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

Nicole Grmelová (Ed.)

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# PREFACE

Dear Ladies and Gentlemen,

These conference proceedings constitute a selection of papers submitted to the 14th International Scientific Conference "Law in Business of Se-lected Member States of the European Union" which was organized by the De-partment of Business and European Law, Faculty of International Relations, Pra-gue University of Economics and Business, Czech Republic. The conference was held in the University'
participants from both Europe (Ireland, Germany, Croatia, Poland, Romania, Greece, Slovakia, and the Czech Republic) and overseas (South African Republic, India). The conference was held in a hybrid format, being streamed online for those who could not join the conference venue in person and to reach a wider audience.

All papers were checked for their originality using the iThenticate software developed by Turnitin kindly provided by the Prague University of Economics and Business.

Unlike the conference events held in the past years, this conference has grown much more sustainable. Plastic water bottles were replaced by glass packaging, hence no plastic was produced during the entire conference event.

The conference has been supported by the Internal Grant Agency Project No. F2/44/2022 “Law in Business of Selected Member States of the European Union (14th annual conference)” of the Prague University of Economics and Business.

The conference organizers will be happy to welcome both international academics and practitioners to the 15th conference to be held next year between 26 and 27 October 2023 in Prague. For more information on the call for papers for the upcoming conference please check the conference webpage at https://lawinbusiness.vse.cz/.

**Nicole Grmelová**
*Chair of the Scientific Committee of the Conference*


FACULTY
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VŠE

# Abuse of the Consumer's Right to Withdraw from the Contract without Giving any Reason

**Monika Mikuškovicová**

Bc. Monika Mikuškovicová
monika.mikuskovicova@vsci.cz
ORCID 0000-0003-1782-2580
Student, Department of Private Law
CEVRO Institut, z. ú.
Prague, Czech Republic

***Abstract:***
Consumers are considered to be the weaker party in consumer relations. Their rights include the right to withdraw from a distance or off-premises contract without giving any reason, and without carrying any sanction. The article deals with the issue of abuse of such a right and its legal regulation anchored not only in the Czech, but also in the EU legislation and case-law. Of course, the issue is explored also in the context of principles of law; the main question being asked here is how to balance the principle granting a special protection to the weaker party and the principle prohibiting the abuse of rights. Furthermore, the article focuses on the specific type of abuse of consumer's right to withdraw from a contract, namely when the consumer makes the businessperson a "free products rental", and on the appropriate treatment of that practice.

***Key words:*** *abuse of rights, businessperson, consumer, principles of law, right to withdraw from a contract, weaker party*

## INTRODUCTION

The special right of the consumer to withdraw from the contract without giving a reason and without carrying any sanction is enshrined for consumer contracts concluded at a distance (distance contracts) and off-premises contracts concluded. The purpose of this right is to compensate for the disadvantages for consumers associated with the way such consumer contracts are concluded.[1] The significance of

1 LOOS, Marco. Rights of Withdrawal. In: HOWELLS, Geraint, and Reiner SCHULZE, eds. *Modernising and Harmonising Consumer Contract Law*. Munich: Sellier European Law Publishers, 2009, 237. 978-3-86653-082-9. DOI 10.1515/9783866538603.

this special right is also indicated by the fact it goes through the categories which the consumer law is conceptually divided into.[2]

A consumer contract is the legal reason for the creation of contractual obligations, where on one side the trader acts as a professional, and on the other side the consumer acts as a non-professional. The consumer is therefore the weaker party that must be protected. A consumer contract concluded at a distance within the meaning of Article 2 (7) Directive 83/2011/EU is a contract that is concluded between a consumer and a trader at a distance without the simultaneous physical presence of the parties. Another condition is the exclusive use of one or more means of distance communication, until the moment of conclusion of the contract (including this moment). Under Article 2 (8) Directive 83/2011/EU, a consumer off-premises contract is an offer made by the consumer or a contract concluded during the simultaneous physical presence of the parties in a place that is not the business premises of the trader. Such a place can be, for example, a hotel or the street. Another case may be a contract that is concluded at the trader's business premises or is concluded using means of distance communication, but only immediately after a personal and individual address to the consumer in a place that is not the trader's business premises. An off-premises contract is also considered a contract that is concluded during a trip organized by the trader, the purpose of which is the promotion and sale of goods or services to consumers.[3]

## 1. SPECIAL RIGHT OF CONSUMER TO WITHDRAW FROM THE CONTRACT – LEGAL REGULATIN OF THE EUROPEAN UNION

The right of consumer to withdraw from a distance contract or off-premises without giving a reason within 14 days is enshrined in the legislation of the European Union in Article 9 (1) of Directive 2011/83/EU of the European Parliament and of the Council of 25 October 2011 on consumer rights, amending Council Directive 93/13/EEC and Directive 1999/44/EC of the European Parliament and of the Council and repealing Council Directive 85/577/EEC and Directive 97/7/EC of the European Parliament and of the Council.[4] In case of unsolicited visits by a trader to a consumer's home or excursions organised by a trader with the aim or effect of

2 RICHTER, Štěpán. Consumer Protection in Contractual Practice of Supply of Digital Content and Digital Services. In: SKRABKA, Jan, and Nicole GRMELOVÁ (eds.). Challenges of Law in Business and Finance. Conference proceedings 13th International Scientific Conference "Law in Business of Selected Member States of the European Union". November 4-5, 2021, Prague, Czech Republic. Bucharest, Paris, Calgary: ADJURIS, 2021, pp. 211-212. 978-606-95351-1-1.

3 Directive 83/2011/EU of the European Parliament and of the Council of 25 October 2011 on consumer rights [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02011L0083-20220528.

4 Directive 83/2011/EU of the European Parliament and of the Council of 25 October 2011 on consumer rights [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02011L0083-20220528

promoting or selling products to consumers, Member States may extend the period for withdrawing from the contract up to 30 days. This period starts to run on the day following the day when the contract was concluded or the goods were delivered (the day the goods were taken into physical possession).[5] If the trader fails to provide the consumer with information on the right to withdraw from the contract, the period is extended by up to 12 months from the expiry of the original one (i.e. 12 months and 14 days). The right to withdraw from the contract is thus one of the fundamental means of consumer protection. However, the consumer's right to withdraw from the contract depends on whether the consumer is informed about this right, including information about the conditions, period and procedures for exercising such a right.[6] If the consumer is not informed (notified of the right to withdraw from the contract), they are not responsible for the reduction in the value of the goods. Not even if they handled the goods in a different way than was absolutely necessary to get to know them.

Under Article 11 of the Directive, the consumer has the right to withdraw from the contract using a standard form, or can make any other unequivocal statement setting out their decision. If the consumer does not use the standard form, under recital 44 of the Directive, the burden of proof that the consumer has withdrawn from the contract is borne by the consumer. The express declaration plays a key role, because if the consumer refuses the delivery of the goods or does not collect the goods at the post office, such action is not considered a valid expression of withdrawal from the contract.

Another essential deadline is, in the case of withdrawal from the contract by the consumer pursuant to Article 14 (1) of the Directive, the period of 14 days within which the consumer is obliged to send the goods back to the trader. Another option is that the consumer hands over the goods directly to the trader or to a person authorized by the trader. However, the consumer bears only those costs that are directly related to the return of the goods and of which the trader has informed them in advance. The trader can also pick up the goods themselves. However, in the case of contracts concluded outside business premises, if the goods cannot be returned by the usual postal route, the trader must collect the goods themselves at their own costs. The same period applies to the other contracting party, i.e. the trader. Under Article 13 (1) of the Directive, the trader is obliged to return all payments (including delivery costs) received from the consumer, but no later than 14 days from the date on which he was informed of the consumer's decision to withdraw

5 The period for withdrawing from the contract depends on when this period begins. In the case of a purchase contract, a contract for the provision of services, a contract relating to online digital content or a contract for the provision of public services, the beginning of the period is different.

6 Judgment of the Court of Justice of 23 January 2019. Walbusch Walter Busch GmbH & Co. KG v. Zentrale zur Bekämpfung unlauteren Wettbewerbs Frankfurt am Main eV. Case C-430/17 [online]. In EUR-Lex. [accessed on 2022-07-26]. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1658865957356&uri=CELEX%3A62017CJ0430.

from the contract. A different situation arises in the case of a purchase contract, where, according to Article 13 (3) of the Directive, the trader has the right to wait with the refund of payments until he receives the goods back from the consumer, or the consumer proves that he has sent the goods back. If, in such a case, when the 14-day period expires "*...the trader should reimburse the consumer without undue delay. What constitutes an "unnecessary delay" must be assessed on a case-by-case basis; however, under normal circumstances, a refund should not take longer than a few working days."*[7]

This brings me to the crucial Article 14 (2) of the Directive, in conjunction with Recital 47. These are the provisions that regulate the responsibility of the consumer for handling the goods in a manner other than what is necessary to familiarize the consumer with the nature, characteristics and functionality of the goods. If the consumer uses the goods to a greater extent than necessary, they do not lose the right to withdraw from the contract, but should be responsible for any reduction in the value of the goods.[8] This provision can be demonstrated by the example of a distance contract (specifically a purchase contract) where the consumer buys a mechanical wristwatch through an e-shop. Instead of just trying them on to see if they suit them in terms of their nature, characteristics and functionality, as would be possible if it was bought in a shop, the consumer decides to take it to the swimming pool. Water seeps into the watch during swimming, resulting in reducing the value of the goods.

According to the case law of the Court of Justice of the EU (CJEU), this right gives the consumer the opportunity to actually see the goods within a 14-day period, i.e. to make sure of the nature of the service provided, to examine and test it. The consumer can therefore generally use the purchased goods without fear that the trader would claim damages in the event of withdrawal from the contract or return of the goods.[9] At the same time, however, the aim is not to grant the consumer rights that go beyond what is necessary to exercise them. The judgment also refers to the reasoning of the directive, from which it follows that the Member States must lay down further conditions for the exercise of the right of withdrawal. In general, it can be said that the EU legislation prevents the national legislation from allowing the trader to claim compensation from the consumer for the use of the goods acquired by the consumer contract concluded at a distance. However, the principles of private law, such as the principles of good faith or unjust enrich-

7 Guidance on the interpretation and application of Directive 2011/83/EU of the European Parliament and of the Council on consumer rights. European Commission - European Commission [online]. 2021 [viewed 18 July 2022]. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52021XC1229(04)&from=EN.

8 STEENNOT, Reinhard. The Right of Withdrawal under the Consumer Rights Directive as a Tool to Protect Consumers Concluding a Distance Contract. Computer Law and Security Review [online]. 2013, 29 (2), 116-117. 0267-3649. DOI 10.1016/j.clsr.2013.01.005 [viewed 18 August 2022]. Available from: https://www.sciencedirect.com/science/article/abs/pii/S026736491300023X

9 ABRIL, Patricia, BLÁZQUEZ, Francisco, and Joan EVORA. The Right of Withdrawal in Consumer Contracts: A Comparative Analysis of American and European Law. University of Miami Business School Research Paper. 2018, 3, 33-34.

ment, must be taken into account. If the consumer has used the goods or service in a manner inconsistent with these principles, then they may be required to pay compensation for their use.[10]

The reduction in the value of the goods by the consumer is also taken into account by the Model Instruction on Withdrawal from the Contract (form) in Part A of Annex I to the Directive, where in paragraph 5 (c) the trader may state, in the event that the consumer has received the goods, that they are only responsible for such a reduction in the value of the goods that does not exceed the extent necessary to familiarize themselves with the nature, characteristics and functionality of the goods.

Therefore, the Directive does not regulate, in the context of the responsibility of the consumer for the depreciation of the value of the goods, whether or not the trader can initiate legal proceedings against the consumer. Alternatively, the question of whether the trader may charge the consumer for compensation or reduce any compensation by it (e.g. by returning all payments upon withdrawal) is not regulated. Here, therefore, we must apply the regulation of the Member States, or national legislation.

In another important case-law of the CJEU, it reflects the issue of opening the packaging of goods by the consumer in order to access its contents. The consumer should only be able to open the packaging of the goods under such conditions and in such a way as if the goods were normally unpacked in a shop. In this case, the ruling concerned a mattress, which is an exception because its protective film serves to protect health and is used for hygienic reasons. The court confirmed the explicit right to test the mattress, i.e. to unpack it. However, the far more important question is whether a mattress can still be considered "new" after it has been tested and the consumer has withdrawn from the contract. It depends on whether the trader is able to adjust the mattress to its original new condition (e.g. clean it). If the goods can no longer be sold as new to a third party, then the trader must mark such goods as used and thereby reduce their price.[11]

From the logic of the matter, therefore, the reduction in the value of the goods will primarily consist of the cost of repairing the goods, or the costs incurred by the trader when the goods can no longer be resold as new. The testing of the goods by the consumer and their degree of necessary familiarity with the goods will therefore have to be assessed on a purely individual basis. The starting point is what the consumer is allowed to do in the shop. For a better understanding, I will give a few examples to illustrate the situation. When a consumer bought a mobile phone, they would turn it on, load all the necessary data from the previous mobile phone

10 Judgment of the Court of Justice of 3 September 2009. Pia Messner v. Firma Stefan Krüger. Case C-489/07 [online]. In EUR-Lex. [accessed on 2022-07-17]. Available from: EUR-Lex - 62007CJ0489 - EN - EUR-Lex (europa.eu).

11 Judgment of the Court of Justice of 27 March 2019. slewo - schlafen leben wohnen GmbH v Sascha Ledowski. Case C-681/17 [online]. In EUR-Lex. [accessed on 2022-07-18]. Available from: EUR-Lex - 62007CJ0489 - EN - EUR-Lex (europa.eu).

and use it. In order to restore a mobile phone, it would be necessary to reboot (or configure the software) such a device, which leads to depreciation and cannot be considered new. The same would apply to the purchase of an electric kettle, the consumer could theoretically ask the shop for a demonstration of the goods, fill it with water and start it. However, when using an electric kettle, traces are left behind, which reduces the value of the goods. In other words, the buyer could be bothered by the fact that there are traces left in the kettle after the seller has put it into operation several times before. One of favourite examples is clothing. If the consumer buys new clothing, the necessary required level of familiarity with the goods is in this case testing, but not wearing or cutting off the price tag.

## 2. THE SPECIAL RIGHT OF CONSUMER TO WITHDRAW FROM THE CONTRACT – LEGAL REGULATIN OF THE CZECH REPUBLIC

Consumer protection as an independent constitutionally guaranteed right is not enshrined anywhere in the constitutional order of the Czech Republic, in contrast to EU law (see Art. 38 of the EU Charter of Fundamental Rights). However, the Constitutional Court of the Czech Republic, for example, bases its case law primarily on the fact that the consumer is in an unequal position towards the trader. The trader is considered to be a professional with a better knowledge of the law, and therefore the consumer is considered to be the weaker party in need of an increased level of legal protection.[12] However, it must be said that in the Czech Republic there is a lack of concretization of the consumer model contained in the legislation. The Czech courts, unlike the CJEU, require the consumer to act in contractual relationships as a person who is able to analyze information and who behaves rationally.[13] The right to withdraw from a consumer contract is enshrined in the legislation of the European Union and is further implemented into national legislation, specifically in Act No. 89/2012, the Civil Code. Domestic legislation must be harmonised with the European Union legislation, which is why in most cases the provisions are the same. According to Section 1829 (1) and (2) of the Civil Code, the consumer has the right to withdraw from a contract concluded remotely or outside the business premises within 14 days from the date of conclusion of the contract or receipt of the goods. This period is intended to protect the consumer and give them the opportunity to examine and test the purchased goods. However, if the consumer has not been informed of this right by the trader, the withdrawal period is 1 year and 14 days. If the trader instructs the consumer

12 Decision of the Constitutional Court of the Czech Republic of 11 November 2013. No. I.ÚS 3512/11 [online]. In NALUS. Ústavní soud České republiky. [accessed on 2022-07-26]. Available from: http://nalus.usoud.cz/Search/GetText.aspx?sz=1-3512-11_1.

13 SIMON, Rita. Consumer concepts in European and Czech Law with Regard to Contract-law Disputes. The Lawyer - Scientific Review for Problems of State and Law. 2018, 157(5), 405-406.

during this period in accordance with Section 1830 of the Civil Code, the period of 14 days is calculated from the day the trader has provided the requested instructions. Article 1831 (1) of the Czech Civil Code provides for a subsequent 14-day period for sending (possibly handing over) the goods back to the trader after the consumer withdraws from the contract. On the contrary, under Article 1832 (1) of the Czech Civil Code, the trader is obliged to return all funds to the consumer (including delivery costs), again within 14 days of withdrawal. The most important one is Article 1833 of the Czech Civil Code, according to which *"The consumer is liable to the entrepreneur only for the reduction in the value of the goods that occurred as a result of handling the goods in a manner other than what is necessary with regard to their nature and characteristics."*[14] However, this does not apply if the trader does not provide the consumer with information regarding their right of withdrawal, including the conditions, periods and procedures for exercising it. In the case of a consumer contract, the subject of which is the provision of services, the consumer is obliged under Article 1834 of the Czech Civil Code to pay the trader a proportionate part of the price for the performance, if the consumer expressly requested such performance before the expiry of the withdrawal period. The case where the trader is obliged to take the goods back from the consumer's household at their own expense is governed by Article 1835 of the Czech Civil Code. That provision makes that obligation subject to three conditions, which must be cumulatively fulfilled. It must be a withdrawal from a contract concluded outside the usual business premises of the trader. Another condition is that the goods were delivered to the consumer's household at the same time as the consumer concluded the contract. The third condition is that the nature of the goods does not allow the consumer to send it by the usual postal route (e.g. a fridge).

Under Article 1836 of the Czech Civil Code, the consumer does not bear any costs when withdrawing from a consumer contract, if the subject of the contract is the provision of services and the trader has not met the statutory information obligation towards the consumer, or if the trader has fulfilled it before the expiry of the withdrawal period.

The legislation on withdrawal from distance and off-premises contracts contained in the Czech Civil Code is very similar to the Consumer Rights Directive and to the Proposal for a Regulation of the European Parliament and of the Council on a Common European Sales Law (CESL)[15]. The right to exercise the right of withdrawal and its effects coincide with all three legislations. The legislation also similarly require the traders to provide the consumer with information on the possibility of withdrawal, together with a model withdrawal form, before conclud-

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

15 Proposal for a Regulation of the European Parliament and of the Council on a Common European Sales Law COM/2011/0635/final-2011/0284 (COD) of 11 October 2011 [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52011PC0635.

ing the contract. The 14-day withdrawal period is the same, too. The limitation of the right of withdrawal is regulated in a very similar way in all three regulations, but the most elaborate list of exceptions to the right of withdrawal contains CESL, which lists exceptions and also adds some of them. The legislation on the return of goods no later than 14 days after withdrawal is less favourable for traders in the Czech Civil Code than in the legislation on CESL and the Consumer Rights Directive. European regulations explicitly give consumers the possibility, unlike the Czech Civil Code, to pick up goods from consumers by the traders themselves.

## 3. THE SPECIAL RIGHT OF THE CONSUMER TO WITHDRAW FROM THE CONTRACT IN THE CONTEXT OF LEGAL PRINCIPLES

The specific right of the consumer to withdraw from a distance or off-premises contract is at the intersection of several legal principles. Legal principles play an essential role in finding a solution to any legal issue *"...courts must try to find a principle that does provide a solution to the case and fits with the relevant legal materials and with the prevailing political morality."*[16] On the one hand, it is about protecting the weaker party (i.e. the consumer). However, if the consumer uses the goods beyond the extent necessary to familiarize themselves with the purchased goods without having the will to acquire ownership of such goods (e.g. clothing that the consumer buys only with the vision of one use for a special event), it is necessary to assess whether it is a legal act not exceeding the legal limit. The principles of civil law should be applied in the resolution of any disputes. On the other hand, there is one of the principles of civil law, namely the prohibition of abuse of rights. In the event of obvious misuse, the abuse of rights is enshrined in Article 8 of the Czech Civil Code and does not benefit from legal protection. The Czech Civil Code used the word "obvious" with regard to the fact that even the prohibition of abuse could be abused; the point is that *"there must be no doubt as to the materiality of the facts in the legal assessment."*[17] However, when it comes to resolving factual disputes, it is already a very thin line. When in doubt, the one who has a subjective right and invokes it must be protected. Individual disputes must therefore be dealt with on a truly individual basis. Mention should also be made of the special case of abuse of rights concerning bullying behaviour, the purpose of which is to cause damage to the other party. Another relevant principle of civil law is Article 7 of the Czech Civil Code, which can also be applied in the resolution of a dispute. It is a legal presump-

16 HESSELINK, Martijn. The General Principles of Civil Law: their Nature, Roles and Legitimacy. Centre for the Study of European Contract Law Working Paper Series [online]. 2011, 14, 16. [viewed 02 August 2022]. Available from: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1932146.

