law Review, vol. 86 (2001), at 1165.

31 Hungary was pondering the introduction of the so-called '1000 Forints KFT' – which would be an LTD or GmbH founded with mere 1000 Forints (roughly 4 Euros in 2011) somewhere in 2008.

though there, given that the question of the minimization or elimination of capitalization requirements is already on the table of many national lawmakers in Europe. On that front, the problem is that the 2nd EU Company Directive has solidified the capitalization requirement, a continental law-based rule. Yet again, the answers to these questions do not naturally flow from the *acquis* and those countries aspiring for EU membership should go beyond to find the best solutions for their specific needs.

2.3. The unnoticed limits of system thinking: the case of German *kautelarische Sicherheiten*

The designation 'system-' or 'dogmatic thinking' is primarily the feature of German law and the systems that have modeled themselves after it. Although books could be written about what this feature and its myriad repercussions denote, in a shorthand manner it means strict adherence to the once erected system of interlinked legal categories – resembling very much Darwin's evolutionary tree of species. The venerable European civil codes are perhaps its best materializations. This type of thinking hardly (if ever) is willing to allow changes in the established system of legal categories, rules and principles. The underlying philosophy is that the system is gapless and judges, or others applying the law, should find answers to any and all legal issues As opposed to that, for example, the US UCC has not been even conceived as a gap-less system and, for example, it does not extend to agency law.

As modern times have showed, however, even though the codes are deemed to be gapless and solutions could eventually be found even to the latest generation problems, the solutions offered by the codes to modern problems are often ill-suited. The issue is, in other words: can concepts forged based on the circumstances and understanding of the 19th (or 20th) century fit modern times?

Examples could be easily found on how novel problems are stretching and testing the confines of the codes nowadays. One of the best examples are the German *kautelarische Sicherheiten*, or contract-clauses-based security devices, which gained full recognition even though they were invented by the business and later blessed solely by courts – but not by the legislator. After the 'steam engine' of German economy was set again in motion somewhere in the 1950s, German businesses faced a serious shortage of credit inevitable for growth. The universal banks had had already significant stakes in the largest and most important companies based on pledged shares and were reluctant to extend further credits without adequate new collateral and without appropriate priority rules; suppliers had similar problems. In a nutshell, the demand for credit was the driving force behind the innovation, then expansion and extension, of security devices that used personal property – or in Continental European legal parlance: movables and intangibles (rights and claims) – as collateral. By now they have become widely, almost routinely, utilized – irrespective that virtually only the simple retention of title is explicitly regulated by the German Civil Code. In other words, they became popular by financiers and suppliers alike and as well an integral part of German law.

Their common law equivalents, known as 'personal property security'[32], or 'secured transactions' laws, are fundamentally different from the German system. The main difference is that in the Anglo-Saxon systems the basic rule is that security devices – creating security interests or proprietary (*in rem*) rights – must be registered, or public notice must be given on their existence by such other means as transfer of possession or by acquisition of control. The main rational is the protection of the participants of the market against ostensible ownership (or false wealth) – i.e., extension of credit on the strength of an asset that only ostensibly is owned by the debtor. The German system is also hostile to secret liens, but its main solution is the famous *numerus clausus* of proprietary rights[33], to wit, the prohibition of the invention of new *in rem* (proprietary) security devices but the ones that had been enshrined into the Civil Code in the 19th century. To give a concrete example, while in the US virtually all contracts with a retention of title clause and performing a security function must be perfected (typically filing in a public filing office), according to German law they are valid without any kind of registration with any public registry.

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[32] Only in the US is this branch of law denominated as 'secured transactions' (as regulated by Article 9 of the UCC), in Australia, Canada, New Zealand or UK – and other systems modeling themselves after English law – the 'personal property security law' is the accepted one. Though, the difference is not only in the designation: while Australia, Canada and New Zealand have reformed their laws following the US pattern, England has refused to do that.

[33] See, e.g., Sjef van Erp, *A Numerus Quasi-Clausus of Property Rights as a Constitutive Element of a Future European Property Law?*, Electronic Journal of Comparative Law, vol. 7, No. 2 (2003) (http://www.ejcl.org/72/art72-2.PDF; last visited on 29 August 2011). As van Erp succinctly put it: according to "the so-called numerous clauses doctrine of absolute rights […] the number and content of real rights (rights against the world, distinguished from merely personal rights) is limited. As such, the [doctrine] is a characteristic of civil law systems […]." *Ibid.*, at 1.

In Europe, one could speak only of a very piecemeal rapprochement achieved since Ulrich Drobnig, one of the doyens of German commercial law, in 1980, found that the differences in the domain are so big that no harmonization, let alone unification, was possible. This dogma was broken, however, by the EBRD when it launched it secured transactions project in 1992 to assist the post-socialist countries of CEE build market economy. Since then many things have changed in various parts of Europe, though no major breakthrough occurred, irrespective that Book IX of the Draft Common Frame of Reference has quite out of the blue made a major move towards the unitary secured transactions law model now forming an important part of the commercial laws of the United States, Canada, New Zealand and Australia.[34] Yet as the DCFR is a soft law of very recent vintage aimed solely to "serv[e] as a source of inspiration for law making and law teaching at all levels"[35], this novelty may but must not mean a lot.

The lack of a unified position in the EU is, however, only the smaller problem. It should be of a much bigger concern to some CEE countries that the two conflicting systems have come to exist side by side, making the priority position of creditors unclear. Poland seems to be the best example because this country has revamped its personal property security law – named as 'registered pledge' law[36] – to a meaningful extent following the common law pattern of

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[34] For a more detailed comparison of the new Australian Personal Property Security Act and of the European segmented systems see Tibor Tajti (Thaythy), *Testing the Equivalence of the New Comprehensive Australian Personal Property Securities Act, its Segmented European Equivalents and the Draft Common Frame of Reference*, Bond Law Review, vol. 24, No. 1 (2012), at 85 – 148.

[35] Christian von Bar, *A Common Frame of Reference for European Private Law – Academic Efforts and Political Realities*, Electronic Journal of Comparative Law, vol. 12, No. 1 (May 2008) (http://www.ejcl.org/121/art121-27.pdf; last visited on 25 April 2011).

[36] The post-socialist act influenced by common law is the Act of 6 December 1996 on Registered Pledge and Register of Pledges (*Ustawa o zastawie rejestrowym i rejestrze zastawów*), published in Journal of Laws 1996, No. 149, Item 703. This act, though, drew also on the pre-WWII laws aimed at introducing non-possessory security interests (i.e., registered pledges) on various collateral. These were: Act on registered security interests over motor vehicles of 28 April 1938 (*ustawa o rejestrowych prawach rzeczowychna pojazdach mechanicznych*), published in Journal of Laws 1938, No. 36, item 302, the Act of 15 June 1939 on registered pledge over equipment (*ustawa o zastawie rejestrowym na maszynach i aparatach*), published in Journal of Laws 1939, No. 60, item 394, and the Act on the Registered Pledge over Wood of 14 March 1932 (*ustawa o rejestrowym zastawie drzewnym*), published in Journal of Laws 1932, No. 31, item 317. For the history of Polish secured transactions law see John A. Spanogle, *Secured Transactions Law in Eastern Europe: the Polish Experience as an Example*, Thomas

the EBRD. This system gives priority to creditors if they register their 'pledges' in a public registry for pledges on movables (i.e., registration has a 'constitutive effect'). Roughly simultaneously with the introduction of this systems, the German fiduciary security devices[37] – not requiring any kind of registration, just inclusion into credit contracts – have spread as well in business life; to a great extent because of the strong presence of German universal banks and German business practices. As a result, conflicts have arisen between registered pledges and the unregistered fiduciary security interests, at the detriment of predictability.[38] Similar problems emerged also in Hungary, though here, due to the clearer regulation, the charges registered in the centralized and computerized registry maintained by public notaries have been given clear priority.[39]

As CEE systems tend to embark on the upgrading of their secured transactions systems with the financial help coming from west, the model transplanted is as a rule the one promulgated by the donor. Having regard to the complexity and novelty of the field very few local experts truly understand what is at stake – especially if such diametrically opposite yet developed models are offered as the common law registration-based versus the German registration-hostile

Jefferson Law Review, vol. 31 (2010), at 279, 291; Krzysztof Kaźmierczyk and Filip Kijowski, *Enforcement of Contracts in Poland,* in: Stefan Messmann and Tibor Tajti (eds.), *The Case Law of Central and Eastern Europe: Enforcement of Contracts*, volume II (European University Press, 2009), at 521, 607.

37 The fiduciary security devices are also known as contract-based securities – or in German *kautelarische Sicherheiten* – and are the product of the innovativeness of businessmen, which were in need of security devices whereby inventory, equipment or receivables could have been used easily as collateral. Eventually German courts gave recognition to these innovations. From Germany then they spread to the neighboring countries. The two most popular devices are the 'security transfer' (*Sicherungsübereignung*) – used by banks – and the variations of 'retention of title' (*Eigentumsvorbehalt*) – used extensively by suppliers. See, e.g., Rolf Serick, *Securities in Movables in German Law: An Outline* (Kluwer, 1990); Tibor Tajti, *Comparative Secured Transactions Law* (Akadémiai könyvkiadó, 2002), chapter on Germany; or Tibor Tajti, *Viehweg's Topics, Article 9 UCC, the 'KautelarischeSicherheiten' and the Hungarian Secured Transactions Law Reform*, Vindobona Journal of International Commercial Law and Arbitration, vol. 6 (2001) (downloadable from SSRN), at 93.

38 As the non-registrable security devices are less costly, they used to be more popular than the common law-inspired registered pledges, what eventually brought the reform results into question. It is fair to say that the Polish hybrid system gives flexibility however at the price of increased risk of conflicts. See Kaźmierczyk and Kijowski, *op. cit.* (fn. 36), at 699.