17 ELIÁŠ, Karel. Nový občanský zákoník s aktualizovanou důvodovou zprávou a rejstříkem. Ostrava: Sagit, 2012, 68. ISBN 978-80-7208-922-2.

tion that a person who has acted in a particular way has acted honestly and in good faith. At the same time, however, the principle of good faith protects the subjects in their actions. According to this principle, the rights of the consumer cannot be restricted, as this would lead to a violation of the law, as well as all domestic and European principles. In particular, the responsibility of the consumer towards the trader for the reduction in the value of the goods, which arose as a result of the handling of the goods in a way other than necessary and with regard to the nature and characteristics of the goods, could be more freely expressed by saying that the inadmissibility of restricting the exercise of the special right of the consumer to withdraw from the contract in terms of the motives of this step and the prohibition of the abuse of this right are not in direct conflict, but the relationship between them is very sensitive (and it will often be very difficult to balance them).

For example, just like the Czech Civil Code, the new Hungarian Civil Code (HHC) has also been drafted, according to which the concepts of good faith, fair dealing and the prohibition of abuse of rights have the same root, but they are not actually equal. The prohibition of abuse of rights is not the "final frontier" of conduct that does not meet the requirement of good faith.[18]

The trader is protected to a certain extent, even explicitly in several provisions. Under Article 1833 of the Czech Civil Code, the consumer is obliged to pay the trader the costs for the reduction in the value of the goods, which arose as a result of handling the goods in a manner other than necessary and with regard to the nature and characteristics of the goods. Sometimes this is not the case, and protection against abuse of the consumer's special right to withdraw from the contract must be inferred from the general prohibition of abuse of rights. This "interpretative" protection is more demanding in terms of argumentation, and therefore the more general conclusions of the case-law of the EU judicial institutions concerning the protection of the trader against the abuse of the special right of the consumer to withdraw from the contract are of particular importance. Therefore, if the trader could prove that the consumer used the thing without a real will to own it, then the above-mentioned principles of civil law would be applied instead of the provisions of Article 1833 of the Czech Civil Code.

For example, the German Federal Court of Justice (BGH) has stated that if a consumer compares prices on the market and requires the trader to pay the difference in the price for withdrawal; this cannot be considered an abuse of rights. It is only an advantage provided by the protection of consumer rights and a competitive market.[19]

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18 PUSZTAHELYI, Réka. Abuse of the Right of Unilateral Termination in Contract Law. *Acta Universitatis Sapientiae, Legal Studies* [online]. 2018, 7(1), 52. [viewed 02 August 2022]. Available from: https://view.officeapps.live.com/op/view.aspx?src=https%3A%2F%2Flawinbusiness.vse.cz%2Fwp-content%2Fuploads%2FConference-paper-template-Law-in-Business.docx&wdOrigin=BROWSELINK.

19 Judgment of the Federal Court of Justice, Germany of 16 March 2016. No. VIII ZR 146/15 [online]. In Entscheidungen. Bundesgerichtshof. [accessed on 2022-08-02]. Available from: http://juris.bundesgerichtshof.de/cgi-bin/rechtsprechung/document.py?Gericht=bgh&Art=en&nr=74440&pos=0&anz=1.

In the case of the special right of withdrawal, it is an exception to the general contract rule *pacta sunt servanda*, which raises the question of whether this exception has had a positive impact for the consumer in terms of his protection.[20]

## 4. CASES OF "FREE RENT"

Cases in which the consumer abuses the special right of withdrawal may vary; extreme cases include *"...the consumer "just borrowed" the good for a singular occasion"*.[21] It is these cases that I will focus on in the last part of my article. Cases where the consumer has borrowed goods, obviously used them and then returned them, saying that he has the right to do so and that they are not obliged to do anything because of the obvious use, are often almost comical. However, for traders, this can pose a significant problem that is not explicitly addressed by the law. The main problem here is the trader's burden of proof. The latter must prove that it is an abuse of rights on the part of the consumer, because, as already mentioned above, abuse of rights does not enjoy legal protection. For example, if a consumer buys a camera for the purpose of taking beautiful holiday photos, after returning from holiday, they will be able to withdraw from the consumer contract within 14 days. When returning the goods, the trader discovers the consumer's holiday photos in the camera, as well as the sand inside the camera. This is something that consumers have been doing for quite some time. The consumer does not have to state the reason why they wish to withdraw from the contract and the trader is not entitled to inquire about such a reason. Nor should the trader, by definition, take any steps in this regard to investigate why the consumer actually withdrew from the contract. So how can the trader defend themselves against such abuse?

If the trader opts for the solution of "free renting", it is necessary to take care of the link to the protection of the consumer's personal data. One of the options to counter "free renting" could be to examine the consumer's "purchase history" with this trader (consumers who repeatedly purchase the trader's goods for the purpose of abusing their rights could be put on a list; a "blacklist"). If a consumer were to grant consent to the processing of personal data for a specific purpose in accordance with Article 6 (1) (a) of the GDPR[22], in this case consent to the use of their purchase history, in my opinion, this could be a lawful processing of personal

20 LUZAK, Joasia. To Withdraw or Not to Withdraw? Evaluation of the Mandatory Right of Withdrawal in Consumer Distance Selling Contracts Taking into Account Its Behavioural Effects on Consumers. Journal of Consumer Policy [online]. 2014, 37(1), 106. DOI 10.1007/s10603-013-9249-6. [viewed 03 August 2022]. Available from: papers.ssrn.com/sol3/papers.cfm?abstract_id=2243645.

21 ROCKENBACH, Bettina. Fairness Crowded Out by Law: An Experimental Study on Withdrawal Rights. *Journal of Institutional and Theoretical Economics JITE* [online]. 2007, 163(1), 106. 0932-4569. DOI 10.1628/093245607780181964 [viewed 04 August 2022]. Available from: https://www.researchgate.net/publication/5174402_Fairness_Crowded_Out_by_Law_an_Experimental_Study_on_Withdrawal_Rights_Comment.

22 Regulation (EU) No 679/2016 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data (General Data Protection Regulation) [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32016R0679.

data. However, this solution has two drawbacks. Firstly, the requirement of such consent by the trader may be to the detriment of the freedom of consent required by Article 7 (4) of the GDPR. Secondly, consent may be withdrawn in accordance with Article 7 (3) of the same regulation.

This brings us to the question of whether it would be a lawful processing of personal data even if the trader used the consumer's purchase history in a case where there is evidence of abuse of the right to withdraw from the contract by the consumer, and the consumer does not give such specific consent at all. Then it would be possible to consider Article 6 (1) (f) of the GDPR, which authorizes the processing of personal data[23] that are necessary for the purposes of the legitimate interests of the trader (or third party). This solution will have to be subjected to a proportionality test, where, on the one hand, the protection of the consumer's personal data is considered, and, on the other hand, the protection of the trader against the abuse of the right by the consumer. This test must consider the circumstances of the individual case, so that its result may be questionable; however, this must be taken into account and is not a reason to reject such a solution outright.

## CONCLUSION

*"In Europe, mandatory rights of withdrawal exist for transactions that take place by phone or on the Internet, and other transactions that do not fully take place on the premises of the seller. Depending on the type of transaction, consumers may have as long as two weeks to return the goods for a refund. These rules apply to a range of transactions, including ordinary goods, services, and loans, and sellers cannot opt out of them."* In this sense, the right of the consumer to withdraw from the contract, which is enshrined in EU law, can be described as "generic".24 Consumer contracts concluded at a distance or off-premises carry a number of uncertainties and risks for the consumer when purchasing goods. The compensation for the consumer is the extensive protection of his rights, which in the case of a special right of withdrawal can be easily abused. It could be said that this protection gives the consumer the room to change their decisions regarding the purchase of goods and change their mind whenever they want, instead of behaving reasonably and honestly towards the trader. At the same time, the trader does not have the possibility to defend themselves in this respect in a direct way, by means of firmly established provisions. Courts and their jurisprudence play a crucial role in achieving justice. The solution of how to fight against consumers is not clear-cut and often hovers on the borderline of legality. Therefore, there is a need to define narrower limits

23 KARPAT, Andrej. Právní podklad pro zpracování údajů v souladu s GDPR. In: Právo v podnikání vybraných členských států Evropské Unie – sborník příspěvků k X. ročníku mezinárodní vědecké konference. Praha: TROJAS, 2018, 138. 978-80-88055-04-4.

24 BEN-SHAHAR, Omri, and Eric, POSNER. The Right to Withdraw in Contract Law. *The Journal of Legal Studies* [online]. 2011, 40(1), 116. DOI 10.1086/658403 [07 August 2022]. Available from: https://www.jstor.org/stable/10.1086/658403.

within the consumer's right of withdrawal, so that the right of withdrawal becomes the exception rather than the rule. On the other hand, these limits should not be so narrow as to discourage consumers from buying goods, so that the market mechanism is preserved.

In my opinion, the aim should be to increase the motivation of the consumer before buying the goods, but also after the purchase to properly consider all aspects of a possible withdrawal from the contract and to take this solution as a last resort. Simply put, the consumer should follow the rule "measure twice, cut once". Rules such as the consumer's obligation to pay the costs of the delivery of the goods (Article 13 (1) of the Directive), or the obligation of the consumer to pay the cost of returning the goods (Article 14 (1) of the Directive).25 It would also be worth considering a change to the 14-day withdrawal period. For individual types of contracts, the withdrawal period should be different and, in some cases, even shorter. It is very important to reflect the trends that have emerged due to the COVID pandemic. Online shoppers have started to use more and more multichannel marketing and click and collect vs. click and reserve retailing strategies. In these cases, where consumers order goods and then pick them up at the point of sale, the problem is solved by being able to get acquainted with the goods on the spot. These types of strategies also have the advantage that the consumers do not have to pay often expensive postage. Such transactions could contribute to a balanced exercise of the consumer's right of withdrawal.

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25 WATSON, Jonathon. Withdrawal rights. In: TWIGG-FLESNER, Christian, eds. *Research Handbook on EU Consumer and Contract Law*. UK: Edward Elgar Publishing Limited, 2016, 248. ISBN 9781782547365.

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# Tax savings for financial institutions in the Slovak Republic after applying the super deduction for research and development

**Lea Jančičková, Renáta Pakšiová**

Ing. Lea Jančičková
lea.jancickova@euba.sk
ORCID 0000-0002-0535-6124
PhD student, Department of Accounting and Auditing
Faculty of Economic Informatics, University of Economics in Bratislava
Bratislava, Slovakia

Prof. Dipl. Ing. Mgr., PhD. Renáta Pakšiová
renata.paksiova@euba.sk
ORCID 0000-0002-3833-9339
Professor, Department of Accounting and Auditing
Faculty of Economic Informatics, University of Economics in Bratislava
Bratislava, Slovakia

***Abstract:***
Financial institutions are intermediaries in the capital market with SDG preferences, in their business some respond to the increasing demand for technologically more advanced products, services, innovative procedures, and tools by their own R&D. Since 2015, there is a super deduction of R&D costs in Slovakia, which can be applied by companies if they also carry out R&D in addition to their activities and meet the conditions for its application. The aim of the paper is to evaluate the R&D costs and the income tax savings of financial institutions in Slovakia in 2015-2020 due to the applied super deduction. A quantitative analysis of the costs of the super deduction and the amount of savings is carried out in 4 banks and 1 insurance company that used the super deduction. The institutions totally keep higher profit after tax by 4,142,312.85 euros, as their income tax decreased due to the applied R&D super deduction and a saved capital has the potential for institution sustainable development.

***Key words:*** *super deduction, research & development, financial institution, tax savings*

## INTRODUCTION

The global economy is currently facing new challenges in context SDG that are not only related to globalization, the advent of new technologies, the promotion of creativity[1] and the transition to a knowledge-based economy, but especially to the ongoing Covid19 pandemic and military conflict in Ukraine.[2] For all activities is important capital. The result is rapidly rising prices in markets with increasingly strong global competition, which forces companies to provide value-added products, processes and services. The flow of capital should be guided by financial institutions with the application of the EU taxonomy regulation of activities in accordance with sustainable finance, assessing contracts based on cost-benefit assessment.[3] The EU taxonomy helps guide the flow of capital by classifying activities with an impact assessment in line with sustainable finance in the context of the SDGs. By applying the EU taxonomy, financial institutions can direct the flow of capital to activities aimed at fulfilling the SDGs. R&D is a tool for improving of entities in all fields through the application of various supports. It also has the potential to improve aspects of sustainability in all business sectors. Financial institutions are specific and there is important to explore their contribution to sustainability, digitization, and efficient use of equity capital for innovation through the application R&D and saving own capital too.

The role of investment in R&D is becoming significant, as it is often considered an essential driver of innovative results and maintaining a competitive position in the market.[4] For the long-term viability of modern companies, investments in R&D are important, especially in the conditions of a constantly changing business environment.[5] Companies should be motivated to invest in R&D in order to develop their competitive advantages[6].

Subsidies or various fiscal incentives intended for R&D are used by most OECD countries. Governments in these countries try to use various incentives to stimulate innovation. However, the effectiveness of the mentioned tools depends on the coun-

1 BORSEKOVÁ, Kamila. et al. The Nexus between Creative Actors and Regional Development. *Land* [online], 2021, 10(3): 276. [viewed 24.08.2022]. Available from: https://doi.org/10.3390/land10030276.

2 This paper is the result of the research project: "Use of income tax savings resulting from the super-deduction of R&D costs in the business environment in the Slovak Republic".

3 HOUSKA, Daniel. Dusk over the european contract law? Cost-benefit assessment: A review. *Lawyer Quarterly*, 2019, 9(4), pp. 359–366.

4 ARKHIPOVA, M., et. al. Cooperation in R&D as a Leading Indicator of Innovative Activity Growth. International *Journal of Economics & Business Administration* [online], 2019, 7 (Special 2), 242-257 [viewed 24.08.2022]. Available from: https://doi.org/10.35808/ijeba/389.

5 MacGREGOR PELIKÁNOVÁ, Radka. R&D expenditure and innovation in the EU and selected member states. *JEMI – Journal of Entrepreneurship, Management and Innovation* [online], 2019, 15(1):13-33 [viewed 24.08.2022]. Available from: https://doi.org/10.7341/20191511.

6 RAVŠEJL, Dejan, et. al. The Impact of R&D Accounting Treatment on Firm's Market Value: Evidence from Germany. *The Social Sciences* [online], 2019, 14(6), 247-254. [viewed 24.08.2022]. Available from: https://doi.org/10.36478/sscience.2019.247.254.

try's fiscal system and the goals of its programs. [7, 8] In commercial law, we find legal norms that regulate the status of entrepreneurs, business, and taxes. Tax law is very important in the field of business law, from the point of view of sustainable business, because it creates the conditions for maintaining the capital produced in the business for further activity. The effectiveness of the legislation favouring the R&D super deduction to reduce the tax burden serves the benefit of meeting the goals of sustainable development, innovation, and R&D support in all economic spheres of the economic space. At the beginning of 2015, the Slovak Republic started to use a new type of tax incentive, the so-called "super-deduction", which is aimed at supporting companies engaged in R&D (most often it concerns the progress of new or meaningly innovative products, improved technologies, processes and services). This type of incentive constitutes a fair, transparent and less administrative demanding form of support for business R&D. The most advanced economies of the world, including countries of the Visegrad Group[9], use similar types of support for the implementation of R&D. The super deduction for R&D costs represents state support intended for businesses, and self-employed persons who carry out R&D. The support is provided in the form of a decrease of the tax burden, as it allows for the deduction of a higher amount of expenses (costs) spent on R&D, and their multiple inclusion when submitting a tax return for income tax after meeting the conditions set out in the Income Tax Act.[10] We encounter the provision of tax incentives and direct subsidies to support private investment in R&D implemented by the governments of most countries.[11]

The Taxonomy of the European Union is closely connected with R&D support, the main goal of which is to direct private investments into activities that are necessary to achieve climate neutrality. The taxonomy and other EU directives result in new requirements for companies and financial institutions in the reporting of non-financial information. Banks and other investors will require more and more companies to meet higher sustainability requirements.[12] Sustainable development has long been the focus of the European project regarding the economic, social and environmental burden. We speak of sustainability in an R&D research project when

7 EUROPEAN COMMISION. Raising EU R&D Intensity. Improving the Effectiveness of Public Support Mechanism for Private Sector Research and Development: Fiscal Measures. EUR 20714, DG for Research Knowledge Based Society and Economy Strategy and Policy, Investment in Research, Luxemburg [online]. 2005 [viewed 24.08.2022]. Available from: https://op.europa.eu/en/publication-detail/-/publication/70d44ab5-120f-4ecc-8060-ff0e5299046f.

8 ARROW, Kenneth. Economic Welfare and the Allocation of Resources for Inventions. In: R. Nelson (Ed.), *The Rate and Direction of Inventive Activity*. Princeton University Press, 1962, 609-626.

9 BOCKOVA, Nina. Research, development and innovations in Czech manufacture of electronic products. Equilibrium. *Quarterly Journal of Economics and Economic Policy*, 2015, **10**(4), 163–180.

10 SLOVAK REPUBLIC Act No. 595/2003 Coll., on income tax [Act No. 747/2004 Coll., on the supervision of the financial market and on the amendment of certain laws].

11 D'ANDRIA, Diego., et. al. Towards a European R&D incentive? An assessment of R&D provisions under a common corporate tax base. *Economics of Innovation and New Technology* [online], 2018, 27 (5-6), 531-550 [viewed 24.08.2022]. Available from: https://doi.org/10.1080/10438599.2017.1376168.

12 EUROPEAN COMMISSION. EU taxonomy for sustainable activities. [online], 2022. [viewed 24.08.2022]. Available from: https://finance.ec.europa.eu/sustainable-finance/tools-and-standards/eu-taxonomy-sustainable-activities_en.

it is possible to ensure the continued use of its results even after the project is completed. In the context of sustainability, the most discussed topic is responsibility for the environment. A responsible environmental culture can be supported externally (supporting resource conservation, biodiversity, supporting the environment with friendly activities), but also internally (maximizing savings, minimizing waste, used energy, supporting recycling). Financial institutions develop this concept even further when they declare that the reason is social sustainability - why they were founded. Československá obchodná banka, a.s. states that sustainability and ecology are part of its DNA.[13] A financial institution can be defined as a company dealing with financial and monetary transactions such as loans, deposits, investments, and exchange currency. Financial institutions include a wide range of business operations in the financial services sector, including banks, insurance companies, trust companies, brokerage firms and securities dealers.[14] The activities of these institutions are regulated by the state. Financial institutions are an important element of the flow of capital in the country's economy, therefore the stability of this sector providing financial services is very important. Banks act as the main financial institution in the economic growth and development of any country.[15] The progress and strength of a country's financial situation depend on the health of its banking sector.16 The banking sector also provides various services for the expansion of the economy.17 Commercial banks have a large share in the country's economic activities, and therefore the financial sector is subject to more rigorous control by regulators in individual states as well as in the European Union. Monitoring the development of the economic condition of individual entities of the financial sector can prevent damage that would occur in the economy in the event of problems in individual elements of the financial sector. The financial sector generally has stricter legal regulation than ordinary entrepreneurs, but the possibility of applying the super deduction for R&D costs for income tax in Slovakia has the same rules as apply to all natural and legal persons. In the Slovak Republic according to § 1 par. 3 letter a) of Act no. 747/2004 Coll. on the supervision of the financial market and on amendments and additions to certain laws National bank of Slovakia (further on "NBS") supervises the supervised subjects

13 STANKO, Silvie. Corporate Social Responsibility as a Group Interest. Proceedings of the 13th International Scientific Conference. Prague: TROAS, s.r.o., 2021, 109-119, ISSN: 2571-4082. [viewed 24.08.2022]. Available from: https://lawinbusiness.vse.cz/wp-content/uploads/Law-in-Business-Conference-Proceedings-2021.pdf.