39 See Zsófia Oláh and Csongor Nagy István, *Enforcement of Contract in Hungary*, in: Messmann and Tajti (eds.), *op. cit.* (fn. 36), at 216, 283; also see *ibid.* at 521, 607.

systems – as a consequence of what the stage for mistakes is set. Additionally, primarily because of the irreconcilable differences that exist between western systems, in fact no legislation exists on secured transactions law in the EU. CEE countries are, in other words, left at their own, yet hardly in the position to neglect the importance of the reform of secured transactions laws. The reasons are more or less obvious, on one hand, the financial assistance of EBRD (and other financiers) used to be conditioned on the existence of a credit-friendly system, and on the other hand, the rudimentary mortgage-cum-pledge laws inherited from socialism genuinely require upgrading to make crediting in particular of local businesses possible.

2.4. Organic developments

Some novelties have arrived to CEE without any kind of extraneous impact. Talking of new contract forms, besides 'leasing', the originally American invention – *franchise* – has become one of the most popular business patterns in the region; for various reasons, however, not to the same extent. For example, most of the ex-Yugoslav successor states or Lithuania are lagging behind even in the CEE region. Similarly, virtually out of nowhere, private collection agencies began to spread in the first decade of the 21st century. And yet none of these developments is to be attributed to the EU, where only some remotely relevant laws seem to exist (perhaps with the exception of those ECJ decisions that affect some franchise systems yet primarily from a competition law point of view).

2.4.1. The most successful new business pattern and advanced contract: franchise[40]

Even though the popularity of franchise is not equal in all post-socialist countries[41], the legal issues that surround this newcomer business pattern are

[40] The designation 'franchise' is known, for example, on the territory of the former Yugoslavia as *franšizing* (not spelled out as in English language). See, e.g., the document on franchise compiled by the Serbian Chamber of Commerce *Šta je to franšizing* [What is Franchise about?], http://www.pks.rs/portals/0/fransizing/Brosura%20za%20CD.pdf; last visited on 10 November 2012.

[41] While according to the data of the Hungarian Franchise Association (English language pages at http://www.franchise.hu/index.php?hir_old=14; last visited 10 November 2012) in Hungary there are about 300 – 350 companies that qualify or proclaim to be 'franchises', in some countries even no data is available or there is no franchise association (or similar organization). Though it is to be noted that the naming might be misleading as not all CEE countries have domesticated the English

very similar. Some countries have already introduced franchise-specific regulations[42], others are puzzled what to do - thereby leaving to courts to find the most resembling nominated contract regulated by local codes to solve franchise-related disputes.[43] Needless to say, such an approach makes these systems unpredictable; what not just may scare off foreign investors but may also give the final blow to otherwise promising indigenous franchise systems.[44]

Foreign franchise systems (e.g., Subway)[45] typically contract out of the jurisdictions of their franchisees as a method of protection against the bias of local courts. Though, *prorogatio fori* is not the only condition that is virtually dictated by the financially stronger franchisers: the manuals – containing the franchise agreement and many other related documents – are drafted by them and serve the end of maximal protection of franchisors' interests. Even where disclosure is imposed on franchisors, these voluminous and complex documents (or rather compendiums of various documents) are prohibitive burdens on individuals aiming to become franchisees; proper comprehension is thus a genuine problem.

Exactly because of these features of modern franchise transactions, one of the interesting legal issues CEE systems have been facing is whether asymmetry is the *sine qua non* of franchise agreements? Or, irrespective that the key features of franchise schemes are imposed by the franchisors and hence these contracts are misbalanced in favor of franchisors, are these contracts fully en-

(or French) 'franchise' term. This is the case, for example, in Ukraine where franchise is named as 'commercial concession' (*комерційна концесія*).

42 This is the case, for example, with Hungary, where the new (2010) Civil Code already recognizes franchise (and leasing) as nominated contracts and subjects them to *sui generis* rules.

43 That is the case, for example, in Ukraine where hence a debate is ongoing on the legal nature of franchise agreements. The predominant view (if that could be unambiguously determined due to the scarcity of legal writings on franchise, especially in English) is that franchise is such a complex transaction that contains elements of licensing, service, sales and agency contracts. See, e.g., Leonila Guglya and Oleksiy Kononov, *Enforcement of Contracts in Ukraine,* in: Messmann and Tajti (eds.), *op. cit.* (fn. 36), at 962, 1054.

44 For example, some completely Hungarian franchise systems have become real success stories, not just in Hungary itself, but also in some of the neighboring countries. Besides the franchises employed by the Hungarian national oil and gas company, MOL, the frozen bakery products system FORNETTI (http://www.fornetti.hu/mainpage_hu; last visited 10 November 2012) should be mentioned. For information on franchise in Slovenia see http://www.franchise-slovenia.net/.

45 The homepage of the Subway Corporation is at http://www.subway.com/subwayroot/index.aspx; last visited on 10 November 2012.

forceable? These are interesting legal issues given that the function of contract laws (and civil codes in general) is to maintain a fair balance between the parties and to remedy intolerable misbalances.