14 HAYES, Adam. What is financial institution (FI)? Investopedia [online], 2022 [viewed 24.08.2022]. Available from: https://www.investopedia.com/terms/f/financialinstitution.asp.

15 GAZI, Md Abu Issa, TALUKDER, A. S. *Customer Satisfaction in Banking Sector: A Study on EXIM Bank Limited*. In: University of South Asia Journal, 2017, 3(1), 105-117.

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17 KENOURGIOS, Dimitris, & SAMITAS, Aristeidis. Financial Development & Economic Growth in a Transition Economy: Evidence for Poland. *Journal of Financial Decision Making* [online], 2009, 3(1), 35-48 [viewed 24.08.2022]. Available from: https://www.researchgate.net/publication/228257121_Financial_Development_and_Economic_Growth_in_a_Transition_Economy_Evidence_for_Poland.

of the financial market.[18] When supervising financial market entities, the NBS also oversees compliance with the rations of rightfully binding acts of the European Union, which apply to controlled entities or their activities, if these legally binding acts provide for it. The NBS cooperates in the supervision of controlled entities with other domestic and foreign institutions and authorities, especially regarding making available and providing the required information. The European Supervisory Authorities issue guidelines and references addressed to competent experts or financial institutions to create consistent, effective, and efficient supervisory procedures within the European System of Financial Supervision (ESFS) and to ensure the common, uniform, and consistent application of the European Union law. Competent establishments and financial institutions will make every effort to comply with these guidelines and recommendations.[19] In addition to financial information, the assessment of published non-financial information through indicators is also important when evaluating the presented financial institutions.[20]

The article analyses financial institutions operating in the Slovak Republic, which at the same time applied the super deduction for R&D costs from 2015 to 2020, with a focus on the amount of their income tax savings in the monitored period because of the applied super deduction for R&D costs. The aim of the contribution is the analysis of the application of the super deduction for R&D costs with a focus on the analysis of income tax savings of financial institutions in Slovakia due to the applied super deduction of R&D costs from 2015 to 2020.

## 1. DATA AND METHODOLOGY

The article analyses financial institutions with their headquarters in Slovakia, residents of the Slovak Republic, whose main activity according to SK NACE is not R&D, but they carry out R&D beyond the scope of their business activities in the Slovak Republic and have applied the super deduction, as an additional deduction of costs for R&D for the tax period of 2015-2020. The analysed sample of all financial institutions preparing financial statements according to IFRS and applying the super deduction for R&D costs in 2015-2020 includes 4 banks and one insurance company.

The data needed for the analysis are from freely available sources published on the website of the Financial Administration of Slovakia. Under the leadership of the Ministry of Finance of Slovakia, the Financial Administration of Slovakia supervises compliance with generally binding legal regulations, EU regulations and interna-

18 SLOVAK REPUBLIC Act No. 747/2004 Coll., on the supervision of the financial market and on the amendment of some laws [Act No. 747/2004 Coll., on the supervision of the financial market and on the amendment of certain laws

19 NATIONAL BANK OF SLOVAKIA. Supervision legislation. [online], 2022 [viewed 24.08.2022]. Available from: https://nbs.sk/dohlad-nad-financnym-trhom/legislativa/legislativa/.

20 DOKULIL, Jiri, POPESKO, Boris, and KADALOVA, Katerina. Impact of Non-financial Performance Indicators on Planning Process Efficiency. *International advances in economic research*, 2022, 27(4), 329–331.

tional treaties, thereby ensuring the implementation of trade, customs, and tax policies. Its main mission is to fulfil the revenue part of the state budgets of Slovakia and of the European Union, through an effective collection of taxes and duties.[21] The Financial Administration of Slovakia collects the necessary data on R&D companies from completed and submitted tax returns (regular, additional, or corrective). In their tax returns, companies fill in the number of R&D projects, the goals of the projects and the actual amount of the super deduction for the given tax period.[22] Data is selected for the initial sample, which includes business entities applying the super deduction for R&D costs[23] in Slovakia in the period from 2015 until 2020, when the complete data is published. From the initial sample, we filtered out all financial institutions that claimed the super deduction for R&D costs for the tax period from 2015 to 2020.

Table 1 lists the companies that meet the conditions of being financial institutions and applied the super deduction of R&D costs in income tax in 2015-2020 at least once and represent the sample analysed further. For the examined institutions are used the official names from the Business Register of the Slovak Republic in the Slovak language.[24]

**Tab. 1: Investigated financial institutions (2015–2020)**

| Company name | Financial institution | SK NACE | Application of the super deduction | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
| Allianz – Slovenská poisťovňa, a.s. | Insurance company | 65120 Non-life insurance | No | No | No | No | No | Yes |
| 365.bank, a. s. | Bank | 64190 Other monetary instruments | No | No | No | No | No | Yes |
| Československá obchodná banka, a.s. | Bank | 64190 Other monetary instruments | Yes | Yes | No | Yes | Yes | Yes |
| Slovenská sporiteľňa, a.s. | Bank | 64190 Other monetary instruments | No | No | No | Yes | Yes | Yes |
| Všeobecná úverová banka, a.s. | Bank | 64190 Other monetary instruments | No | No | Yes | No | No | Yes |

Source: own processing

21 FINANCIAL ADMINISTRATION. Financial administration [online], 2022, [viewed 24.08.2022]. Available from: https://www.financnasprava.sk/sk/financna-sprava.

22 FINANCIAL ADMINISTRATION. List of tax subjects with deduction of expenses (costs) for research and development according to §30c par. 8 [online], 2022.[viewed 24.08.2022]. Available from: https://www.financnasprava.sk/sk/elektronicke-sluzby/verejne-sluzby/zoznamy/detail/_0b68d73c-974f-4012-8c78-aa7900c565d6.

23 JANČIČKOVÁ, Lea, PAKŠIOVÁ, Renáta. Super-deduction for research and development in Slovak companies. *3rd International conference on Decisionmaking for Small and Medium-Sized Enterprises DEMSME 2021* [online], 264-274. ISBN 978-80-7510-456-4. [viewed 24.08.2022]. Available from: https://demsme.opf.slu.cz/images/DEMSME_2021_Proceedings.pdf.

24 BUSINESS REGISTER OF SLOVAK REPUBLIC. Searching by business name. [online], 2022. [viewed 24.08.2022]. Available from: https://orsr.sk/search_subjekt.asp.

Of the investigated companies, there are 4 financial institutions that operate in the Slovak Republic as banks and 1 company is an insurance company. By law, the selected companies must report according to International Standards IAS/IFRS. The financial information of the examined companies was drawn from their financial statements published in the Register of Financial Statements of the Slovak Republic.[25]

## 2. RESULTS AND DISCUSSION

### 2.1 R&D costs of financial institutions

From the freely available information published in the Financial Report, we have at our disposal the exact calculation of the sum of super-deduction applied by individual companies in the monitored period. As part of the research, we are interested in the numbers of costs that were spent on innovation, research, and development in individual years. The companies themselves do not provide detailed information on the R&D costs spent in individual years, and therefore it is necessary to quantify their amount according to the following formula:

Eligible research and development costs = Reduction of tax base / Rate of super deduction

By the reduction of the tax base, we mean the amount of the super deduction for the individual investigated companies. The super deduction rate has been 25 % since its introduction into SR legislation. Since 2018, it has increased to 100 %, in 2019 to 150%, and in 2020 it reached its highest level of 200 %. In the following tables 2 to 6, we present the total amount of applied costs in the examined companies.

**Tab. 2: R&D costs incurred in 365.bank, a. s. (EUR)**

| 365.bank, a. s. | Claimed super deduction | Super deduction rate | Eligible R&D costs |
|---|---|---|---|
| 2020 | 3,379,544.82 | 200 % | 1,689,772.41 |
| **Total** | **3,379,544.82** | **X** | **1,689,772.41** |

Source: own processing

Eligible costs of this bank in 2020 were in the amount of EUR 1,689,772.41. It devoted 4 R&D projects, the main goal of which was to improve the performance of outdated application technology, reduce labour, data migration and digitization of payment.

25 REGISTER OF FINANCIAL STATEMENTS. [online], 2022 [viewed 24.08.2022]. Available from: https://registeruz.sk/cruz-public/domain/accountingentity/simplesearch.

**Tab. 3: R&D costs incurred in Všeobecná úverová banka, a.s. (EUR)**

| Všeobecná úverová banka, a.s. | Claimed super deduction | Super deduction rate | Eligible R&D costs |
|---|---|---|---|
| 2017 | 364,520.10 | 25 % | 1,458,080.40 |
| 2020 | 7,435,657.09 | 200 % | 3,717,828.55 |
| **Total** | **7,800,177.19** | **X** | **5,175,908.95** |

Source: own processing

Eligible R&D costs of Všeobecná úverová banka, a.s. in 2017 and 2020 are in total EUR 5,175,908.95. in 14 R&D projects with the main goals of which were to improve electronic banking, consolidate and integrate client data, reduce the time required to open an account, apply for a mortgage, do manual work, and digitally support employees.

**Tab. 4: R&D costs incurred in Slovenská sporiteľňa, a.s. (EUR)**

| Slovenská sporiteľňa, a.s. | Claimed super deduction | Super deduction rate | Eligible R&D costs |
|---|---|---|---|
| 2018 | 505,783.79 | 100 % | 505,783.79 |
| 2019 | 1,119,968.85 | 150 % | 1,679,953.28 |
| 2020 | 917,869.20 | 200 % | 458,934.60 |
| **Total** | **2,543,621.84** | **X** | **2,644,671.67** |

Source: own processing

The bank Slovenská sporiteľňa, a.s. applied for a super deduction from 2018 to 2020. Eligible costs totalled EUR 2,644,671.67 in 10 R&D projects with the main goal to implement and automate processes in the banking application, marketing technologies and automation of credit processes.

**Tab. 5: R&D costs incurred in Československá obchodná banka, a.s. (EUR)**

| Československá obchodná banka, a.s. | Claimed super deduction | Super deduction rate | Eligible R&D costs |
|---|---|---|---|
| 2015 | 194,872.22 | 25 % | 779,488.88 |
| 2016 | 296,892.00 | 25 % | 1,187,568.00 |
| 2018 | 300,322.21 | 100 % | 300,322.21 |
| 2019 | 2,355,551.84 | 150 % | 3,533,327.76 |
| 2020 | 2,575,032.00 | 200 % | 5,150,064.00 |
| **Total** | **5,722,670.27** | **X** | **10,950,770.85** |

Source: own processing

The bank Československá obchodná banka, a.s. applied the super deduction in almost all years of the monitored period, except for 2017. The eligible costs were in the total amount of EUR 10,950,770.85 in 6 R&D projects, the main goal of which was to increase functionality in electronic banking, applications, and data security.

**Tab. 6: Research and development costs incurred in Allianz – Slovenská poisťovňa, a.s. (EUR)**

| Allianz – Slovenská poisťovňa, a.s. | Claimed super deduction | Super deduction rate | Eligible R&D costs |
|---|---|---|---|
| 2020 | 255,867.88 | 200 % | 127,933.94 |
| Total | 255,867.88 | X | 127,933.94 |

Source: own processing

Allianz – Slovenská poisťovňa, a.s. operates as an insurance company and it claimed a super deduction in 2020. Eligible costs were in the amount of EUR 127,933.94 in 1 R&D project, the main goal of which was intelligent pricing of motor insurance.

## 2.2 Savings on income tax for financial institutions due to the super deduction of R&D costs

Quantifying the tax savings of companies due to the application of the super deduction for R&D costs in income tax can be carried out based on information on the amount of their super deduction and the rate of income tax for the relevant tax period. We calculated the tax savings based on the following calculation:

*Tax savings = Reduction of the tax base * Applicable corporate income tax rate*

The corporate tax rate was 22 % until 2016, and from 2017 the basic rate was reduced to 21 %. The legislation also allows the use of a rate of 15 %, but only for those legal entities whose income (revenue) for the tax period did not exceed EUR 100,000.00. We will not use the reduced rate in our post.

In the following tables 7 to 11, we present the total amount of applied years in financial institutions.

**Tab. 7: Tax savings in 365.bank, a. s. (EUR)**

| 365.bank, a. s. | Reduction of the tax base | Applicable corporate income tax rate | Tax savings | Total costs (EUR) | Share of tax savings on total costs | Profit after tax (EUR) | The share of tax savings on the profit after taxation |
|---|---|---|---|---|---|---|---|
| 2020 | 3,379,544.82 | 21 % | 709,704.41 | 138,984,000.00 | 0,51 % | 44,358,000.00 | 1,60 % |
| **Total** | **3,379,544.82** | **X** | **709,704.41** | **X** | **X** | **X** | **X** |

Source: own processing

Tax savings in the 365.bank, a. s. was in the amount of EUR 709,704.41 in 2020. The share of tax savings on total costs was 0.51 % in 2020, and the share of tax savings on the economic result after taxation was 1.60 %

**Tab. 8: Tax savings in Všeobecná úverová banka, a.s. (EUR)**

| Všeobecná úverová banka, a.s. | Reduction of the tax base | Applicable corporate income tax rate | Tax savings | Total costs (EUR) | Share of tax savings on total costs | Profit after tax (EUR) | The share of tax savings on the profit after taxation |
|---|---|---|---|---|---|---|---|
| 2017 | 364,520.10 | 21 % | 76,549.22 | 225,813,000.00 | 0.03 % | 160,021,000.00 | 0.05 % |
| 2020 | 7,435,657.09 | 21 % | 1,561,487.99 | 390,161,000.00 | 0.40 % | 85,039,000.00 | 1.84 % |
| **Total** | **7,800,177.19** | **X** | **1,638,037.21** | **X** | **X** | **X** | **X** |

Source: own processing

Tax savings in Všeobecná úverová banka, a.s. was in the years 2017 and 2020 in the amount of EUR 1,638,037.21. The share of tax savings on the profit after taxation in 2017 was 0.05 % and in 2020 the share increased to 1.84 %.

**Tab. 9: Tax savings in Slovenská sporiteľňa, a.s. (EUR)**

| Slovenská sporiteľňa, a.s. | Reduction of the tax base | Applicable corporate income tax rate | Tax savings | Total costs (EUR) | Share of tax savings on total costs | Profit after tax (EUR) | The share of tax savings on the profit after taxation |
|---|---|---|---|---|---|---|---|
| 2018 | 505,783.79 | 21 % | 106,214.60 | 449,046,000.00 | 0.02 % | 180,176,000.00 | 0.06 % |
| 2019 | 1,119,968.85 | 21 % | 235,193.46 | 474,147,000.00 | 0.05 % | 174,436,000.00 | 0.13 % |
| 2020 | 917,869.20 | 21 % | 192,752.53 | 491,457,000.00 | 0.04 % | 114,633,000.00 | 0.17 % |
| **Total** | **2,543,621.84** | **X** | **534,160.59** | **X** | **X** | **X** | **X** |

Source: own processing

Tax savings in Slovenská sporiteľňa, a.s. was during years 2018 to 2020 in the amount of EUR 534,160.59. The share of tax savings on the after-tax economic result was gradually increasing, reaching 0.06 % in 2018, in 2019 0.13 % and in 2020 the share increased to 0.17 %.

**Tab. 10: Tax savings in Československá obchodná banka, a.s. (EUR)**

| Československá obchodná banka, a.s. | Reduction of the tax base | Applicable corporate income tax rate | Tax savings | Total costs (EUR) | Share of tax savings on total costs | Profit after tax (EUR) | The share of tax savings on the profit after taxation |
|---|---|---|---|---|---|---|---|
| 2015 | 194,872.22 | 22% | 42,871.89 | 152,533,000.00 | 0.03% | 71,729,000.00 | 0.06 % |
| 2016 | 296,892.00 | 22% | 65,316.24 | 159,732,000.00 | 0.04% | 78,488,000.00 | 0.08 % |
| 2018 | 300,322.21 | 21% | 63,067.66 | 165,720,000.00 | 0.04% | 53,158,000.00 | 0.12 % |
| 2019 | 2,355,551.84 | 21% | 494,665.89 | 170,096,000.00 | 0.29% | 70,147,000.00 | 0.71 % |
| 2020 | 2,575,032.00 | 21% | 540,756.72 | 165,161,000.00 | 0.33% | 50,813,000.00 | 1.06 % |
| **Total** | **5,722,670.27** | **X** | **1,206,678.40** | **X** | **X** | **X** | **X** |

Source: own processing

Tax savings in Československá obchodná banka, a.s. was, except for 2017 (they did not apply the super deduction), a total of EUR 1,206,678.40. The share of tax savings on the result of the economy after taxation increased from 0.06 % (2015), 0.08 % (2016), 0.12 % (2018), 0.71 % (2019) to 1.06 % (2020).

**Tab. 11: Tax savings in Allianz - Slovenská poisťovňa, a.s. (EUR)**

| Allianz – Slovenská poisťovňa, a.s. | Reduction of the tax base | Applicable corporate income tax rate | Tax savings | Total costs (EUR) | Share of tax savings on total costs | Profit after tax (EUR) | The share of tax savings on the profit after taxation |
|---|---|---|---|---|---|---|---|
| 2020 | 255,867.88 | 21 % | 53,732.25 | 752,372,000.00 | 0,01 % | 92,472,000.00 | 0,06 % |
| **Total** | **255,867.88** | **X** | **53,732.25** | **X** | **X** | **X** | **X** |

Source: own processing

Tax savings in Allianz - Slovenská poisťovňa, a.s. was in the amount of EUR 53,732.25 in 2020. The share of tax savings on total costs was 0.01 % in 2020, and the share of tax savings on the economic result after taxation was 0.06 %.

Corporate tax rates and business risk are inversely proportional.[26] The higher the tax rate a company faces, the weaker its incentive to take risks. Authors Albertus, Glover and Levine concluded in their research that in the context of multinational companies moving transferable capital in an international environment with different tax operations, the incentive to invest in R&D projects is stronger the higher the US tax rate compared to rates that are valid abroad.[27] The possibility of using the super-deduction of R&D costs enables the reduction of the tax burden on financial institutions and thus the preservation of tax savings. Tax savings can be used to maintain the sustainability of the company and digitize the services offered.

## CONCLUSION

The EU taxonomy helps guide the flow of capital by classifying activities with an impact assessment in line with sustainable finance in the context of the SDGs. By applying the EU taxonomy, financial institutions can direct the flow of capital to activities aimed at fulfilling the SDGs. R&D is a tool for improving the financial situation of entities through the application of various supports, but it also has the potential to improve aspects of sustainability in all business sectors. Financial institutions are specific and there is important to explore their contribution to sustainability, digitization and efficient use of equity capital for innovation through the application R&D and saving own capital too. The results of the activities of

26 GREEN, Richard C., TALMOR, Eli. The Structure and Incentive Effects of Corporate Tax Liabilities. *The Journal of Finance* [online], 1985, 40 (4), 1095-1114. v [viewed 24.08.2022]. Available from: https://doi.org/10.1111/j.1540-6261.1985.tb02365.