In a very instructive post-1990 Polish case, precisely this issue was raised. The facts of the case were simple. An unsuccessful franchisee of an ice-cream selling system by use of mobile sales points (*Family Frost – Polska Sp. z.o.o.*) wanted to escape from the obligation of paying the accumulated royalties, rentals and the price of goods supplied by the franchisor by blaming the franchisor for the failure of its outlet. Its main argument was that as everything was dictated by the franchisor, the failure of the outlet was to be ascribed to the franchisor. The Katowice court was asked to rule on the essential question whether franchise contracts are inherently asymmetric and if yes whether that makes the contract voidable?[46] The second instance court – obviously understanding the economy and essence of the newcomer franchise contract – correctly ruled for the franchisor and rejected the arguments of the franchisee as meritless (contrary to the opinion of the first instance). Otherwise, no special legislation existed on franchises in Poland at the time of the deciding of the case.[47]

Given that little (if any) data exist on the faith of the newcomer franchises in much of CEE, it is hard to draw far reaching conclusions on the basis of this single case. Yet it is fair to presume that courts have or will face the same issue in other countries of the region. As lawyers from the region hardly take a look at the experiences of their neighbors and as very little has been published in English or other more widely spoken foreign languages and consequently information on local experiences is normally inaccessible, one can just hope that similarly business-friendly decisions will be made in other countries as well. At the moment, however, little guidance of use could be expected from Brussels related to franchise contracts. That is a problem because finding of the proper balance between the legitimate interests of the inherently strategically more powerful franchisers and the exposed franchisees is a challenging task in the lack of clear laws. True, the model offered by the DCFR might be of use in that respect and could be taken as a major step made in the right directly; yet the animosity that surrounds the whole project cannot but point to the conclusion that the pattern will hardly make a substantial dent in history. In other words, finding the proper formula for franchise asymmetry versus protection of the weaker franchisees seems to have been left also to national lawmakers.

[46] Decision of the Court of Appeal in Katowice of 4 March 1998, in the case I ACa 636/98.

[47] See Kaźmierczyk and Kijowski, *op. cit.* (fn. 36), at 521, 653.

2.4.2. New industries: the case of collection agencies

Yet not only advanced contracts of the leasing and franchise-sort have enriched business practices of Europe after 1990. Private collection agencies[48] have appeared in many European systems virtually out of the blue and now they are spreading not just geographically but - in the lack of regulation - also as far as the scope of their activities is concerned.[49] This is a paradox given that according to black letter law only common law systems tolerate self-help as a debt collection method contrary to civilian jurisdictions that recognize only a very narrow version of self-help being restricted to mere self-defense of one's property or body from imminent threats.[50] As enforcement seems to remain an irresolvable problem, there will be a need for their services not just in Europe, but also in the countries aspiring for EU membership.[51] This raises the issue what the role of law and lawmakers should be *vis-à-vis* these newcomer businesses.[52]

48 The naming should not be misleading: these are private businesses having one of the forms for doing business known by the host countries laws (e.g., company, partnership or agency law).

49 As examples, let us mention a few international collection firms that have become successfully domesticated in a growing number of European countries: 'IntrumJustitia' being active in EU member states (http://www.intrum.com/), 'the EOS Group' (http://www.eos-solutions.com/) seated in Hamburg, Germany, is, however, active already, besides EU Member States, also in Russia, or in Croatia, Macedonia, Serbia and Slovenia.

50 According to German law two types of self-help are strictly speaking known: *Besitzwehr* (§859(1) BGB) being a form of self-defense, and *Besitzkehr* (§859(2) BGB) – the latter empowering "the possessor to recover the object from the dispossessor immediately after the interfering act." See Sjef van Erp and Bram Akkermans (eds.), *Cases, Materials and Text on Property* Law (Hart, 2012), at 115. This new book on an important aspect of European private law should be welcome even though – given that it contains a discussion on German 'self-help' but nothing on the same in English law – it creates that false impression that self-help is unknown in the British Isles. Quite to the contrary, English law is the most permissive in Europe in that respect.

51 It is another matter, yet theoretically and pragmatically interesting that the collection industry itself is undergoing changes in order to attract customers. CEE is lagging behind, though once present, local subsidiaries catch up quickly. It will be interesting to see what is going to happen to such firms as 'Michcon de Reya' specializing in "recovering substantial amounts for financial institutions … [by exploiting] a range of powerful litigation tools … [and] forceful injunctions to freeze and seize assets." See the website of the company at http://www.michcon.com (last visited on 10 November 2012) and the advertisement of the company in the Financial Times, 4 May 2011 issue, on page 1.

52 In particular instructive is the case of Romania, which has not only private repossession agencies run by local people, but has also quite widely embraced the US approach to self-help. After the initial warm welcome, however, the reaction of

Numerous problems have already arisen and have remained unnoticed (with a few exceptions) because of the mushrooming collection businesses though very little (if anything) could be made use of from EU law to combat their often times problematic business practices. The most alarming is that businesses operating in the twilight zone between legality and illegality (if not being active completely in the latter one) have also appeared in the market; primarily because the service of debt collection is very lucrative and there is a burgeoning market for it. In Europe, however, only a handful of states have first generation regulatory responses.

Additionally, as the rich experiences of the common law countries may easily show, private collection is not just prone to provoke violence, but tends to fall pray in the hands of the strategically and financially stronger collection agencies by many other ways – especially in consumer debtor cases. In other words, the existence of a very detailed regulation of what collection agencies can and cannot do, for example, in the United States[53] or Australia[54], is not without a good reason. As the consumer protection laws of the EU have not been drafted with these in sight, they are completely ill-suited to address the very real risks inherent to the activities of the providers of these services.

Irrespective that the European dimensions of this problem have not been properly researched yet, many queries may come to mind. One of the puzzles relates to which branch of law and what regulatory agency should be entrusted with the monitoring of the collection industry? This is more than a theoretical issue because it seems there is a serious confusion on the relationship of the collection industry with financial services in the form of 'factoring'. While factoring is looked upon as a legitimate business regulated as a financial service and is registrable with and hence monitored by local financial (banking) supervisory agencies, problems arise when a firm designated as 'factoring company' gradually expands to such forms of collection which clearly do not qualify as 'factoring'; like repossession of collateral (e.g., cars under leasing).

As virtually all kinds of debts could be expressed in an issued invoice – for the collection of what factoring companies are per definition specialized for –

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courts and much of the legal community has cooled down. See Klaudia Fábián, Alexandra Horváthova and Cătălin-Gabrial Stănescu, *Is Self-Help Repossession Possible in Central Europe?*, The Journal of Eurasian Law, vol. 83, No. 1 (2011), at 4.

53 The text of the 1978 federal *Fair Debt Collection Practices Act* can be downloaded at http://www.ftc.gov/bcp/edu/pubs/consumer/credit/cre27.pdf; last visited on 10 November 2012.

54 The Australian *National Consumer Credit Protection Act 2009 No. 134, 2009 - An Act relating to credit, and for related purposes* can be downloaded at http://www.comlaw.gov.au/Details/C2011C00150; last visited on 10 November 2012.

hardly is there anything that would prevent a factoring company (especially in the lack of clear regulatory prohibition) to do more than just merely advance cash for the transferred invoice.

It should be, hence, simply realized that EU law does not seem to offer the *panacea* to these types of problems. As the prohibition of self-help by venerable principles of civil codes is clearly not of any use[55], perhaps the wise thing would be to look for inspiration to common laws – no matter the raised eyebrows. Hardly would a detailed regulation similar to the US Fair Debt Collection Practices Act be of any detriment to consumer-debtors any of the CEE systems; especially if private collection has already entered through the back door.

2.5. Idiosyncratic problems and risks of individual countries: Focus on Central and Eastern Europe

While franchise and the unregulated problematic practices of collection agencies represent novel phenomena that are present also in Western Europe, let us mention examples that are idiosyncratic to CEE. Again, EU law – or even the laws of the leading European systems – would not necessarily offer the realistically implementable solutions.

2.5.1. Bypassed problems

a) Contempt of court rules[56] *and failed or partially successful bankruptcy reforms*

Although it is commonly known that numerous problems lessen the efficiency of the work of courts in CEE and some projects have, indeed, been

[55] For example, the new Hungarian Code contains the following principle in one of the very first articles: '§1:7. [Guarantying Court Enforcement] The enforcement of rights provided by this Act is through courts, unless otherwise provided.' (In Hungarian: "1:7. § [A bírósági út igénybevételének biztosítása] A törvényben biztosított jogok érvényesítése – törvény eltérõ rendelkezése hiányában – bírósági útra tartozik." (The Code was passed by the Parliament on 9 November 2009 – yet the various parts of it did not come into force at the same time. Entry of the full code is expected in 2013.)

[56] As Chesterman put it "the common law-maintains that judicial power to punish non-compliance with court orders under the doc-trine of contempt of court is inherently and incontrovertibly necessary for the workings of a system of administration of justice [and while] the civil law-operates without a general concept of contempt: the concept is 'simply unknown' […]" parallel rules exist just not in the form of a self-standing doctrine. Chesterman compared common law and the rules in the French Criminal and Civil Codes of Procedure. See Michael Chesterman, *Contempt: In the Common Law, but not the Civil Law*, The International and Comparative Law Quarterly, vol. 46, No. 3 (July 1997), at 521 – 560.

launched to remedy that, few (if any) seems to have targeted the question of how to increase the respect towards the judicial system with all of its paraphernalia and the analysis of the benefits that may follow from that. In other words, what could potentially CEE systems learn from common law 'contempt of court rules'. Truth be told, some experts from common law systems promote the idea of exactly doing the opposite: upgrading their contempt of court rules by transplanting civilian solutions; what however should not lead to the conclusion that everything is fine on this front in CEE.[57]

On the contrary: even though, for example, Montenegro has introduced a local version of 'civil contempt of court rules' by its new Civil Procedure Act of 1998[58] inspired by US law, the exploitation of the new possibilities by the judges remains an issue. Obviously generations will be needed to make the necessary mind shift that would ensure fuller implementation of the new possibilities; though – as visible in other CEE countries as well – the number of variations whereby courts are disrespected and eventually 'serving of justice' or effectuation of the law is hindered or prevented has increased in the post-1990 period.