27 ALBERTUS, James. F., GLOVER, B., LEVINE, O. Heads I win, tails you lose: Asymmetric taxes, risk taking, and innovation. *Journal of Monetary Economics* [online], 2019, 105, 24-40 [viewed 24.08.2022]. Available from: https://doi.org/10.1016/j.jmoneco.2019.04.010.

financial institutions, which are increasingly willing to invest in R&D, create the ground not only for improving their competitiveness, but also for simplifying the use of services by clients, and they also affect the economic growth of the country of operation. Several countries apply various means to increase the attractiveness of investing in R&D and thereby help the country's economic growth and improve its position in the world. Since 2015, the legislators of the Slovak Republic decided to move closer to developed European countries and introduced the so-called super deduction for R&D costs in income tax. Natural persons and legal entities can apply for super credit if they carry out R&D beyond the scope of their business as defined by SK NACE, keep costs related to R&D on analytical records, and have developed a research project(s). In our contribution, we focused on financial institutions operating in the Slovak Republic, which also claimed the super deduction for R&D costs from 2015 to 2020. For the purposes of the contribution, banks (4) and insurance companies (1) are examined under financial institutions. In the monitored period, the examined financial companies saved a total of 4,142,312.85 euros, which they did not have to pay as income tax due to the applied super deduction for R&D. In 2020, all surveyed companies claimed the highest super-deduction of R&D costs at the highest 200 % rate of possible income tax reduction so far, saving up to 3,058,433.91 euros at the current 21 % corporate tax rate. Over time, as the percentage rate of the super deduction increases, so does the number of companies that claim it in their tax return, this also applies to financial companies. The financial institution Všeobecná úverová banka, a.s. managed to achieve the highest tax savings, even though they claimed the super deduction in only two years (2017, 2020), namely in the amount of 1,638,037.21 euros. On the contrary, the lowest savings (EUR 53,732.25) was recorded by Allianz – Slovenská poisťovňa, a.s., which applied the super deduction only in 2020. The highest and at the same time the lowest share of tax savings on the after-tax economic result was achieved by Všeobecná úverová banka, a.s. In 2017, the share of tax savings in the economic result after taxation was only 0.05 %, and in 2020 it was already 1.84 %. The lowest share of tax savings in total costs was in Allianz - Slovenská poisťovňa, a.s. in 2020 (0.01 %) and the highest share of tax savings on total costs was achieved by 365. bank, a. s. in 2020 (0.51 %). The achieved savings in the analyzed financial institutions can be used towards the further development of the institution with the introduction of digitization of the offered services, associated with reduced demands for the consumption of resources in the context of meeting the SDGs, e.g. reducing paper consumption. Further research will focus on the use of tax savings.

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# Current trends of serious crimes in the economic field: The case of Romania


## Delia Magherescu

JUDr. Delia Magherescu, Ph.D.
delia_magherescu@yahoo.com
ORCID 0000-0003-0939-1549
Lawyer
Gorj Bar Association
Târgu Jiu, Romania



***Abstract:***
The phenomenon of serious crimes has become more aggressive in Southeast Europe in the last decades. The beginning of 21st century has meant an unbalanced tool for deepening crisis in terms of criminalization, most of time it being confronted with causes and consequences for the countries in region. The same is true in the field of economic serious crimes which have reached several forms. The real challenge of the judicial bodies was to disrupt the organized crime groups that the judicial authorities face in practice. The current research aims at analysing the serious crimes in the economic field both from criminological and criminal judicial perspectives. Some case-law studies have been analysed by conducting of qualitative research activities on serious crimes and the forms that the phenomenon presents in Southeast Europe. Romania has delivered the judicial instruments of fighting criminality and represents an important factor in strengthening the capacity of law enforcement agencies to achieve the best results in the field of controlling phenomenon. The results of study state certain forms of serious crimes, such as organized crime in public procurement contracts, and crimmigration committed for the purpose of criminality in the economic field. The conclusion is that the serious crimes are linked to the cases of transnational criminality. The similitudes between these issues generate a series of consequences that the phenomenon produces in Southeast Europe, a particular attention being paid on the case of Romania.



***Key words:*** *serious crimes, transnational criminality, economic field, crimmigration, fighting criminality; criminal justice.*

## INTRODUCTION

In the era of growing the criminal phenomena, a new generation of serious crimes has been developed. The current situation of serious crimes which occur in Southeast Europe is more accustomed to generate several particular criminal cases than the law enforcement agencies have expected. In practice, there are criminal cases on investigation and judgment of serious crimes committed in different economic, banking and financial areas. In this matter, the case-law examples mean a real source of conducting research for criminologists who have permanently been involved in analysing the phenomena of serious crimes in the economic area and how to control the 'criminalized migrants'[1], also having repercussion in the economic field.

In this context, Romania has adopted legal instruments in the domestic legislation and delivered judicial mechanisms to fight against the serious crimes at the transnational level in close cooperation with the EU Member States[2].

The interest for studying the current forms of serious crimes in the economic field is emphasized by a series of questions, as the following.

- What are the current trends in serious crimes of the economic field in the area of Southeast Europe?
- What kind of results have been achieved by the judicial bodies as a consequence of their activity in this matter?
- Are the law enforcement agencies able to strengthen the fight against these phenomena?
- Has Romania made efforts enough in order to fight against serious crimes in the economic field?

Basically, it could be stated that many forms of serious crimes in the economic field present particularities in accordance with the general situation created already in terms of fighting the criminality in Southeast Europe.

Considering these aspects, the current paper is devoted to the three pillars that the concept of fighting criminality is looking for. It is about the *prevention, combating, and sanctioning* the forms of serious crimes in Southeast Europe – special attention being paid on the case of Romania.

1 BOWLING, Ben, and Sophie WESTENRA. 'A really hostile environment': Adiaphorization, global policing and the crimmigration control system. *Theoretical Criminology*. 2018, 24(2), 163–183.

2 Council Directive 90/2002/EC of 28 November 2002 defining the facilitation of unauthorized entry, transit and residence [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32002L0090&qid=1421139238307&from=EN

## 1. OVERVIEW OF CONCEPTUAL APPROACH

In purpose to achieve the above-stated goals, some objectives have been outlined. They refer to the issues of studying the premises which produce the phenomena of serious crimes with consequences in the economic field, analysing the forms of serious crimes, as well as discussing the results gathered in terms of fighting criminality. All these issues will be analysed under the method of the case-study observation of the judicial decision-making process given by the courts of law in Romania.

The activity of research conducted on the current topic has taken into account two themes, each of them being structured around one form of serious crimes related to the economic field. They refer to the organized crime in public procurement, and crimmigration committed for economic purpose. The research methodology is thus concordant with the two case-study presentations involving Romania and the manner of solving the criminal cases of serious crimes, committed either at the national or transnational level.

In practice, there are criminal cases of obtaining of public procurement contracts by the private business companies whose activities are conducted on the 'screening' organized crime groups. In order to analyse this theme, no less than four cases present interest in the matter. They refer to initiating, establishing, adhering and supporting the organized crime groups, as incriminated by Article 367 of Criminal Code of Romania.

The research was also focused on the conceptual approach in accordance with the literature review of those doctrine's opinions expressed on two themes of the current study: organized crime in public procurement contracts, and crimmigration committed for economic purpose.

Last but not least, the conclusion gathered during the research activity conducted could be basis for the forthcoming legislative modification in the field of serious crimes, whose *de lege ferenda* proposals are pertinently argued.

## 2. SERIOUS CRIMES' INVOLVEMENT IN THE ECONOMIC FIELD

The research conducted on the current trends of serious crimes in the economic field has stated more than general conditions on the topic involved. A generalization of the phenomena was impossible to be pointed out, as long as there are several cases of serious crimes which occur in practice, especially in the field of transnational organized crime associated with money transfers of fictitious and suspicious transactions[3].

3 KUDEIKINA, Inga, and Sandra KAIJA. Problems of the fight against money laundering in the context of business-related legal developments. In: Právo – Obchod – Bchod - Ekonomika: Zborník Vedeckých Prác, Košice: Univerzita P. J. Šafárika v Košiciach, 2020, pp. 175-182. 978-80-8152-930-6.

By the Romanian law on preventing and sanctioning the money laundering[4], the suspicious transaction means the financial operation which does not apparently have an economic or legal purpose or, analysing by its unusual nature and feature in accordance with the customer's activities (i.e., credit and financial institutions; administrators of the private funds; authorized marketing agents; auditors specialized in fiscal and audit consulting; banking accounts, a.s.o.), arose the suspicion of money laundering.

The above-stated remarks constitute premises for the two themes analysed from the point of view of the specific research elements gathered both from literature and jurisprudence. Both of them are covered by the umbrella of the legislative framework in the field of combating all forms of organized crime.

Consequently, the results of this action are visible, knowing the huge number of criminal cases solved by the courts of law in Romania, which disrupted several organized crime groups, including those of smuggling activities[5]. Nevertheless, Romania was notified by the European Commission in the mid of 2022, in the matter of irregular transposition of the fifth EU Directive on combating money laundering[6].

*De iure*, the legislative drawbacks of one Member State produce negative consequences for the entire European Union construction, and, based on this inconvenient, the rules adopted by the European authorities should imperatively be implemented in order to avoid any form of criminality and assure the protection of financial system at the European level. Since July 2022, Romania was notified that it has no more than two months in order to transpose correctly that Directive and make appropriate measures on this way.

### 2.1 Organized crime in public procurement contracts

A new trend in the field of organized crime has been observed especially in cases in which the organized crime groups (hereinafter OCGs) meet the public authorities. This *modus operandi* was observed in the last period of time in the area of the OCGs working in close cooperation with the civil servants or politicians, whose main duties are related to the auctions of public procurement contracts conducted in this field.

The jurisprudence is then accustomed with the idea of the OCGs which penetrate the public sectors of activities in order for them to gather huge amount of money apparently legal. In some cases, in which the representatives of private business

4 ROMANIA Law No. 656/2002 on preventing and sanctioning money laundering, and for establishing certain measures on preventing and combating the financing terrorism [Official Journal No. 702/12 October 2012], modified by Law No. 125/2017 [Official Journal No. 415/6 June 2017].

5 Global Organized Crime Index. Romania [online]. 2021 [viewed 11 August 2022]. Available from: https://ocindex.net/country/romania

6 Council Directive 843/2018 of 30 May 2018 on amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and amending Directives 2009/138/EC and 2013/36/EU [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32018L0843&from=RO

companies want to participate in public procurement auctions, they firstly get in touch with civil servants under the corruption crime interests, and succeed in their approach of gathering the public procurement contracts[7]. On this way, they manage the public procurement contracts through committing the crimes of money laundering.

In some criminal cases, it has been stated that even the politicians are usually involved in mediating the contracts of public procurement, consequently the institution of public procurement is vulnerable to corruption crimes[8]. The de facto situation of this kind of crimes reveals that there are real OCGs behind the 'screening' business companies, which are prevalently focused on committing different forms of crimes. A serious threat appears in cases of cross-border fraudulent operations for criminal purpose. Thus, the organized crime in public procurement contracts leads to fourth classical issues.

- Initiating OCG presents the particular feature of one or two persons who arrange to constitute an OCG for the general purpose of committing the organized criminal activities incriminated by the criminal law.
- Establishing OCG is the main task of the minimum three people who are bringing together in purpose to commit illegal activities in criminal cases.

The actions of initiating and establishing OCG are not so relevant for the case-law references presented in the current theme. However, in the matter of fact, the court of law will always retain the action of establishing OCG, as a crime of danger, incriminated by Article 367 of Criminal Code of Romania, although the crime of scope was not committed yet[9]. Otherwise, if the crime of scope was repealed, then the court of law cannot retain the crime of establishing OCG, regulated by Article 367 thereof.

This is because the crimes of scope are the only one purpose of the OCGs. Thus, they will never be constituted in order for them to exist without a further goal. Basically, the crimes of scope are related to committing the crimes of trafficking in counterfeit goods and smuggling goods[10], as well as the other similar criminal activities linked to the organized crime in economic field.

- Adhering to OCG is one of the criminal activities which consists in other persons who, once they adhere to the OCG, become its members. This means that the people who adhere are the other ones than the members themselves. In other words, the adherent persons are outside from the OCG.

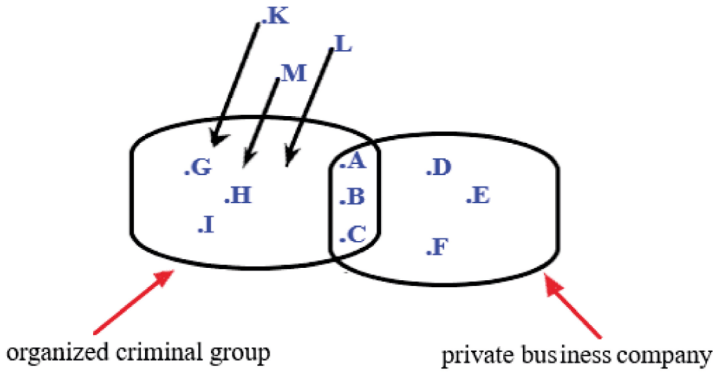
7 Criminal Decision of the HCCJ, Romania. No. 15/A/2022 [online]. [accessed on 2022-08-28]. Available from: https://www.scj.ro

8 GNOFFO, Salvatore. A dynamic performance management approach to frame corruption in public procurement: a case study. *Journal of Public Procurement*. 2021, 21(1), 75–96.

9 Criminal Decision of the HCCJ, Romania. No. 329/RC/2021 [online]. [accessed on 2022-08-16]. Available from: https://www.scj.ro

10 Ibidem.

**Fig. 1: Adhering to OCG connected to a private business company**




Source: own processing

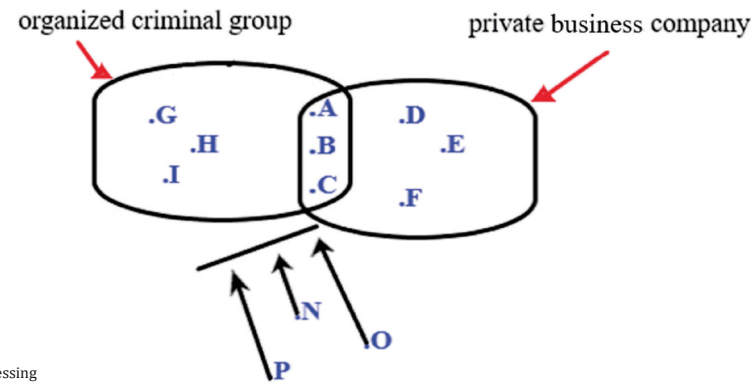
Figure 1 reveals the situation in which other persons agree to adhere to the OCG although they are not employed in the private business company. The people named A, B, and C are both leaders of the private business company and members of the OCG. Their main role is to manage the private business company, and the OCG's interests.

The people named D, E, and F are only employed in the private business company, but they are not members of the OCG. The people named G, H, and I are only members of the OCG, but they are not employed in the private business company. Finally, the people named K, L, and M are neither members of the OCG, nor employed in the private business company. The last ones could become members of the OCG if they choose to join it and commit crimes in an organized manner, as stipulated by the criminal provisions.

In fact, referring to the people named D, E, and F, there is the possibility for them to adhere to the OCG, but it is less understood by the group members A, B, and C to accept their participation in the criminal activity of the group. Why? Because at a given moment one of them could be tempted to submit a criminal reporting to the Anticorruption National Department or to the Directorate for Investigating Organized Crime and Terrorism in order to denounce the illegal activity of the OCG.

- Supporting OCG is the fourth action related to the criminal activity of an OCG, which might be carried out by the other persons than the members themselves. The specific feature of this criminal action is that, by helping the OCG, these persons do not become members, although they work in close cooperation each other in purpose to achieve the criminal activity goals.

**Fig. 2: Supporting OCG connected to a private business company**




Source: own processing

Figure 2 reflects *modus operandi* of the OCGs in accordance with their connection to the other persons who support them. The hypothesis is the same in relation with the persons named from A to I. A question should be asked to know: Who are the persons named as N, O, and P related both to the private business company and the OCG? The main premise is that they are not members of the OCG, and do not become members once they support the group. These people are usually civil servants or politicians, who participate in the OCGs' activities by helping the groups.

In the field of jurisprudence, it has been stated that, in the cases of supporting OCG, although the crime is consumed at the time of committing one act of support, the perpetrator can keep on committing other similar actions, because the plurality of actions does not change the form of crime. In order to establish the crime configuration, the judicial body will analyse entire criminal activity committed, because the dangerous result of crime is exhausted by doing the last criminal act[11].

Considering these aspects, the phenomenon of organized crime in the public procurement contracts means a new trend which comes to characterize the economic field. The recommendation is to enhance judicial instruments of fighting the economic criminality when it is linked to the public sector.

### 2.2 Cases of crimmigration for economic purpose

The concept of crimmigration in Southeast Europe presents certain particularities in the field of committing the crimes for economic purpose. In fact, the phenomenon of crimmigration joins together two concepts, immigration and crimi-

11 Criminal Decision of the HCCJ, Romania. No. 353/A/2020 [online]. [accessed on 2022-08-15]. Available from: https://www.scj.ro

nality[12], and means the issue of immigration committed subsequently for criminal purpose[13], discussed by doctrine as immigration-crime nexus[14], or immigration for criminality, viewed by the people who face the era of crimmigration[15]. It is also associated with the concept of "hostile border" in creating "hostile environment for illegal immigrants"[16], as part of the national policy of states in accordance with the European one[17].

Moreover, the discussion on the issues of migration policy leads to the action plan on fighting crimmigration, as a "better external border management, a standard European asylum policy, and the development of channels for regular migration"[18].

Usually, the concept of crimmigration does not involve the economic field, but in particular criminal cases the main purpose of perpetrators is to obtain huge profit through committing the economic offences. The most frequent cases involve the crimes of smuggling and counterfeiting goods.

In order to analyse the above-stated crimes, some preliminary considerations should be pointed out. One pertinent issue is how Romania can manage the crimmigration taking into account the high level of crimes committed in economic circumstances. The crimmigration for economic purpose is developed in Southeast Europe because of its transnational feature that the law enforcement agencies face in different forms and suppose different routes.

For the phenomenon of crimmigration for economic purpose in Southeast Europe, Romania is one of the transit countries[19], more than a destination one[20]. However, the perpetrators choose Romania for their criminal activity and succeed in committing the economic offences. In most cases, the transnational crimmigration creates an unbalance for the consequences produced in the Romanian economic field. The legal doctrine has analysed the diversification of crimmigration as an interdependent element within the larger context of international migration[21].

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12 MAGHERESCU, Delia. Crimigrația în Europa: Concept, evoluție, tendințe. In: Dreptul Românesc la 100 de ani de la Marea Unire, Bucharest: Universul Juridic Publishing House, 2018, pp. 511–514. 978-606-39-0247-5.

13 LEONETTI, Carrie. Editor☒s introduction: The crimmigration issue. *New Criminal Law Review*. 22(3), 233–235.

14 JIANG, Jize, and Edna EREZ. Immigrants as symbolic assailants: Crimmigration and its discontents. *International Criminal Justice Review* [online]. 2018, **28**(1), 5–24. 1556–3855 [viewed 20 August 2022]. Available from: https://journals.sagepub.com/doi/abs/10.1177/1057567717721299

15 BILLINGS, Peter. Introduction. In: Peter Billings, eds. *Crimmigration in Australia. Law, Politic, and Society*. Springer, 2019, pp. 3–18. 978-981-13-9092-0.

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21 ANDRICA, Nicoleta, Adriana GIURGIU, and Andreea-Florina FORA. International migration. Case study: Romania. *The Annals of the University of Oradea*. 2019, XXVIII(1), 217–226.

(a) Referring to *the cases of smuggling*, the situation presents two directions.

- The phenomenon of migrant smuggling is a very profitable business[22], which facilitates the perpetrators to get money through avoiding the legal provisions and financial taxes.

Paradoxically, in cases of migrant smuggling, the courts of law could make decisions with lower punishment[23] or even acquittal[24]. The appeal court has decided that the sentence of acquittal pronounced in the first instance is not fair from the point of view of the serious crime's feature. Consequently, the court of law has found the defendant guilty for committing the crime of migrant smuggling in a transnational manner[25]. Together with the other defendants, an OCG has been constituted in purpose for them to gather benefit from illegal activities of economic offences.

- Another direction focuses on the cases of goods smuggling, a phenomenon also very developed in Romania, taking into account that several cases are solved by the courts of law.

In this regard, the doctrine has emphasized that the Balkan region is a smuggling corridor and tobacco illegal trade[26], distributed either in the region countries or within the EU area. In the matter of fact, the perpetrators are usually involved in cigarette smuggling, both casual and organized, and in the other counterfeiting goods, increasing a real shadow economy[27].

The jurisprudence has stated that the defendants are convicted for committing the criminal activity of collecting, possessing, transporting goods which should be placed under the customs regime. In fact, the smuggled goods were introduced in Romania from another place than the custom offices, by avoiding the official control, the defendant knowing that the goods proceed from smuggling operations[28]. The judicial bodies have retained *modus operandi* specific to the Eastern border of Romania. It consists in substantial number of cigarettes smuggled without legal documents of origin, resulted from smuggling operation, which causes a significant damage for the national budget[29]. By criminal action committed, the immediate consequence of the offence consists in a dangerous situation created for the legal custom order.

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22 EU Action Plan against migrant smuggling (2015-2020) [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52015DC0285&from=EN

23 Criminal Decision of the HCCJ, Romania. No. 326/RC/2016 [online]. [accessed on 2022-08-03]. Available from: https://www.scj.ro

24 Criminal Decision of the HCCJ, Romania. No. 195/RC/2021 [online]. [accessed on 2022-08-18]. Available from: https://www.scj.ro

25 Ibidem.

26 BUDAK, Jelena, Edo RAJH, Goran BUTURAC, and Anamarija BRKOVIĆ. Tobacco grey market in the Western Balkans. *Journal of Balkan and Near Eastern Studies*. 2021, 23(1), 62–77.

27 GOEL, Rajeev K., and James W. SOUNORIS, Cigarette smuggling: using the shadow economy or creating its own? *Journal of Economics and Finance*. 2019, 43, 582–593.

28 Criminal Decision of the HCCJ, Romania. No. 55/RC/2022 [online]. [accessed on 2022-08-02]. Available from: https://www.scj.ro

29 Ibidem.

(b) In cases of *counterfeiting goods*, it has also been observed that the main aim of the perpetrators leads to the economic profit gathered within an illegal framework. The criminal scheme supposes that the perpetrators are involved in committing of transnational trafficking in counterfeit goods, coming from the Romania's neighbouring non-EU countries. The crime is as dangerous as it exceeds one country's borders and gets transnational feature. The target of perpetrators is to penetrate the EU borders and spread out the counterfeit goods into the community markets[30].

Regarding the counterfeit goods, they belong to a very large areas of interest, most of them having a high economic value. The jurisprudence has revealed that the perpetrators are usually looking for counterfeiting of industrial goods and food[31], alcoholic and pharmaceutical products. The fashion industry[32] is also preferred, as well as the credit cards are object of these crimes in order to be used in e-commercial illegal operations. They are also interested in counterfeiting money, especially foreign currency[33], to be then spread out over the black market.

## CONCLUSION

The current study on the new trends in the field of economic organized crime in Southeast Europe states that the phenomena discussed are a serious challenge for the Romanian authorities. During the last decades, several cases of organized crime have been discovered and sent to trial in order to be solved beyond any reasonable doubt. The practice states that there are several cases of OCGs whose criminal activities are involved in economic crimes, from smuggling to counterfeiting goods, all of them for an economic purpose.

In cases of public procurement contracts, it could be concluded that the main activity of OCGs leads to the traffic of influence provided by Article 291 para 1 of Criminal Code of Romania, reported to Article 7 (a) of the law on preventing, discovering and sanctioning the corruption offences. *Modus operandi* is approximately similar in many cases solved by the courts of law in Romania. Basically, it refers to the criminal activity of taking bribery by the civil servants or politicians in exchange for their interference in the public procurement committee organized within a public institution.

In cases of crimmigration, several criminal activities have been discovered by the courts of law, and solved them legally in accordance with the defendants' guilt of committing crimes. Thus, the courts of law shall always take into account the

30 The same is true in the field of competition law of the EU area. In this regard, see YUSUPOVA, Regina. Pricing algorithms: are they threatening the competition?. In: Challenges of Law in Business and Finance, Bucharest, Paris, Calgary: ADJURIS – International Academic Publisher, 2021, pp. 107–118. 978-606-95351-1-0.

31 SOON, Jan Mei, and Louise MANNING. Developing anti-counterfeiting measures: The role of smart packaging. *Food Research International*. 2019, 123, 135–143.

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33 KRATCOSKI, Peter C, and Maximilian EDELBACHER. Fraud and corruption. Cham: Springer, 2018. 978-3-319-92332-1.

features of the crime committed regarding the phenomenon of crimmigration, and consequently solve them legally according to the evidence submitted and administered in these criminal cases. It has been concluded that, the perpetrators are involved in committing the serious crimes for economic purpose. Although the crime of establishing or adhering to an OCG is a serious crime, the phenomenon of crimmigration generates usually economic offences, as the High Court of Cassation and Justice of Romania decided in the case discussed during the previous section.

Another issue is the delimitation which exists between different forms of crimmigration committed for economic purpose. The delimitation results from the criminal activities of the OCGs, and their *modus operandi* which characterizes each criminal action.

Considering all these aspects, a pertinent conclusion leads to the Romanian authorities which have made huge efforts in order to strengthen the fight against the phenomenon of organized crime and enhance the strategic capacity of fighting the economic crimes in Southeast of Europe.

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# Will the pensions of members of limited liability companies always be enough?

**Jana Blažková, Iva Hasíková, Milena Otavová, Jana Gláserová**

Ing. Jana Blažková
author@email.address
Ph.D. student, Department of Accounting and taxes
Faculty of Business and Economics, Mendel University
Brno, Czech Republic

Ing. Iva Hasíková
author@email.address
Ph.D. student, Department of Accounting and taxes
Faculty of Business and Economics, Mendel University
Brno, Czech Republic

Ing. Milena Otavová, Ph.D.
milena.otavova@mendelu.cz
ORCID 0000-0003-2481-479X
Academic staff, Department of Accounting and taxes
Faculty of Business and Economics, Mendel University
Brno, Czech Republic

Dr. Ing. Jana Gláserová
jana.glaserova@mendelu.cz
ORCID 0000-0001-5038-8347
Academic staff, Department of Accounting and taxes
Faculty of Business and Economics, Mendel University
Brno, Czech Republic

***Abstract:***
Members of limited liability companies (LLC) in the Czech Republic can legally minimize their tax liability, but they are often unaware of the consequences of their decision for the future. Prioritizing higher incomes in the working life without taking advantage of tax liability savings may result in low pensions and a steep decline in living standards. The aim of the paper is to evaluate different forms of remuneration of LLC members in relation to their future pensions and to recommend

a combination of possible forms of remuneration in relation to the optimization of the tax burden, net income and the future pension. The results show that from the perspective of LLC members and their financial security for future pensions, it is appropriate to set remuneration as a profit share supplemented with an employment income. The most suitable seems the gross salary corresponding to the first reduction limit for a pension. However, a pension at this level will often only provide about 15% of the value of the member's net earnings in the working life. The problem is that profit shares in the Czech Republic are not subject to pension contributions. It has been found that such contributions are made, for example, in Hungary or Lithuania, and this could become an inspiration for the Czech Republic.

***Key words:*** *pensions, LLC members, tax liability, profit share, employment income*

## INTRODUCTION

Members of limited liability companies (LLC) in the Czech Republic can legally minimize their tax liability, but they are often unaware of the consequences of their decision for the future. Prioritizing higher incomes in the working life without taking advantage of tax liability savings may result in low pensions and a steep decline in living standards.

## 1. LITERATURE REVIEW

### 1.1 A limited liability company and methods of remuneration of its members

A limited liability company, s.r.o. in Czech, (hereinafter referred to as "LLC") is one of the most common legal forms of business entity in the Czech Republic and LLCs form a large part of the business sector (zalozeni-sro.biz, 2019). One of the reasons why LLCs have become so popular is a relatively quick and easy process of establishment and low costs, including low capital requirement. The popularity of LLCs is also proven by the statistics provided by Bisnode, which show that in 2020 there were approximately 491,849 limited liability companies and only 26,725 joint-stock companies (Štěpánová, 2021).

LLC members are jointly and severally liable for obligations up to the amount of unpaid deposits of all members, as registered with the Companies Register. (Moravec and Andreisová, 2021, pp. 58–59). Káhinská (2021) views a member as an "investor waiting for increasing the value of their initial investment." Members exercise their rights as members of the general meeting where, besides other things, they elect the executive (jake-james.cz, 2021). The power of influence during voting and discussion at the general meeting is determined by the size of the member's share, which is expressed as the ratio of the amount of their deposit to the regis-

tered capital (Moravec and Andreisová, 2021, pp. 58–59). Act No. 90/2012 Coll. on Commercial Companies and Cooperatives, as amended (hereinafter referred to as "ZoK"), does not limit the number of members and at the same time it allows the so-called chaining of single-member companies. Josková, Pravdová and Dvořáková (2021, pp. 25–26) explain that a single member can be a member of several limited liability companies.

On the other hand, the executive is a statutory body acting for and on behalf of the company (Komárková 2021). The primary duties of the executive include, e.g., business management of the company, hiring employees and financial decision-making (Běhounek, 2016).

The executive and also the member of the limited liability company may enter into a contract with the company (an employment contract or an agreement to work outside the scope of employment) in the form of an employment relationship regulated by Act No. 262/2006 Coll, Labour Code, as amended (Hnátek, 2019, p. 55; Roučková and Schmied, 2021, pp. 48–51). However, the necessary condition that must be met is that the scope of work in the employment contract does not overlap with the responsibilities for the management and business operation of the company entrusted to the executive (Kučerová, 2020). Pecháčková (2020) adds that this type of contract is also possible under ZoK, where, however, certain conditions are stipulated. They are also related to the remuneration of members which may take different forms with different effects on the taxation regime.

The executive and also the LLC member can pay themselves profit shares. Komárková (2021b) states that profit shares are considered as a basic property right of the member. Veselý (2021) adds that it does not only belong to the member of the limited liability company, but under an arrangement for the discharge of function, profit shares may be awarded to the executive himself (without being at the same time the member who taxes such earnings) as employment earnings according to § 6, paragraph 1(d) of Income Tax Act (hereinafter referred to as "Income Tax Act"), including contributions to social and health insurance. Vychopeň (2016, p. 182) says that this type of remuneration is very disadvantageous to the executive. Moreover, these expenses are non-deductible for the company because they are not wage expenses (Pilařová, 2021). Profit shares paid to the members are taxed according to § 8, paragraph 1 (a) of Income Tax Act and are subject to 15% withholding tax according to § 36, paragraph 2 of Income Tax Act. The company is obliged to deduct 15% withholding tax on profit shares and pay it no later than the end of the month following the month in which the tax was withheld (Truhlářová, 2021). Hnátek (2021, pp. 107–109) points out that income from capital assets is not included in the basis of assessment for social and health insurance contributions. Přib (2022a) adds that profit shares do not impose an obligation on the member to contribute to pension insurance and Červinka (2018, p. 62) points out that profit shares are not subject to health insurance contributions.

Member of LLC can also be rewarded with other types of shares, among which Floriánová (2016) ranks:

- share associated with a higher share of profit,
- share with the right of veto,
- share with a wider range of rights to information,
- share with a different setting of voting rights,
- share with a preferential profit share. However, the paper further deals only with profit shares.

The LLC member in the position of the executive can be remunerated in various forms, which are subject to different taxation regimes. However, the most common methods are an arrangement for the discharge of function together with an employment contract and agreements to work outside the scope of employment, which are viewed as employment taxed according to § 6 of Income Tax Act. For individual types of remuneration, it is important to specify the amount and obligation of social and health insurance contributions which represent a large part of the total burden. The key legal regulations in this area are primarily Act No. 586/1992 Coll., Act of the Czech National Council on Income Taxes, as amended; Act No. 48/1997 Coll. on Public Health Insurance; Act No. 187/2006 Coll. on Sickness Insurance; Act No. 155/1995 Coll., on Pension Insurance, and Act No. 589/1992 Coll., on Social Security Premiums and Contributions to State Employment Policy.

Taxes of LLC members in the position of executives are regulated by an arrangement for the discharge of function where income under this arrangement is considered as employment income and taxed according to § 6, paragraph 1 (c) Clause 1 of Income Tax Act. The remuneration of the executive for work performed for the company may be regulated by an employment relationship taxed as an employee's income. Despite the fact that this type of income is considered by Hnátek (2019, p. 55) to be less advantageous with regard to the amounts of levies, it also brings benefits especially with regard to health, sickness and pension insurance.

According to Pokorná, Malachová (2020) and Roučková and Schmied (2020, p. 14), concurrent functions are the situation when the executive concludes with the company an arrangement for the discharge of function together with an employment contract for the duties and responsibilities of the executive. Pravdová, Josková and Dvořáková (2021, pp. 232–234) distinguish between "true" and "false" concurrence. The expert group Rozumné právo (Sensible Law) (Advokátní deník, 2021) adds that the law itself does not prohibit the concurrence of functions but the Supreme Court takes a different position in its judgements.

Pravdová et al. (2018, pp. 93–94) characterize false concurrence as the activities that are performed by the executive under an employment contract but they do not overlap with the activities and competences of the executive (e.g., IT administration, graphic work, etc.). Pravdová, Josková and Dvořáková (2021, pp. 232–234) add that false concurrence is permissible according to judicial decisions, it is also implicitly permitted by the judgement of the Supreme Court (File No. 21 C do 4028/2009). In judgements, true concurrence refers to a situation when the executive carries out duties within his competence under the arrangement for the discharge of function and also under the employment contract (e.g., employment contract for team management and leadership) (Pokorná, 2020). This type of contract is viewed as invalid and the executive does not have an employment relationship with entitlement to remuneration (Pravdová, Josková and Dvořáková, 2021, pp. 232–234). Pracovní poradna (2020) as well as Roučková and Schmied (2020, pp. 13–15) have objections and argue that the law itself does not prohibit this, and therefore the contract is not automatically invalid and needs to be thoroughly examined. Gorčík (2021) adds that true concurrence must be viewed very carefully especially with regard to the frequently changing attitudes and decisions of the courts.

The most important judgement concerning true concurrence is the opinion of the Constitutional Court, File No. I. ÚS 190/15, which is supplemented with other judgements of the Supreme Court, File No. 31 Cdo 4831/2017, File No. 29 Cdo 3478/2016, and the latest provision of the Supreme Court, File No. 27 Cdo 4482/2018 (Pravdová, Josková and Dvořáková, 2021, pp. 232–234). These determine that the relationship between the company and the executive is not an employment relationship, therefore a contract of employment cannot be used for these activities and a contract on the discharge of function must be made (Pravdová, Josková and Dvořáková, 2021, pp. 232–234). The opinions of the courts argue that the relationship between the executive and the company does not fulfil the characteristics of an employer/employee relationship and therefore a contract of employment should not be concluded.

Pravdová et al. (2018, pp. 90–96), however, have a different opinion on this issue based predominantly on the findings of the Constitutional Court, File No. I.US 190/15 and III. 669/17, where the Constitutional Court itself did not prohibit concurrence of functions but brought more questions than answers about this issue. According to the interpretation of the findings, the arrangement for the discharge of function may be governed by the Labour Code, despite the fact that there is no employment relationship. "The Constitutional Court does not rule out concluding a contract on the discharge of function concurrently with a contract of employment and a management contract" (Pravdová et al., (2018, pp. 90–96).

### 1.2 The pension system in the Czech Republic

The Czech pension system is a combination of the private and public sectors, it is a "**three-pillar system**" (Finance). Since 2013 the Czech pension system has consisted of three pillars (Ministry of Finance, 2021):

- Pillar 1– state continuously funded system
- Pillar 2 – pension savings (it is impossible to join this pillar now)
- Pillar 3 – additional pension insurance and supplementary pension savings.

This three-pillar pension system is also based on the recommendations of the World Bank regarding the reform of the pension system (James, 1995). The multi-pillar scheme of the pension system is the way in which the private and public sectors are interwoven, creating a private-public partnership (Sorsa, 2016).

## 2. METHODOLOGY

For the research part of the paper, methods of analysis, comparison, description and modelling were used. The paper assumed LLC member's in the position of executive. Another assumption is that the company is able to pay profit shares in accordance with the legislation.

The start value chosen for the LLC member's remuneration was an amount of 2,500,000 CZK as net income, on which the following models were based. Model 1 - payment of profit shares only; Model 2 - a combination of salary in the amount of the first reduction limit for the calculation of pension and profit shares; Model 3 – a combination of salary in the amount of the average salary and profit shares; Model 4 – salary in the amount of the second reduction level for the calculation of old age pension. For calculations in individual models of remuneration, data from the Czech Statistical Office and the Ministry of Labour and Social Affairs for the year 2022 were used. Due to similar political and economic developments, the V4 countries and the Baltic States were chosen for international comparison.

In the model examples, old age pensions will be processed using methods valid for 2022 and then individual options will be compared. The calculated old age pensions will reflect different periods of participation in the pension insurance, namely 35 and 45 years. The models consider retirement in 2022 with a minimum period of participation of 35 years, necessary for the legal entitlement to old age pension. The period of drawing pension benefits is determined by the average life expectancy of senior citizens, namely 17 years. A procedure for the calculation of the old age pension of the LLC member is governed by the Pension Insurance Act and the methodology of the Czech Social Security Administration (CSSZ, 2022).

# 3. RESULTS

The section Results is divided into three parts, the first part focuses on the remuneration of the LLC members, the second is devoted to the pensions that will be paid to them in the future and the last part gives a comparison of the situation in selected countries.

## 3.1 Remuneration of LLC members

This chapter deals with the comparison and selection of a suitable form of remuneration of the LLC members with regard to their net incomes and tax burdens in relation to pension aspects. The calculations show the advantages and disadvantages of remuneration in the form of profit shares and salaries in different amounts.

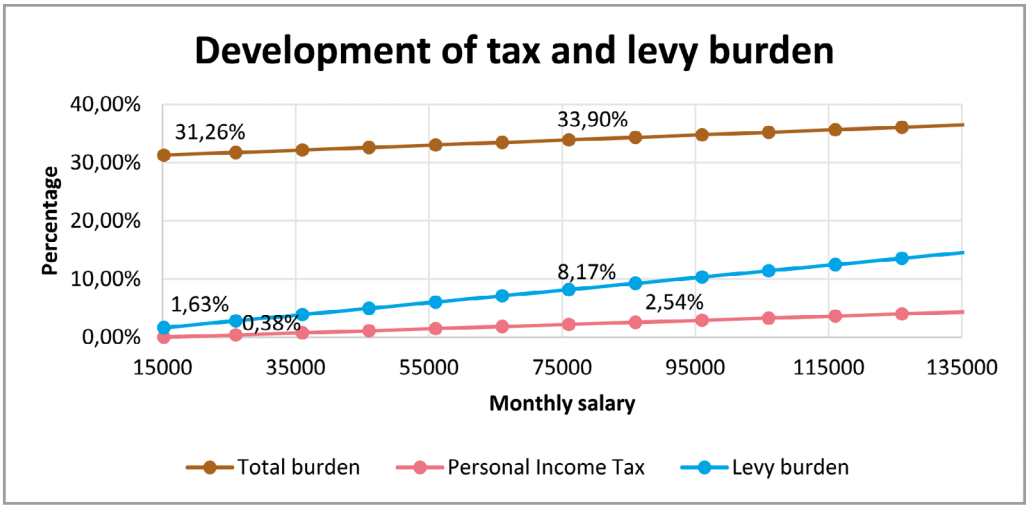
**Tab. 1: Comparison of the remuneration of the LLC member in the position of the executive**

| | Model 1 | Model 2 | Model 3 | Model 4 |
|---|---|---|---|---|
| Initial value | 2,500,000 CZK | 2,500,000 CZK | 2,500,000 CZK | 2,500,000 CZK |
| Monthly salary | 0 CZK | 17,121 CZK | 37,929 CZK | 155,644 CZK |
| **Social security and health insurance (Employer)** | **0 CZK** | **5,787 CZK** | **12,820 CZK** | **52,608 CZK** |
| **Social security and health insurance (Employee)** | **26,244 CZK** | **1,883 CZK** | **4,172 CZK** | **17,121 CZK** |
| Personal income tax | 0 CZK | 0 CZK | 3,119 CZK | 20,777 CZK |
| Total annual wage costs | 0 CZK | 274,895 CZK | 608,988 CZK | 2,499,020 CZK |
| **Gross initial value** | **2,500,000 CZK** | **2,225,105 CZK** | **1,891,012 CZK** | **979 CZK** |
| Corporate Income Tax | 475,000 CZK | 422,770 CZK | 359,292 CZK | 186 CZK |
| Withholding tax | 303,750 CZK | 270,350 CZK | 229,758 CZK | 119 CZK |
| **Net profit share** | **1,721,250 CZK** | **1,531,985 CZK** | **1,301,962 CZK** | **675 CZK** |
| Pension insurance contributions | 0,00% | 2,30% | 5,10% | 20,92% |
| **Total burden** | **32,20%** | **31,41%** | **33,22%** | **43,45%** |
| **Total net income** | **67,80%** | **68,59%** | **66,78%** | **56,55%** |

Source: Authors' own work.