It is to be noted as well that the understanding of the real role contempt of court rules play in the implementation virtually branches of law should be of interest to comparativists and reformers alike – notwithstanding of what it seems that this particular issue has been almost completely neglected so far. Reformers of bankruptcy laws of many CEE countries, for example, look puzzled at the poor results the western and – to a much lesser extent – US-law inspired new laws produce and the twisted crippling decisions that come out from under the hands of bankruptcy judges; let alone the numerous problems corollary to the activities of the bankruptcy trustees. It would not be mistaken to claim that in CEE bankruptcy is widely known among businessmen as a method whereby one can "legally" defraud one's creditors. Likewise, fraudulent conveyance and avoidance rules simply do not work and fraudsters can

57 Chesterman conclusion is that "[...] the 'message' which French law delivers to the common law is that the time seems ripe for abolition of the broad concept of contempt of court, at least, so far as criminal contempt is concerned, and for the substitution of a regime of suitably drafted criminal offences." *Ibid.*, at 560.

58 The rules are in chapter fourteen (sections 177 through 185) of the Act. See Biljana Đuričin, *Zakon o parničnom postupku Crne Gore* [The Civil Procedure Act of Montenegro] (IVPE Cetinje, 2004), at 83 – 88. The enthusiasm of Prof. Đuričin is the sole reason Montenegro has taken this, in the region unprecedented, yet obviously correct step. Good intentions are, however, often insufficient given – as Prof. Đuričin has herself noted – exploitation of the new possibilities by judges remains an issue. *Ibid.*, comment to the chapter on page 88.

easily remove assets from their businesses and then disappear and become judgment proof by resort to bankruptcy law itself.

Notwithstanding that the abuses of bankruptcy law are virtually common knowledge in many CEE countries, nobody seems to have taken a look at the role contempt of court rules may play in disciplining the debtors and other participants of the bankruptcy process. The usefulness of contempt of court rules in the context of criminal and in particular civil procedure is something natural but it is perhaps less known and yet of bigger importance to emerging markets trying to figure out how to make their laws more efficient that tailor-made contempts play a disciplining role as well in the context of many branches of business law.[59] Still, the documents produced by Brussels would be of little help in this respect either.

b) The irresolvable problem of circular indebtedness

A genuinely epidemic problem in CEE, grinding even entire industries to halt, is known as 'circular indebtedness'.[60] Perhaps the best example is the

59 In the years when one of the central questions is how to control the behavior of managers and directors, a burning problem both in East and the West, it is noteworthy to point, for example, to section 227(b) of Delaware General Corporation Law, which "empowers the Court of Chancery to cite a director or officer for contempt in disobeying a court order." In the lack of empirical evidences it is admittedly risky to state anything, yet based on the personal experiences of the author of this paper, even if similar powers are given to courts by a company act of a CEE country, they have been hardly if ever utilized. Company law-based litigation *per se* is in its infancy in CEE. Bankruptcy law is still quite obscure to most of the CEE lawyers and hence it is no wonder than that hardly could the post-1990 bankruptcy reforms be called as successful. Besides the impropriety and novelty of the rules, the myriad question marks that could be raised related to the training and activities of the fresh generations of would-be-bankruptcy trustees (typically called as žadministrators'), it is a major problem and the systems cannot really do much with the disrespect of bankruptcy rules and courts. In the light, the US cases like the *Fidelity Mortgage Investors (550 F.2d 47 [1976])* might be instructive on the potential role contempt of court rules may play for the betterment of the bankruptcy process. In this case, the private parties have been found in contempt of the court for initiating state court action without first getting permission for that from the bankruptcy court.

60 See, e.g., the 16 February 2009 article in the Montenegrin daily Pobjeda *U Crnoj Gori se povećava međusobna zaduženost kompanija* [The Inter-Company Indebtedness is Increasing in Montenegro] (http://www.pobjeda.co.me/citanje.php?datum=2009-02-16&id=158633; last visited on 10 November 2012). According to the memo prepared by the Representative Office of the Hungarian Chamber of Commerce and Industry related to the planned amendment of the late payment directive of 5 October 2009, in the Hungarian construction industry there is about 400 bn Hungarian Forints of circular debt (1€ was about 270 HUF in August 2011), half of which gets never paid because the debtor has disappeared, has ceased to exist or has

construction industry and in particular various major-governmental projects. In case of these public projects the government contracts only with a few major (often politically linked) contractors, who then sub-contract the works to a bigger number of typically small and mid-scale businesses not having any kind of leverage with the government. While often it is the government that triggers the chain-reaction of non-payments, the bigger problem is that the main contractors receive the payments but instead of transferring the due moneys to sub-contractors, they either “disappear” with the moneys or they refuse payment by resorting to the limited liability concept of company laws and to the “offerings” of bankruptcy law. Fraud or corruption is, however, not necessarily the only cause of circular indebtedness.

Here, EU has passed laws to remedy the problem[61] – though not to address specifically the problems of CEE countries. CEE countries, on the other hand, tend to resort in addressing this very problem to occasional nation-wide practices known as ‘multilateral set-off’.[62] As this exercise could not be but voluntary, the otherwise recalcitrant and fraudulent debtors could easily stay out of the initiative; what dooms many of these initiatives to nothing but wishful thinking.