As shown in Table 1, Model 2 appears to be the most advantageous with regard to the overall burden. Profit share payment is a less favourable way with regard to the future old age pension. Model 4 seems to be the least advantageous because of the highest levies with no fundamental effect on the amount of the future pension. Also, the amount of salary exceeding the second reduction level is not included in the calculation of the pension.

**Fig. 1: Development of tax and levy burden on profit shares and salaries**




Source: Authors' own work.

To supplement the results shown in Table 1, Figure 1 was constructed. It illustrates the development of tax and levy burden on the LLC member. The results show that it is more advantageous to the LLC member to get a lower gross salary and to receive the remaining money as profit shares because of a lower tax burden and a higher net income.

### 3.2 The old age pension of the LLC member and financial security for retirement

The following part shows differences in pensions using different models of LLC members' remuneration and different periods of participation in pension insurance. As pointed out in the theoretical part, not every taxpayer is obliged to pay contributions to pension insurance. By allowing this, the State puts responsibility into the hands of the citizens themselves.

One of the variants of how to achieve pension security through social insurance is the combination of an employment relationship and an executive function, from which a share in the profit flows. In the case of profit payouts, the company meets the insolvency test and other requirements set out in the Act of Business Corporation.

**Tab. 2: Comparison of pension insurance contributions and paid pensions**

| | Model 2 | Model 3 | Model 4 |
|---|---|---|---|
| **Insurance period of 35 years** | | | |
| Old age pension (drawing for 17 years) | 2,629,259 CZK | 3,208,679 CZK | 6,486,571 CZK |
| Pension insurance contribution (35 years) | 1,905,120 CZK | 4,460,450 CZK | 18,303,734 CZK |
| Difference between drawing and contributions in relation to state budget | -724,139 CZK | 1,251,772 CZK | 11,817,164 CZK |
| **Insurance period of 45 years** | | | |
| Old age pension (drawing for 17 years) | 3,153,162 CZK | 3,898,130 CZK | 8,112,562 CZK |
| Pension insurance contribution (45 years) | 2,588,695 CZK | 5,734,865 CZK | 23,533,373 CZK |
| Difference between drawing and contributions in relation to state budget | -564,467 CZK | 1,836,735 CZK | 15,420,811 CZK |

Source: Authors' own work.

Table 2 shows differences in the amount of pension insurance withdrawals and pension insurance contributions to the state budget. Even though Model 2 offers the lowest tax burden and is very advantageous to the taxpayer, it appears to be less advantageous to the pension system. In this model the members pay less money than they draw later during their retirement. In other models the balance is positive.

**Tab. 3: Ratio of net incomes and old age pensions with an insurance period of 45 years**

| | Model 2 | Model 3 | Model 4 |
|---|---|---|---|
| Annual net salary | 166,324 CZK | 320,694 CZK | 1,286,704 CZK |
| Annual net profit share | 1,531,985 CZK | 1,301,962 CZK | 675 CZK |
| **Total annual net income** | 1,698,309 CZK | 1,622,656 CZK | 1,287,379 CZK |
| **Annual old age pension** | 185,480 CZK | 229,302 CZK | 477,210 CZK |
| **Ratio of pension to net income** | **10,92%** | **14,13%** | **37,07%** |

Source: Authors' own work.

As for making provision for retirement, it is advisable for LLC members to focus on the ratio of the old age pension and the net income during their working life. The ratios for all three models are given in Table 3 where an insurance period of 45 years was chosen. The models show lower old age pensions in comparison with net salaries during the working life.

### 3.3 Taxation of LLC members in different countries

This part of paper presents a comparative analysis of tax burden, which focuses on the taxation of profit shares and employment income of the LLC member. Due to similar political and economic developments, the V4 countries and the Baltic States were chosen for international comparison.

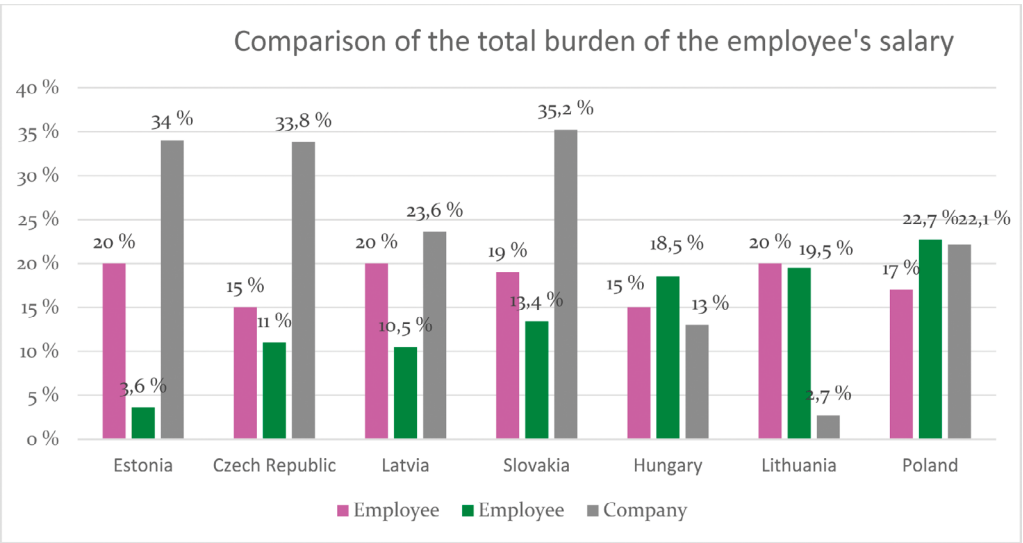
**Tab. 4: Comparison of absolute burdens in selected countries for 2022**

| | Hungary | Poland | Slovakia | Lithuania | Latvia | Estonia | Czech Republic |
|---|---|---|---|---|---|---|---|
| Personal Income Tax | 15 % | 17/32 % | 19/25 % | 20/32 % | 20/23/31 % | 20 % | 15/23 % |
| Corporate Income Tax | 9 % | 10 %/19 % | 15/21 % | 0/5/15 % | 0/20 % | 0/ 20 % | 19 % |
| Profi share tax | 15 % (SI 13%) | 19 % | 7 % | 15 % (SI 15,7 %) | 20 % | 7 % | 15 % |
| **Employee** | | | | | | | |
| Social insurance (SI) | 11,50 % | 13,71 % | 9,40 % | 12,52 % | 10,50 % | 3,60 % | 6,50 % |
| Health insurance | 7 % | 9 % | 4 % | 6,98 % | x | x | 4,50 % |
| **Employer** | | | | | | | |
| Social insurance (SI) | 13 % | 19,48 - 22,14 % | 25,20 % | 1,45–2,71 % | 23,59 % | 21 % | 24,80 % |
| Health insurance | x | x | 10 % | x | x | 13 % | 9 % |

Source: Authors' own work based on data provided by Alvarado et. al., 2020; Bencze, 2022; Serugová and Kratky, 2022; Komorowska, 2022; Nedzinskas and Miltenytė, 2022

Table 4 shows the amount of taxes and levies in selected countries, A comparative analysis of the Baltic States and the V4 countries shows that most of these countries apply progressive elements of taxation except Hungary and Estonia.

**Fig. 2: Comparison of total burden on the executive's salary in selected countries**

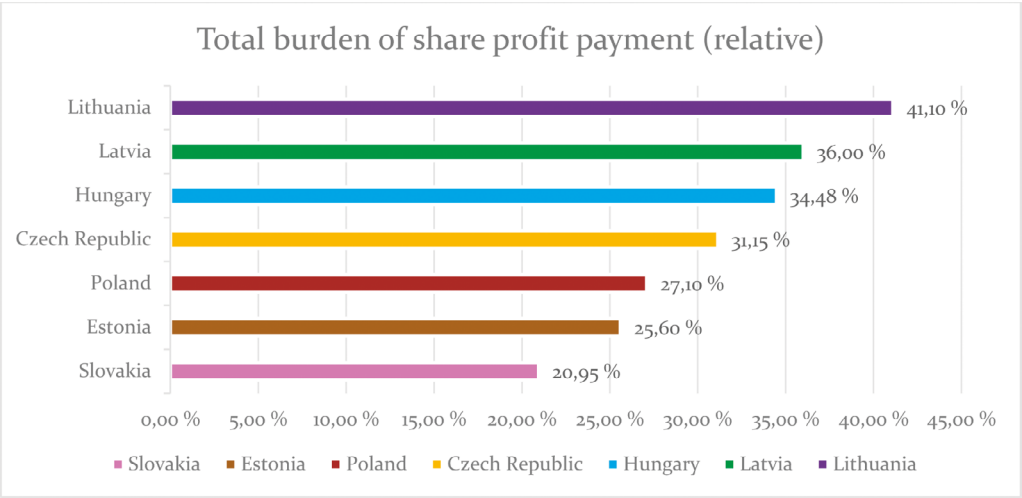



Source: Authors' own work based on data from the OECD Tax Database (2021), CountryPedia (2022); Alvarado et al. (2020)

Figure 2 reveals significant differences in the composition of levy burden on companies and employees. Although the employee pays less from their wage than in another country, the remaining value of levies is paid by the company and vice versa. The results also show that employees pay the highest absolute premiums

in Poland (22.71 %) and Lithuania (19.50 %), while employees in Estonia pay the least. However, to make an objective comparison of higher net incomes, it would be necessary to take into account the purchasing power parity, but this is beyond the scope of this paper.

**Fig. 3: Comparison of profit share payment in selected countries.**




Sources: Elksnina-Zascirinska, 2022; Lentsius, 2021, Bradford, 2022

Figure 3 shows the taxation of profit shares in selected countries. Profit shares are subject to the highest taxation in Lithuania. This also due to the obligation to pay social insurance contributions from the remuneration. On the contrary, the lowest tax burden is in Slovakia where the member receives the highest value of profit shares amounting to 79.05%. The Czech Republic is in the middle, taking fourth place.

## 4. CONCLUSION AND DISCUSSION

The Results section of the paper showed that to LLC members Model 2 of remuneration is the most advantageous, i.e., a combination of profit shares and salaries in the amount of the first reduction level for the calculation of the pension (also with regard to the fact that the period of receiving salary with pension insurance contributions is included in the insurance period for the assessment of pension). In addition, members can claim tax discounts and have the lowest tax burden of 31.41%. Payment of profit shares only (Model 1) is not advantageous to LLC members, because neither social insurance nor health insurance is deducted from profit shares. Zero social insurance contributions mean that LLC members do not meet the condition of the minimum insurance period and must provide for retire-

ment by themselves because they lose entitlement to old age pension from the pension system of the Czech Republic. At the same time, they have to make health insurance contributions as persons without any taxable income.

In addition to Models 1 and 2, there are also two other models which combine profit shares with the average salary (Model 3) and the second reduction limit (Model 4). These models included in the paper reflect the element of solidarity, which is typical of the Czech pension system. As shown in Table 2, in the case of the average salary, the LLC member with a 45-year insurance period will pay about 3.2 million CZK more to the pension system than in Model 2, but in retirement he draws only about 700,000 CZK more than in Model 2. In Model 4, the element of solidarity is even more evident. The LLC member who is paid a salary in the amount of the second reduction limit together with profit shares contributes almost three times more money to the pension system than they later draw as pension benefits. A higher salary, exceeding the second reduction limit, has no effect on the increase in the future old age pension.

All models, however, revealed a significant decline in the amount of money in old age. In the case of payment of profit shares only, LLC members could experience a significant drop in their standard of living and find themselves on the verge of poverty. The option presented in Model 2, which was evaluated as the most advantageous to the LLC member with regard to the total tax burden, causes a drop in income in old age to about 10% of net income during the working life. As shown in Table 2, this option also causes a negative balance in the pension account, which means that the LLC member withdraws more in pension benefits than they paid for pension insurance during their working life. According to Tománková (2020), a financially secure pensioner is a taxpayer whose income in old age will cover 70% of income before reaching retirement age. Recommendations to LLC members is to focus more on securing income in old age, for example, through the 3rd pillar of the pension system or with the help of private investing. From the point of view of the Czech pension system, it would be good to consider introduction of mandatory contributions to pension insurance in the case of payment of profit shares only. These mandatory social insurance contributions are common in countries such as Hungary and Lithuania.

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# Self-employed Status of the Commercial Agent in European View

**Václav Pilík**

JUDr. Václav Pilík, Ph.D.
vaclav.pilik@vsci.cz
ORCID 0000-0001-9594-3922
Assistant Professor, Department of Private Law
CEVRO Institute
Prague, Czech Republic

***Abstract:***
The commercial agents' self-employed status is an integral part of their definition. By this status, commercial agents are distinguished especially from persons engaged in similar activities, but in dependent position towards the principal. In general view, criterion of self-employed status seems to be clear; in specific cases, however, it may be difficult to apply. In EU Member States, moreover, it shall apply accordingly to Commercial Agents Directive. In this contribution, I attempt systematically to assess the case law of EU courts and Draft Common Frame of Reference as valuable sources of guidelines for interpretation and application of that criterion.

***Key words:*** *business transaction, commercial agent, entrepreneur, mandate-type contracts, self-employed intermediary*

## INTRODUCTION

Regardless of the specific legal framework (whether national or otherwise), the self-employed status of commercial agents should be considered as a key feature. Before dealing with this feature, it is worth recalling that verba might vary, while the ratio remains the same. Commercial agents can thus be referred to as "self-employed intermediaries",[1] "independent contractors",[2] "independent entrepreneurs",[3] or otherwise. In this contribution, I prefer the attribute "self-employed"[4]. But it is

1 Council Directive 86/653/EEC of 18 December 1986 on the coordination of the laws of the Member States relating to self-employed commercial agents, Art. 1 (2). In EUR-Lex [online]. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A31986L0653

2 BASKIND, Eric, Lee ROACH, and Greg OSBORNE. *Commercial Law*. Oxford University Press, 2016, 51.

3 CZECH REPUBLIC Act No. 89/2012 Coll., the Civil Code [zákon č. 89/2012 Sb., občanský zákoník], Sec. 2483 (1).

4 In particular, with regard to wording of the Directive cit. sub 1.

the ratio that must be followed in order to interpret (and apply) the self-employed status of commercial agents correctly.

In EU Member States, due to the Council Directive 86/653/EEC on the coordination of the laws of the Member States relating to self-employed commercial agents (hereinafter referred to as "CAD"), **the self-employed status of commercial agents should be interpreted in conformity with EU law**. In this contribution, I attempt systematically to assess two valuable sources of that interpretation and application: the case law of EU courts (Section 1) and the Draft Common Frame of Reference (2009, hereinafter referred to as "DCFR", Section 2). I will subsequently deal with the question of whether the aforementioned sources make it possible to derive a concise test of the self-employed status of a commercial agent (Section 3).

If we ask the question of why it is worth dealing with the correct interpretation of the self-employed status of commercial agents nowadays, this is primarily because it is one of the conditions for the plausible functioning of the EU regulation of commercial agency. Another reason may be the contemporary trend of increasingly new forms of work and cooperation that trigger the need to assign an adequate legal regime to them.

## 1. SELF-EMPLOYED STATUS OF THE COMMERCIAL AGENT IN EU LAW

### 1.1 General notes

The key act of EU law on commercial agency is CAD; as a directive, it is legally binding in the sense of Art. 288, third para., of the Treaty on the Functioning of the European Union (ex Art. 249, third para., EC Treaty), i.e. including, in principle, only the indirect effect (consisting in the requirement to interpret and apply the national law in conformity with EU law).[5] **The commercial agent is defined in Art 1 (2) CAD as a *"self-employed intermediary* *who has continuing authority to negotiate the sale or the purchase of goods on behalf of another person, hereinafter called the 'principal', or to negotiate and conclude such transactions on behalf of and in the name of that principal".***

Regarding **the term "intermediary"**, it is and must be more precisely defined with regard to different concepts of agency across the legal systems of the EU Member States.[6] This concept is close to the agency in German and French law and narrower than the agency under English law.[7]

5 In more detail, RANDOLPH, Fergus, and Jonathan DAVEY. *Guide to the Commercial Agents Regulations*. Oxford [England]: Hart Publishing, 2003, 13-14.

6 VERHAGEN, Hendrik. Agency and Representation In: SMITS, Jan M., ed. *Elgar encyclopedia of comparative law*. Cheltenham [England], Northampton [MA, USA]: Edward Elgar, 2006, 54.

7 LANDO, Ole. The EEC Draft Directive relating to Self-Employed Commercial Agents: The English Law Commission versus the EC Commission. *Rabels Zeitschrift Für Ausländisches Und Internationales Privatrecht / The Rabel Journal of Comparative and International Private Law*. 1980, 44(1), 4; MUNDAY, Roderick. *Agency: Law and principles*. Oxford [England]: Oxford University Press, 2010, 8-9; FOGARTY, Paul, and Caroline BERGIN-CROSS. Commercial Agents Directive and Liability – Part I. *Irish Law Times*. 2014, 32(1), 195–200.

Regarding **the term "self-employed"**, which this article is primarily concerned with, a more precise definition of it is lacking in CAD (looking beyond some indications in the recitals). With some simplification, a self-employed person can be described as the opposite of a regular employee, i.e. as a person who *"must be able to decide how and when to perform his obligations under the intermediary contract"*.[8] In more detail, it must be assumed that a "self-employed intermediary" is an autonomous concept of EU law. In general, *"[t]he EU has developed a multifaceted approach to the concepts of "worker", "employee" and "self-employed", crafting different definitions depending on the subject matter of the relevant legislation."*[9] In relation to commercial agents, the relevant concept of self-employed status is one in the ambit of the freedom of establishment and services. In this ambit, the Court of Justice of the European Union *"has construed the notion of 'self-employed' by contrary inference to that of 'worker', stating that 'since the essential characteristic of an employment relationship within the meaning of Article 48 of the EC Treaty ... is the fact that for a certain period of time a person performs services for and under the direction of another person in return for which he receives remuneration, any activity which a person performs outside a relationship of subordination must be classified as an activity pursued in a self-employed capacity for the purposes of Article 52 of the Treaty'".*[10] As we can see, the distinction from an employee is indeed the core element of the self-employed status of a commercial agent.

Regarding the term "self-employed", in addition, this status does not set juridical (i.e. artificial) persons apart from the category of commercial agents. Opposing views have occasionally appeared in national legal systems,[11] but were based on linguistic impression rather than on substantive arguments.

### 1.2 EU Case Law

For the interpretation of the self-employed status of a commercial agent in the sense of Art. 1 (2) CAD, the case law of the EU courts, especially the Court of Justice of the European Union, is of particular importance. Although the self-employed status of a person is found in various areas of EU law, in this sub-chapter I only deal with case law on CAD. Despite this case law not offering a comprehensive definition of the self-employed status of a commercial agent, it does draw attention to important features of it. **The self-employed status of a commercial agent**

8 EFTESTØL-WILHELMSSON, Ellen. EC Agency Law and Intermediaries in Shipping. *Scandinavian Institute of Maritime Law Yearbook*. 2006. Helsinki Legal Studies Research Paper No. 11, 153. Available also at SSRN, from: https://ssrn.com/abstract=1948526

9 TOSATO, Andrea. An Exploration of the European Dimension of the Commercial Agents Regulations. *Lloyd's Maritime and Commercial Law Quarterly*. 2013, Part 4, 554-555, with reference to the judgment of the Court of Justice of 6 October 2009. María Martínez Sala v. Freistaat Bayern. Case C-85/96 [1998] ECR I-02691, para 31, and CONTOURIS, Nicola. *The changing law of the employment relationship: comparative analyses in the European context.* Aldershot: Ashgate, 2007, 171-191.

10 TOSATO, Andrea, op. cit. sub 9, with reference to the judgment of the Court of Justice of 15 December 2005. Nadin and Nadin-Lux. Joined Cases C-151/04 and C-152/04 [2005] ECR I-11203, para 31.

11 E.g., RANDOLPH, Fergus, and Jonathan DAVEY, op. cit. sub 5, 39.

(1) **is among the three necessary and sufficient conditions inferred from Art. 1**

(2) **CAD** in the case *Zako v. Sanidel*[12] for a person to be classified as a "commercial agent";

(2) **is material in the sense that formal trappings shall not be determinative**. This is illustrated by the cases *Bellone v. Yokohama*[13] *and Caprini v. CCIAA*[14] in which the European Court of Justice concluded that an entry in a register (as an instance of formal trapping) is not referred to as a condition for protection under CAD;

(3) **is intrinsic or substantial in the sense that superficial or *prima facie* trappings shall not be determinative**. This is illustrated by the aforementioned case *Zako v. Sanidel* in which the Court of Justice of the European Union concluded that *"the fact that a person who has continuing authority to negotiate the sale or the purchase of goods on behalf of another person, or to negotiate and conclude such transactions on behalf of and in the name of that person, performs his activities from the latter's business premises does not prevent him from being classified as a 'commercial agent'"*[15] (thinking in the way that performing the activity in the second party's business premises is only superficial or a prima facie trapping of the regular employment);

(4) does not, in principle, contradict the fact that the commercial agent must safeguard the principal's interests and comply with terms of the contract which binds him to the principal. The Court of Justice of the European Union concluded thus in the case *Marchon Germany v. Karaszkiewicz*[16] (in this way, we were reminded by the Court of the fact that the self-employed status of a commercial agent and the contractual, and moreover procurement, nature of his activity are separate terms);

(5) **does not mean that a commercial agent must be fully independent in all aspects of his activity**. On that ground, the Court of Justice of the European Union in the case *Trendsetteuse v. DCA*[17] interpreted that a person can have the status of commercial agent even if he does not have the power to amend

12 Judgment of the Court of Justice of the European Union of 21 November 2018. Zako v. Sanidel. Case C-452/17, para 22. In EUR-Lex [online]. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A62017CJ0452&qid=1661976095230

13 Judgment of the European Court of Justice of 30 April 1998. Bellone v. Yokohama. Case C-215/97, paras 13, 18. In EUR-Lex [online]. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A61997CJ0215&qid=1661976146784

14 Judgment of the European Court of Justice of 6 March 2003. Caprini v. CCIAA. Case C-485/01, paras 16-20. In EUR-Lex [online]. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A62001CJ0485&qid=1661976539590. In this case, the Court added that merely maintaining the register of commercial agents by Member States does not contradict CAD.

15 Judgment cit. sub 12, para 36.

16 Judgment of the Court of Justice of the European Union of 7 April 2016. Marchon Germany v. Karaszkiewicz. Case C-315/14, paras 31 and 32. In EUR-Lex [online]. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=ecli%3AECLI%3AEU%3AC%3A2016%3A211

17 Judgment of the Court of Justice of the European Union of 4 June 2020. Trendsetteuse v. DCA. Case C-828/18. In EUR-Lex [online]. Available from: https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:62018CJ0828

the conditions of sale and to set the price of the goods he sells on behalf of the principal. While this interpretation is primarily based on the word "negotiate" in Art. 1 (2) CAD, it has a strong link to the self-employed status of a commercial agent in the same Article. By that interpretation, the Court of Justice of the European Union clearly refused the opposite interpretation of the French *Cour de cassation*.[18, 19] This case appears interesting at least in two respects. Firstly, the self-employed status of a commercial agent must be understood as a comprehensive category and cannot stand and fall by one specific characteristic. Secondly, the commercial agent's status under the CAD has been confirmed as an autonomous concept of EU law, which must be interpreted uniformly and can not be modified either by national law or by national case law;

(6) **also has certain limits, not including a person who acts on behalf of a principal, but in his own name** (commission agent, *Kommissionär, commissionnaire, commissionario*). The European Court of Justice excluded these persons from commercial agents in the case *Mavrona & Sia v. Delta Etaireia Symmetochon.*[20] The question was not so much whether those persons could be classified as commercial agents under CAD, but rather whether CAD should apply to these persons *per analogiam*. The negative answer to the former question is based directly on the wording of Art. 1 (2) CAD.21 The latter and main question requires consideration of the aim of CAD, including the self-employed status of a commercial agent. The European Court of Justice argued that activities pursued by commercial agents and activities pursued by commission agents are different; the interests and the need for protection of the two occupations are not the same, and CAD does not contain any provision nor any indication that it might apply to commission agents.[22, 23]

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18 It should be noted that the approach of French Case Law to that question was not uniform. See ibidem, para 17.

19 On adaptation of the French Case Law to the Trendsetteuse v. DCA see e.g. FOURNIER, Frédéric. FRANCE: French Court decisions slowly align with the EUCJ EU Trendsetteuse case. International Distribution Institute [online]. 15 July 2021. Available from: https://www.idiproject.com/news/france-french-court-decisions-slowly-aligns-eucj-eu-trendsetteuse-case/ or Simmons+Simmons. Commercial agents: Change after change in Case Law. Simmons+Simmons [online]. 12 April 2021. Available from: https://www.simmons-simmons.com/en/publications/cknen6eg31deb095169tw21ds/commercial-agents-change-after-change-in-case-law

20 Order of the European Court of Justice of 10 February 2004. Mavrona & Sia v. Delta Etaireia Symmetochon. Case C-85/03. In EUR-Lex [online]. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:62003CO0085

21 If commercial agent is defined as "has […] authority to negotiate […] on behalf of another person […] or to negotiate and conclude such transactions on behalf of and in the name of that principal", a person who acts on behalf of a principal, but in his own name, is clearly not covered.

22 Order cit. sub 20, paras 16 and 17.

23 It might be added that, in this case, the question of whether commission agents should fall under CAD (though *per analogiam*) was resolved in relation to Greek Law, but a similar question also appears in the law of other Member States. In the Czech Republic, the former rules on commission agency in the Commercial Code (Act No. 513/1991 Coll., repealed on 1 January 2014) provided expressly (Sec. 590) that a long-term commission agency was also subject to rules on commercial agency; this was also accepted by the Case Law of the Supreme Court (*Nejvyšší soud*) of the Czech Republic; see judgment of 30 June 2009, No. 23 Odo 1787/2006. In Nejvyšší soud [online]. Available from: https://www.nsoud.cz/Judikatura/judikatura_ns.nsf/WebSearch/A3837D26C623F85AC1257A4E0065EC5A?openDocument&Highlight=0,null. However, the current rules on commission agency (Sec. 2455 to 2470) in the Civil Code have not endorsed the express reference to rules on commercial agency (Sec. 2483 to 2520). So currently it might be debatable whether a long-term commission agency should have a commercial agency regime. In my opinion, the judgment in the case *Mavrona & Sia v. Delta Etaireia Symmetochon* gives no other answer than "no". Congruently, e.g., KINDL, Tomáš. In PETROV, Jan, Michal VÝTISK and Vladimír BERAN. *Občanský zákoník: komentář.* 2. vyd. Praha: C. H. Beck, 2019, Sec. 2483, 2651.

## 2. SELF-EMPLOYED STATUS OF THE COMMERCIAL AGENT IN DCFR

### 2.1 General Notes

DCFR deals with the commercial agency in Book IV, Part E, Chapter 3;[24] the document as a whole is not legally binding, but possesses the power of persuasion. Two preliminary observations are called for in the provisions of DCFR on commercial agency. Firstly, DCFR (2009), Book IV, Part E, was preceded by Principles of European Law: Commercial Agency, Franchise and Distribution Contracts (PEL CAFDC, 2006).[25] The provisions on commercial agency differ, but not significantly;[26] the definitions of it are essentially identical. Secondly, on the field of commercial agency, DCFR (as well as earlier CAFDC) seeks to find common European rules, but at the same time to take CAD into account.

The commercial agent is defined in Art. IV. E. – 3:101: Scope as a party who "agrees to act on a continuing basis as a self-employed intermediary to negotiate or to conclude contracts on behalf of another party, the principal, and the principal agrees to remunerate the agent for those activities". As we can see, the definition differs from that set out in CAD, a little more than from that in PEL CAFDC. Nonetheless, as in the Directive, a commercial agent is defined as a self-employed intermediary, and the agency follows a civil law, not the common law concept.[27] What is particularly interesting is the part stating: "conclude contracts on behalf of [...] the principal" where the commercial agent is not required to act in the name of the principal. This differs from CAD (taking into account the case *Mavrona & Sia v. Delta Etaireia Symmetochon*).

### 2.2 DCFR Authentic Commentary

For the interpretation of the self-employed status of a commercial agent in the sense of Art. IV. E. – 3:101 DCFR, the authentic Comments are of particular importance. **It is specifically stated that "[t]he concept of a self-employed intermediary is taken from the Directive 86/653/EEC."**[28] In other words, it has taken a pragmatic approach and the question is how to evaluate this approach. On the

24 VON BAR, Christian, Eric CLIVE, eds. Principles, Definitions and Model Rules of European Private Law Draft Common Frame of Reference (DCFR). Full Edition. Volume 3. Munich: Sellier, 2009, 2336-2382.

25 HESSELINK, Martijn W., Jacobien W. RUTGERS, Odavia BUENO DÍAZ, Manola SCOTTON and Muriel VELDMAN. *Principles of European Law. Commercial Agency, Franchise and Distribution Contracts (PEL CAFDC)*. Munich: Sellier, 2006.

26 For more detail, see CASHIN RITAINE, Eleanor. The Common Frame of Reference (CFR) and the Principles of European Law on Commercial Agency, Franchise and Distribution Contracts. *ERA Forum*. 2007, 8(4), 573-574.

27 JURKEVIČIUS, Vaidas, Yuliia POKHODUN and Raimonda BUBLIENĖ. Peculiarities of International Commercial Agency Agreements from a Comparative Perspective. In: *12th International Scientific Conference "Business and Management 2022"* [online]. Vilnius Gediminas Technical University, 918. Available from: http://bm.vgtu.lt/index.php/verslas/2022/paper/viewFile/750/457

28 VON BAR, Christian, Eric CLIVE, eds. *Principles, Definitions and Model Rules of European Private Law Draft Common Frame of Reference (DCFR). Full Edition*. Volume 3. Munich: Sellier, 2009, 2337. A more detailed explanation of the deviation is unfortunately missing.

one hand, this approach can be appreciated for its dynamics. On the other hand, comments could have sketched a systematic test of self-employed status on the basis of the Acquis, including EU case law.

With regard to the part of the definition related to the commercial agent who concludes contracts on behalf of the principal, without condition to do so in the name of the principal, the Comments confirm that *"[t]hese rules may in principle apply to commission agents."*[29] This deviation from the definition in Art. 1 (2) CAD as interpreted in the case *Mavrona & Sia v. Delta Etaireia Symmetochon* shows the issue (including the question of the possible extent of the self-employed status of a commercial agent) as closed only in EU *lex lata*, not in EU *lex ferenda*.

## 3. A CONCISE TEST OF SELF-EMPLOYED STATUS OF THE COMMERCIAL AGENT

### 3.1 The Current State

Having assessed the case law of EU Courts (Section 1) and the Draft Common Frame of Reference (Section 2) as two valuable sources of interpretation and application of the self-employed status of a commercial agent, we can move toward **the question of whether these sources make it possible to derive a concise test of this status**.

**The case law of EU Courts** has not yet created that test at a general level (i.e. for purposes of CAD); on the other hand, it has brought forward several important items in that test (see Sub-section 1.2).

**The DCFR** (as well as earlier CAFDC) pragmatically adopts the concept of a commercial agent's self-employed status from CAD, including relevant EU case law.

### 3.2 Prospects

Starting from the current state and assuming that a concise test of a commercial agent's self-employed status is desirable, we are faced with two questions. Firstly, where should such a test be formulated? Secondly, how should it be formulated?

**The first question** opens up different solutions. Generally speaking, they can be sought at national or EU level and can be formed in the legislation, case law (which legally binding effect varies according to the respective jurisdiction), and non-legally binding instruments.[30] In my opinion, **it is essential that the concise test of self-employed status of the commercial agent for the purposes of CAD be developed at EU level, and the case law of the Court of Justice of the**

29 Ibidem.

30 For an interesting example of non-legally binding instruments, see

**European Union appears to be the most appropriate "medium"**. Only a test developed at EU level guarantees uniform application. The case law offers better expressive potential[31] as well as greater flexibility, if compared to the legislation, and it is part of the sources of EU law, if compared to non-legally binding instruments developed on a private basis.

**The second question will be dealt with only on a "preparative scheme" level** in this contribution. The inputs of this scheme will primarily be the previous conclusions of the Court of Justice of the European Union (and, formerly, the European Court of Justice) case law. The output of the scheme should be a consistent and well-organised starting point for the formulation of the test. The scheme may be as follows:

**Tab. 1: A concise test of self-employed status of the commercial agent: a preparative scheme**

| Part A – Objective: |
|---|
| A.1. Objective formulation:<br>● To confirm/deny the self-employed status of a commercial agent as a position between a regular employee (or a person similarly dependent on the principal) and a person acting on behalf of a principal, but in his own name.<br><br>A.2. Objective quality:<br>● To do so uniformly at EU level. |
| **Part B – Procedure:** |
| B.1. Preliminary rules:<br>● In principle, the commercial agent's self-employed status must be understood materially (not formally) and must not be understood as independent in all aspects.<br>● In detail, the commercial agent's self-employed status must be assumed with particular attention to case law of the Court of Justice of the European Union (formerly the European Court of Justice) on CAD and, if necessary, on the more general concept of self-employed status in the ambit of the freedom of establishment and services (see Sub-section 1.1.).<br><br>B.2.1. Core or "hard" criteria:<br>● Essential independency of **organisational** level of the activity, as well as<br>● essential independency of **professional** level of the activity<br><br>strongly indicate the self-employed status of a person.<br><br>B.2.2 Auxiliary or "soft" criteria:<br>● being named a commercial agent or by other words, but in a similar sense,<br>● having the back-office for the activity in own premises,<br>● performing the activity for several clients (if not excluded by exclusive agency clause),<br>● bearing costs of own activity,<br>● being paid in the amount according to the number and value of business transactions concluded,<br><br>as examples, may indicate the self-employed status of a person rather than the "regularly employed" status. |

Source: own elaboration, for the purpose of this contribution.

31 By this, I mean the formulation of the statutory law is bound by the requirements of generality and, if possible, brevity, as well as by a number of other legislative and technical requirements.

The test, as sketched above (as a "preparative scheme"), requires at least two remarks. Firstly, for its correct application, it is necessary to eliminate the misconceptions about the status of a commercial agent. Therefore, for example, a commercial agent does not merely have to be a natural person,[32] a commercial agent does not have to be in the position of a weaker party,[33] etc. Secondly, the test does not provide an exact metric. However, it can be a useful aid in clarifying whether a person complies with the self-employed status to be qualified as a commercial agent in the sense of CAD.

## CONCLUSION

A commercial agent's self-employed status is inherent in its definition. This also applies to the definition of a commercial agent under CAD. **At the EU level, apparently the most valuable source for interpretation of this status is the case law of the Court of Justice of the European Union. It offers better expressive potential as well as greater flexibility**, if compared to the legislation, **and is part of the sources of EU law**, if compared to non-legally binding instruments developed on a private basis.

The following can be concluded on the case law of the Court of Justice of the European Union relating to the self-employed status of the commercial agent under CAD:

Firstly, it sees the self-employed status of the commercial agent as a position between a regular employee and a person acting on behalf of the principal, but in his own name. To meet this status, the person is not required to be fully independent in all aspects of his activities (he may not even have the power to amend the conditions of sale and to set the price of the goods he sells on behalf of the principal).

Secondly, it has provided many reliable clues as to how to interpret the self-employed status of the commercial agent, but has not yet reached a concise test of that status.

Thirdly, **it has the potential to develop such a test**. Moreover, its continued development shows that such a test is desirable.

In this contribution, a preparative scheme has been proposed for this test. The formulation of the test is a matter for more comprehensive discussion. In any case, it should be based on the question of whether a person is mainly independent at the organisational and professional levels of his activity. On the one hand, such a test does not promise the accuracy of a mathematical algorithm, but on the other hand, it can be a useful tool for clarifying the legal status of the assessed person.

32 RANDOLPH, Fergus, and Jonathan DAVEY, op. cit. sub 5, 39.

33 HOUSKA, Daniel, and Simona SPISAROVÁ. Ochrana obchodního zástupce – nebo naopak zastoupeného. *Obchodní právo*. 2020, 29(9), 21-22.

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# The Impact of Covid-19 Pandemic on Law Regulating Virtual Shareholder Meetings in Croatia

**Tea Hasić**

Tea Hasić, PhD
thasic@unipu.hr
ORCID https://orcid.org/0000-0001-6079-1156
Lecturer in Law, Department of Organisation, Entrepreneurship and Law
Faculty of Economics and Tourism "Dr. Mijo Mirković",
Juraj Dobrila University of Pula
Pula, Croatia

***Abstract:***
The Shareholder Rights Directive (2007/36/EC) was implemented in the Croatian Companies Act in May 2010. According to respective legislation, companies in Croatia are allowed to enable their shareholders to exercise shareholding rights through remote communication means. To be precise, companies in Croatia are allowed (but not obliged) to hold hybrid (but not exclusively virtual) shareholder meetings only if respective possibility had been anticipated by their incorporation acts.
Due to the Covid-19 pandemic, severe gathering restrictions were enacted in 2020, creating a following legal dilemma for Croatian companies: is it less harmful to organize a shareholder meeting „at place" – thus, breaching gathering restrictions, or to organize a shareholder meeting in a virtual environment – despite the fact that such possibility had not been provided by the Croatian Companies Act?
This paper summarizes the main conclusions from available literature on virtual or hybrid shareholder meetings, emphasizing the most prominent pros and cons when it comes to organizing shareholder meetings online. The aim of the paper is to provide an analysis of different national legislations on virtual shareholder meetings in order to propose optimal legal solution for (Croatian) legislator.

***Key words:*** *virtual shareholder meetings; hybrid shareholder meetings; Covid-19*

## INTRODUCTION

Several decades ago, new technological inventions, i.e. means of electronic communication, enabled remote (even cross-border) share purchase, without the necessity to cross the state border physically or even to leave the armchair. As a consequence, numerous listed companies (especially those operating on international level) diversified their shareholders' structure notably. Remote, especially foreign shareholders, definitely played a significant role in strengthening the phenomenon known as "shareholders' rational apathy".[1] Respective term stands for shareholders who decided not to participate and vote on shareholder meetings as they'd assessed that potential benefits of exercising their shareholding rights will not outweigh cots, time and efforts required to participate in shareholder meetings.[2] Rationally apathetic shareholders caused numerous problems in listed companies' corporate governance.[3] Thus legislators, on both sides of the Atlantic,[4] tried to amend the legislative framework in order to encourage shareholders to exercise their voting rights to a greater extent. In 2003, the European Commission launched a document titled *Modernizing Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward*.[5] As a result, *Directive 2007/36/EC on the exercise of certain rights of shareholders in listed companies*[6] (hereinafter: Shareholder Rights Directive) was enacted, demanding from the EU member states to harmonize their national legislation with its provisions. As an EU accession state at that time, Croatia was also obliged to implement Directive in the national legislation. Thus, in 2009, the Croatian Parliament adopted the *Act on Amendments and Supplements to the (Croatian) Companies Act*[7] which entered into force on 1st May, 2010.

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2 More about shareholders' rational apathy see in: FAIRFAX, Lisa M. From Apathy to Activism: The Emergence, Impact and Future of Shareholder Activism as the New Corporate Governance Norm. Boston University Law Review. 2019, 99, 1304-1305.

3 See: KASTIEL, Kobi, and Yaron NILI. In search of the "absent" shareholders: a new solution to retail investors' apathy. Delaware Journal of Corporate Law. 2016, 41, 60-67.

4 Amendments introduced in the legislative framework of the USA, as a response to corporate scandals, are described in: Ibid, 67–70. Respective amendments are not analyzed in this paper, but it seems worth to mention that those amendments were aimed to ensure additional information and monitoring rights to shareholders.

5 Modernizing Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward. Communication from the EU Commission to the Council and the European Parliament of 21 May 2003. COM (2003) 284 final.

6 Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/eli/dir/2007/36/oj. Respective Directive was amended by Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/eli/dir/2017/828/oj.

More about Shareholder Rights Directive and virtual shareholder meetings, see in: ZETZSCHE, Dirk. Virtual Shareholder Meetings and the European Directive on Shareholder Rights – Challenges and Opportunities. Direito dos Valores Mobiliarios – University of Lisbon. 2008, 473–540.