Here, comparative law, with a glance at legal history, might be of help. It is exactly because of that surprising that notwithstanding the dimensions of the problem nobody seems to have ventured as far as taking a look at how, for example, the US has solved this, or resembling problems in the past. Had somebody done that, two research topics should have been centered upon: payment bonds as well as the Miller Act of 1935.[63] Even though employment

been liquidated. For Serbia, see for example the website of the company ‘mekompenzacije’ at http://www.mekompenzacije.com; last visited on 10 November 2012. Albeit a promising new system – HONEM (Highly Optimalized Network of Debt Elimination Management) – has been launched on 30 June 2011 in more European countries, it remains to be seen whether this will, indeed, yield satisfactory results. For the time being, circular-debt remains a huge problem.

61 See Directive 2000/35/EC of the European Parliament and of the Council of 29 June 2000 on combating late payment in commercial transactions (proposed to be ‘recast … in the interest of clarity’ and ‘to implement the Small Business Act’).

62 In the successor countries of Yugoslavia this is known as *multilateralna kompenzacija*.

63 The federal Miller Act (ch. 642, Sec. 1-3, 49 stat. 793,794, codified as amended at 40 U.S.C. §§ 3131-3134 - formerly 40 U.S.C. §§ 270a-270d) and the state analogue statutes – known as ‘Little Miller Acts’ – aim “to protect those who furnish labor and materials for public buildings and other public works in lieu of lien law remedies, which are not available for public projects.” Though in modern times “even private owners (who ordinarily are subject to mechanics’ liens against their property) often use private payment bonds to obtain the same type of protection as that

of payment bonds in government contracts would obviously add to the costs, it might be a price worth to pay if the problems surrounding circular indebtedness could be even partially solved. Taking a glance at UK experiences might have revealed that a device known as 'netting' would deserve closer scrutiny in trying to find the solution. Yet again, it would have to be recognized that EU law – at least in the form as known today – is not the magic box with the appropriate solution to this specific problem.

Salutary exceptions though do surface. Hungary has, for example, picked up the gauntlet, though primarily with respect to businesses that have resorted (among others) to bankruptcy to escape payment of taxes. Namely, according to an act passed in 2011[64], new companies cannot get registered with the company registry without the issued tax identity number (*adószám*) yet the issuance of which must be rejected by the national tax authority if it turns out that the person requesting it was an officer of a former company that was liquidated with leaving tax duties unpaid. This in particular relates to persons who had voting control in former limited liability or closed joint-stock companies. Although these measures are partially tackling also the problem of circular indebtedness and the first empirical data are encouraging[65], obviously are insufficient; notwithstanding the solemn words in a special program forged by the incumbent government.[66]

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which is available to public entities." See Loren D. Podwill, Randy L. Arthur and Linda M. Bolduan, *Scope of the Payment Bond Surety's Obligation*, in: Kevin L. Lybeck and H. Bruce Shreves (eds.), *The Law of Payment Bonds* (American Bar Association, 1998), at 2 – 3. See generally also W. Noel Keyes, *Government Contracts – Under the Federal Acquisition Regulation* (West, 2nd ed., 1996).

64 See *2011. évi CXCVIL törvény a csődeljárásról és a felszámolási eljárásról szóló1991. évi XLIX. törvény, a gazdasági társaságokról szóló 2006. évi IV. törvény, a cégnyilvánosságról, a bírósági cégeljárásról és a végelszámolásról szóló 2006. évi V. törvény, továbbá az ezekkel összefüggő egyes törvények módosításáról.* With this omnibus law the provisions of the bankruptcy, company, company registration and other linked laws were amended with the aim to speed up liquidation proceedings.

65 According to the data aired by a popular electronic business journal ("Egyperces – Gazdaság", referring to the business journal http://www.vilaggazdasag.hu) on 9 November 2012, since the stepping of the act into force the tax authority refused the issuance of the tax identity number in about seven hundred cases. In the same period, in the capital of Budapest (obviously hosting the biggest number of Hungarian businesses) 9,261 businesses were deleted from the company registry, while the number of new registrations is almost the double of that sum (18,277).

66 One of the major goals of the government that stepped in power in 2010, formed by the deemed-to-be rightist government named 'Fidesz' (Democratic Alliance of

3. IN LIEU OF CONCLUSIONS

The few examples mentioned above are only a few of the many important legal fields that seem to have been paid inadequate attention on the road towards the EU or unfortunately even after having acceded to the EU. Taking over the *acquis communautaire* is undoubtedly a daunting task that requires employing not just financial and human resources of a country but also diverting attention from problems that will not be resolved by EU law. Though, it would be fair to realize that EU law is not foolproof either: the more voluminous and complex it becomes the less easy it will be to determine what and what is not covered by it. The fact that EU Member States are also often caught by this trap, however, should not be a consolation for aspirants.

The prudent approach would be to pay regard also to what systems beyond Europe may offer notwithstanding the blinding euphoria spread by local politicians. Attention and hence some resources should be devoted also to the research of non-European laws. Easy to say, hard to do - yet solutions for local problems may be, indeed, found in Australian, Canadian or the law of the United States (federal or state). And eventually it would be worthwhile to bear in mind that while Asia is carefully looking at and is trying to learn from the experiences (*Horribile dictu*: mistakes!) of Europeans, that is not necessarily the case on the Old Continent (especially in the post-socialist countries of CEE). This paper aimed to highlight this simple yet unfortunate fact.

There is, however, another less directly visible suggestion this paper came up with. Namely if one juxtaposes the above examples and their causes, it should be realized that the role law plays on macroeconomic level has fundamentally changed during the last few decades. Now, protection of the (domestic) system from risks increasingly coming from outside is more than ever the task of law – similarly to what the ozone layer does when protecting the flora and fauna of the Earth from various radiations coming from the space. As our contemporary economic, financial and legal systems, however, are less constant; perhaps a better analogy is to equate law and regulation with the antivirus and firewall systems that protect our PCs from threats lurking at us from the moment we get linked to the Internet. Similarly to these computer-protection

Youth) was set to be combating debt. A separate plan, named after a Hungarian historical figure as *Széll Kálmán Terv* (Kalman Szell Plan) was drafted, point 16 of which foresaw passing of laws that would speed up enforcement and liquidation proceedings as well as making these more transparent.

tools, laws and regulations must also be updated regularly to withstand the ever newer generations of challenges. No better example could be served than the calamities caused by the 2008 Credit Crunch originating in the United States and affecting virtually the rest of the world with varying intensiveness.

In this computer-regulation-analogy, EU law is nothing more than one of the pivotal anti-virus programs, which also requires frequent updating. Besides it, however, other defense-shields are needed, what could be provided by – if noted, known and properly reacted-upon in due time – local lawmakers. In the light of that, the main argument of this paper is that many systems implementing EU law fail (or have failed) to realize exactly that and inadvertently presume that the transposition of EU law will make their systems failure-proof. For the same reasons it is likewise largely ignored that there is a significant room for regulatory competition.

These claims legitimately deserve to be questioned, criticized, and scrutinized to their core, yet it would be mistaken to sweep them off the table with a sleight of hand because the winning systems most presumably will turn to be those in which politicians and lawyers alike would not turn a blind eye to these considerations. At any event, emerging legal systems are well advised to open a new page in their history of legal education; the sooner, the better.

Summary

Tibor Tajti (Thaythy) *

KADA JE I ZAŠTO "PEČAT" EUROPSKE UNIJE NEDOVOLJAN? – UPOZORENJA SUSTAVIMA NA PUTU PREMA EUROPSKOJ UNIJI

Zbog primjene načela supsidijarnosti pravo Europske unije u svojoj je naravi nepotpuno. Stoga ni prijenos i usvajanje acquis communautairea, ni pravo i poticaji koji dolaze iz Bruxellesa nisu rješenje za mnogobrojne, svakodnevne pravne, ekonomske i političke probleme koji nisu u fokusu interesa Europske unije. To se često zaboravlja ne samo u zemljama pristupnicama već i u zemljama članicama. U radu je analiziran niz takvih pravnih i ekonomskih izazova s kojima su posebice suočene države jugoistočne

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Europe i države sljednice bivše Jugoslavije. Iako su primjeri ponajprije iz sfera građanskog i trgovačkog prava, izabrani slučajevi imaju i javnopravnu dimenziju. U vezi s rastućom, no istodobno i vrlo upitnom, djelatnošću novih agencija za naplatu dugova u regiji, na primjer, može se postaviti legitimno pitanje ustavnopravne naravi tko snosi odgovornost za izostanak regulacije. Isto vrijedi i za toleriranje tako velikih problema poput opće nelikvidnosti s lančanim učinkom.

Razlozi, povezani rizici, regulatorne reakcije (ako postoje) i poznata rješenja razlikuju se s obzirom na svaki od izloženih problema. Dok je većina postsocijalističkih država regije reformirala svoja prava realnog osiguranja tražbina (založno pravo) i još su u postupku prilagodbe novih instituta nadahnutih praksom common lawa, franšiza je gotovo neprimjetno postala jedan od najpopularnijih složenijih ugovora i poslovnih modela u regiji, iako ne svuda u istoj mjeri. U pogledu franšize ne samo da je izostala reakcija zakonodavca, već nedostaje i jasan odgovor na neka temeljna pitanja ugovora poput onoga je li nužna asimetričnost pripadajuća poslovnom modelu franšize u skladu s općim načelima privatnog, konkretnije građanskog prava.

Slučajevi piramidalnih prijevara i Ponzi shema instruktivni su zbog drugih razloga: nijedna postsocijalistička država nije izbjegla pojavu tih patoloških financijskih fenomena, a zbog izostanka odgovarajuće regulacije i sankcije postoji tendencija njihova ponovnog javljanja u promijenjenim oblicima. Kako se oni uobičajeno ne smatraju problemom u nadležnosti pravnika, zakonodavci, regulatori i suci koji su suočeni s ovim vješto prikrivenim poslovnim modelima ne mogu primjereno reagirati.

Zajednički nazivnik svih ovih problema i pojava jest da oni nisu regulirani pravom Europske unije te stoga ni bilo kakvo rješenje za njih nije ponuđeno tim pravom. Svaka jurisdikcija, pravni sustav određene države, ostavljena je stoga da sama pronalazi i primjenjuje primjerene pravne mehanizme radi zaštite od tih pojava i borbe s njima.

Ključne riječi: pravo Europske unije, financijsko pravo i financijski rizici, samopomoć, franšiza, pravni transplanti