7 THE REPUBLIC OF CROATIA Act No. 137/09 The Act on Amendments and Supplements to the Companies Act [NN br. 137/09 Zakon o izmjenama i dopunama Zakona o trgovačkim društvima].

According to Shareholder Rights Directive (art. 8) listed companies incorporated in the EU member states are given the possibility **to offer** to their shareholders **any form** of participation in the general meeting by electronic communication means. Croatian legislation on hybrid and exclusively virtual shareholder meetings – *de lege lata*

According to Croatian Companies Act[8] (art. 274, par. 1) general meetings of shareholders shall be organized in a physical form (i.e. at place). But companies are allowed to offer their shareholders additional possibility – i.e. the possibility to exercise their rights *online*. Croatian Companies Act explicitly states that respective additional possibility has to be provided by the articles of association (art. 274, par. 1). To be precise, articles of association may directly authorize shareholders to exercise their rights online, or (through articles of association) management board may be authorized to give shareholders the opportunity to exercise their rights online (art. 274, par. 1). However, the use of electronic communication for exercising shareholding rights from a remote place is allowed only if communication between shareholders and general meeting is maintained in real time, and if the right to vote (during or before general meeting) is not conditioned with the obligation to be represented by proxy in a place where general meeting is maintained in physical form. Finally, shareholders identification, undisturbed electronic communication and immutability of the will expressed by electronic communication means must be secured (art. 274, par. 5).

On the other hand, decisions adopted in exclusively virtual general meetings seem to lack validity (at least in regular circumstances) as they lack the mandatory form prescribed by the law. Since Croatian legislator has failed to enact so-called "crisis legislation" suspending the requirement of in-person gatherings in extraordinary circumstances (as proposed by academics and professionals) it is questionable whether decisions adopted in exclusively virtual shareholder meetings held during extraordinary circumstances (such as pandemic) shall be considered valid and on what grounds? Respective issue is to be discussed under paragraph 2.2.

## 1. PROBLEMS THAT OCCURRED WITH THE RISE OF COVID-19

According to Croatian legislation, companies are obliged to hold shareholder meetings at least once a year, within the six months from the end of the financial year (the so-called "annual meetings of shareholders") as well as in situations where the interests of the company require so – for example, when company's loss reaches at least one half of the company's share capital. If general meeting was not held during the period when mandatory laws or the company's interests require it, the members of the company's board may be personally responsible for consequential damages.

8 THE REPUBLIC OF CROATIA Act No. 111/93, 34/99, 121/99, 52/00, 118/03, 107/07, 146/08, 137/09, 125/11, 152/11, 111/12, 68/13, 110/15, 40/19, 34/22 The Companies Act [NN 111/93, 34/99, 121/99, 52/00, 118/03, 107/07, 146/08, 137/09, 125/11, 152/11, 111/12, 68/13, 110/15, 40/19, 34/22 Zakon o trgovačkim društvima].

Nonetheless, as a response to pandemic caused by a previously unknown virus (Covid-19) gathering and movement restrictions entered into force. In Croatia, respective measures were in force (to a lesser or greater extent) since March 19th, 2020 until April 9th, 2022. But restrictions were mitigated to a significant extent during the summer months – when gatherings were allowed if anti-pandemic measures (such as distance, wearing a mask, etc.) were observed.[9]

Members of the boards of the companies that were obliged to hold a shareholder meeting during the period when the gathering restrictions were the strictest (e.g. 5 persons maximally in the indoor space) found themselves faced with a dilemma: is it better to postpone a meeting (if this was possible without negative consequences for a company); to organize a meeting in a physical form – thus, breaching the anti-gathering measures; to organize a meeting in a hybrid form or to organize a meeting in exclusively virtual form?

According to the author of this article, the most appropriate solution in the aforementioned situation was to postpone the meeting, if there was no real risk of damages due to the delay. But, if the risk of damages was real or if the prorogation signified the blockage of corporate governance, resulting in the blockage of business, prorogation definitely was not the right option.

In two subsequent sub-paragraphs we are going to analyze possibilities to convene hybrid or virtual shareholder meetings in Croatia during circumstances when anti-Covid-19 measures prevented or significantly limited gatherings.

### 1.1 Hybrid shareholder meetings during the gathering restrictions in Croatia

The majority of Croatian joint-stock companies are controlled by controlling shareholders who can block the adoption of decisions on amending the articles of association.[10] Controlling shareholders regularly exercise their shareholding rights – either in person, either through proxies.[11] Thus, they do not have particular interest in providing other shareholders with a right to exercise their rights online. Therefore, it is not surprising that the number of companies that provide the possibility to hold hybrid shareholder meetings is negligible.[12]

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9 Government of the Republic of Croatia: Službena stranica Vlade za pravodobne i točne informacije o koronavirusu. koronavirus.hr [online]. [no date] [viewed 29 September 2022]. Available from: https://www.koronavirus.hr/odluke-stozera-civilne-zastite-za-sprjecavanje-sirenja-zaraze-novim-koronavirusom/323.

10 MAUROVIĆ, Ljiljana, and Tea HASIĆ. Reducing Agency Costs by Selecting an Appropriate System of Corporate Governance. *Economic Research-Ekonomska Istraživanja* [online]. 2013, 26(sup1), 230. ISSN 1848-9664 [viewed 27 September 2022]. Available from: doi:10.1080/1331677x.2013.11517649.

11 For instance, in the USA, institutional investors (that usually hold the controlling share packages) vote in rates of over 90% whilst retail investors vote approximately 30%. See: KASTIEL, Kobi, and Yaron NILI. In search of the "absent" shareholders: a new solution to retail investors' apathy. Delaware Journal of Corporate Law. 2016, 41, 66.

12 See: HORAK, Hana, and Kosjenka DUMANČIĆ. Jačanje prava dioničara i pravo dioničara na informacije. Pravni vjesnik, 11. 2011, 11(3-4), 191–217.

Even when provided by incorporation acts, participation in a hybrid shareholder meeting from a remote place (through the means of electronic communication) may be only a complementary opportunity, not an obligation for shareholders. Thus, in a situation where (for example) company has 150 shareholders and gathering restrictions allow 5 persons in maximum to attend an indoor event; or 100 persons in maximum to attend an outdoor event – companies are not allowed to decide who shall attend the meeting in person, whereas the others shall access the meeting through remote communication means. Namely, such a decision would constitute the breach of fundamental company law principle – i.e. the principle of equal treatment of shareholders. If the general meeting was convened in a way that violates the respective principle, all resolutions adopted on respective meeting would be voidable. Thus, we can conclude that even a few companies that had anticipated (through their incorporation acts) the possibility to hold hybrid shareholder meetings were faced with gathering restrictions to the exact extent as companies that did not provide the respective option – as hybrid shareholder meetings cannot solve the problem that rose from gathering restrictions.

### 1.2 Virtual shareholder meetings during gathering restrictions in Croatia

According to Croatian Companies Act (art. 275) certain decisions of extreme importance for "running a business" can be adopted only by shareholders on properly convened general meetings. Even in situations when, due to extraordinary circumstances, it is not possible to convene the general meeting in proper form, members of the management board are still obliged to run a business and to take decisions in the best interest of the company as a whole (art. 252). Thus, they have to do whatever is necessary in order to eliminate the decision-making blockage and to continue the business. This means that the general meeting shall be convened on time and under the procedures prescribed, but it's on the management board to decide whether to breach gathering restrictions and organize a shareholder meeting in person or to breach the Companies Act and to organize a shareholder meeting in an exclusively virtual form. The latter possibility seems to be much wiser of a choice as it does not expose the company's shareholders to the risk of infection and it protects the board members from possible compensation claims in case of infection. In addition, it protects both shareholders and members of the board (as persons responsible for company's decisions) from sanctions for violating gathering restrictions.

Accordingly, by opting for an exclusively virtual shareholder meeting, management of the company violates Companies Act provisions on mandatory form of the shareholder meeting. But, on the other hand, they enable the realization of the mandatory norms of the Companies Act which state that: a) the general meetings of shareholders must be held whenever it is in the interest of the company; b) that

shareholders must have the opportunity to exercise their rights whenever it comes to issues under their competence.

Though it seems obvious that holding an exclusively virtual shareholder meeting is a "lesser evil" than not holding a shareholder meeting at all; or holding the meeting in the physical form during gathering restrictions, it is questionable whether decisions adopted on exclusively virtual meetings are valid.

In the opinion of the author of this article, if the general meeting was convened on time and under the prescribed procedure, and if all shareholders were provided with the equal rights to participate in general meeting online to the same extent as in in-situ meetings (i.e. if all shareholders were provided with the right to ask questions, to participate in discussions and to vote) Courts shall reject the claims applied by shareholders in order to annul decisions adopted at virtual meetings. Namely, in given circumstances (i.e. during the Covid-19 restrictions) by organizing virtual shareholder meeting the board members acted in the best interest of the company (as the business was unblocked) as well as in the best interest of shareholders (as they were given the opportunity to vote for issues under their competence). If decided otherwise (i.e. not to organize a meeting) the business would be blocked and shareholders would be deprived from the possibility to exercise their rights – what's not in line with their interests. Thus, according to the opinion of the author of this article, if shareholders decided to challenge the decision adopted on a general meeting only because the meeting was not organized in a prescribed form, their action shall be considered as a behaviour disloyal towards the company as a whole and towards other shareholders as well – which constitutes the breach of one of the basic postulates of company law, i.e. the principle of loyalty towards company and shareholders. Such a disloyal behaviour shall not be granted a judicial protection. Thus, respective claims shall be dismissed.

According to the author's knowledge, in Croatian judicial practice there were no attempts to challenge the validity of shareholders' decisions on the grounds described above. However, new crises and new restrictions can occur in future and if Croatian legislative framework on virtual shareholder meetings remains unaltered, the interpretation given above may find its application in practice.

## 2. AN OVERVIEW OF NATIONAL LEGISLATIONS ON VIRTUAL SHAREHOLDER MEETINGS

In this chapter we are going to provide basic information on laws regulating virtual shareholder meetings in the USA and several member states of the EU. In addition, an abundant experience on organizing virtual shareholder meetings from the USA (especially Delaware) will be presented as well, as it provides clear guidelines for *de lege ferenda* legislation on virtual shareholder meetings.

### 2.1 Virtual shareholder meetings during gathering restrictions in Croatia

Over the last two decades, most states in the USA have enacted statutes that enable companies to hold virtual meetings of shareholders in exclusively virtual form. Respective legislation was first enacted (in 2000) in Delaware[13] where the vast majority of public companies is incorporated – and, as a result, laws regulating corporations are most developed whilst judicial practice in this area of law is the most abundant.[14] Before Covid-19 crisis reached the USA, it had been allowed to organize shareholder meetings in hybrid form in forty-four states. Of those forty-four states, thirty states allowed shareholder meetings to be held in virtual form exclusively.[15] On the other hand, six states required shareholder meetings to be held "at place" without the possibility of accessing the meeting through electronic communication means.[16] It is important to emphasize that laws regulating virtual shareholder meetings vary from state to state. In several states, companies' management boards are directly authorized to decide upon the form of general meeting. But, in majority of states, it's on companies' management to decide whether to hold a virtual meeting of shareholders or not, only if respective form of meeting is permitted by companies' incorporation acts or other governing documents.[17]

First virtual shareholder meeting in the USA was held in 2001. From 2001 to 2010, only a small number of companies organized shareholder meetings exclusively in online form. Shareholders and other stakeholders (such as advocacy groups) expressed a strong resistance towards virtual shareholder meetings, as they were afraid that management will use the virtual platforms as a shelter to hide from shareholders and as a filter that retains inappropriate questions or comments.[18] Thus, numerous companies have never convened a virtual shareholder meeting, even though their governing documents provided that possibility.[19] However, from 2010 to 2020, the use of virtual meetings grew constantly. For instance, Broadridge – the first company who launched a successful platform for hosting shareholder meetings online, had hosted just one exclusively virtual shareholder meeting in 2009; but in 2019, Broadridge hosted over 300 virtual shareholder meetings (97 % virtual meetings using audio technology exclusively and just 3 % virtual meetings using video technology).[20] Despite respective increasement, dur-

13 The USA (Delaware): The Delaware General Corporation Law (Title 8, Chapter 1 of the Delaware Code), sec. 211.

14 JACOBS, Jack B. Fifty Years of Corporate Law Evolution: a Delaware's Judge Retrospective. Harvard Business Law Review. 2015, 5, 141–172.

15 According to: BROCHET, Francois, Roman CHYCHYLA, and Fabrizio FERRI. Virtual Shareholder Meetings. *SSRN Electronic Journal* [online]. 2020, 8. ISSN 1556-5068 [viewed 28 September 2022]. Available from: doi:10.2139/ssrn.3743064

16 Alaska, Arkansas, Georgia, New Mexico, South Carolina and South Dakota.

17 FAIRFAX, Lisa M. Virtual Shareholder Meetings Reconsidered. Seton Hall Law Review. 2010, 40(1367), 1370-1382.

18 See more in: FONTENOT, Lisa A. Public Company Virtual-Only Annual Meetings. The Business Lawyer. 2018, 73(1), 44-45.

19 Ibid., 40-41.

20 NILI, Yaron, and Megan WISCHMEIER SHANER. Virtual Annual Meetings: A Path Toward Shareholder Democracy and Shareholder Engagement. Boston College Law Review. 2022, 63(1), 158.

ing pre-pandemic period in-person general meetings prevailed to a great extent, whereas exclusively virtual shareholder meetings were an exception.[21]

Though positions on exclusively virtual shareholder meetings prior to pandemic were mixed,[22] during 2020 (when gathering and travel restrictions entered into force) many companies were put in front of the wall when it comes to organizing shareholder meetings and enabling shareholders to exercise their rights. Thus, organizing a virtual shareholder meeting seemed to be the only path that led towards best interest of the company as a whole. As a reaction to restrictions enacted due to the pandemic, numerous states in the USA amended their legal frameworks in order to facilitate requirements for organizing virtual shareholder meetings. For instance, Delaware, California and New York (all of them allowing virtual shareholder meetings even before the pandemic, upon fulfilling prescribed requirements) have temporarily removed procedural requirements for convening virtual shareholder meetings.[23] Four states that required in-situ shareholder meetings to be held (Alaska, Arkansas, Georgia and New Mexico) have issued executive orders allowing exclusively virtual general meetings to be held for a limited period of time.[24] But, on the other hand, South Carolina and South Dakota failed to provide temporary exception from the obligation to hold shareholder meetings "at place" – thus, leaving companies to struggle between provisions mandating to "stay at home" and provisions mandating to "hold the general meeting in a physical form".[25]

In general, we can conclude that in the USA, Covid-19 has dramatically influenced state laws regulating virtual shareholder meetings. The number of states allowing exclusively virtual shareholder meetings rose from 30 (in the pre-Covid period) to 38 (at the end of 2021).[26] Consequently, the number of companies that held general meetings in exclusively virtual form rose significantly. For instance, from March to June 2020, more than 1500 companies held their general meetings exclusively in virtual form.[27]

Though Covid-19 induced numerous companies to react instantly and to organize shareholder gatherings in an exclusively virtual form, the reported results seem to be satisfying, despite numerous challenges that had to be solved in an

21 FAIRFAX, Lisa M. Virtual Shareholder Meetings Reconsidered. Seton Hall Law Review. 2010, 40(1367), 1383.

22 For *pros* and *cons* when it comes to virtual-only shareholder meetingse, see: BROCHET, Francois, Roman CHYCHYLA, and Fabrizio FERRI. Virtual Shareholder Meetings. *SSRN Electronic Journal* [online]. 2020, 1–63. ISSN 1556-5068 [viewed 28 September 2022]. Available from: doi:10.2139/ssrn.3743064; FAIRFAX, Lisa M. Virtual Shareholder Meetings Reconsidered. Seton Hall Law Review. 2010, 40(1367), 1389–1396; FONTENOT, Lisa A. Public Company Virtual-Only Annual Meetings. The Business Lawyer. 2018, 73(1), 42–51.

23 NILI, Yaron, and Megan WISCHMEIER SHANER. Virtual Annual Meetings: A Path Toward Shareholder Democracy and Shareholder Engagement. Boston College Law Review. 2022, 63(1) 164.

24 Ibid.

25 Ibid.

26 Ibid., 165.

27 Ibid., 169.

extremely short period of time. Available data show that virtual shareholder meetings held during pandemic period did not impact shareholder voter turnout (as compared to pre-pandemic voter turnouts from 2019). However, it is important to highlight that online meetings held exclusively via audio communication (without video communication) had the lowest shareholder turnout.[28]

The ample practice on general meetings from the USA has shown, as follows:

- regardless of the form, a high-quality shareholder meeting is the one that enables communication in real time (between shareholders and management, and amongst shareholders)
- it is highly recommended for shareholder gatherings to be transferred via video technology – as non-verbal communication (in certain occasions) can be more vital than verbal
- platforms for virtual meetings shall be user-friendly and instructions for use shall be clear to the average consumer and provided in advance (early enough to be studied in details by an average consumer)
- digital technology development has extremely accelerated during Covid-19 pandemic (especially when it comes to platforms for video conferences) – thus enabling virtual meetings to satisfy aforementioned conditions and to be equally (or even more) efficient as in-person gatherings.

### 2.2 Virtual shareholder meetings across the EU

Laws regulating general meetings of shareholders in most of the EU member states require general meetings to be held at place. [29] In line with the Shareholder Rights Directive, the EU member states allow companies to offer their shareholders a possibility to exercise their rights through remote communication means. According to national legislations, respective possibility shall be anticipated by articles of incorporation or by-laws.[30]

Due to Covid-19 pandemic, numerous EU member states have enacted "crisis legislation" suspending the requirement of in-person gatherings – thus, legalizing virtual shareholder meetings during the pandemic.[31] As we already mentioned above, Croatia is not one of those countries. In Italy, the validity of virtual shareholder meeting is conditioned upon following requirements: the identification of participants must be verified and the exercise of voting rights must be ensured.[32]

28 Ibid., 178.

29 But, Portugal and Luxembourg allowed exclusively virtual shareholder meetings to be held (under prescribed conditions) even in pre-pandemic times. See more in: ZETZCHE, Dirk A., et al. Covid-19 Crisis and Company Law: Towards Virtual Shareholder Meetings [online]. 17 April 2020, 17. [viewed 28 September 2022]. Available from: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3576707.

30 Ibid.

31 Ibid., 16-18.

32 Ibid., 17.

In Germany, the validity of virtual shareholder gatherings is conditioned with following requirements: meeting must be transmitted in real time using video technology; online voting must be ensured; there must be an opportunity to partake in some form of Q & A as well as the opportunity to express dissent.[33] In addition, "crisis legislation" in Germany limits the right of shareholders to rescind resolutions adopted in virtual meetings only if management has wilfully violated the law.[34] Similar temporary legalization of virtual meetings is provided by "crisis legislation" enacted in France – where holding virtual general meeting is allowed even if not provided by the articles of association.[35]

## CONCLUSION

Numerous countries across the globe (e.g. Canada; Hong Kong; Liechtenstein; UK; the USA – in 30 states)[36] had enabled companies to hold general meetings of shareholders exclusively in virtual form even before the pandemic. On the other hand, during the pre-pandemic period, the EU member states had insisted to a great extent on in-person shareholder gatherings, allowing shareholders to par-ticipate in meetings from a remote place, using means of electronic communication (so-called hybrid general meetings) if such possibility had been anticipated by the articles of association or by-laws.

During the pandemic, numerous states across the globe enacted severe measures in order to combat or to reduce the infection – e.g. gathering and travel restrictions. Those measures diametrically opposed mandatory legal provisions prescribing when and where should general meetings be held.

In order to facilitate the position of management boards who had to decide whether to violate the gathering restrictions or the mandatory provisions on general meetings, the majority of states across the globe enacted the so-called "crisis legislation" aimed at (at least temporary) lifting the limitations and conditions for organizing virtual shareholder meetings.

Nonetheless, despite proposals from the academics and professionals, Croatia is one of the rare countries that failed to enact crisis measures aimed at legalisation (at least temporary) of exclusively virtual shareholder meetings.

At the moment, gathering restrictions in Croatia are not in force. But we cannot exclude the possibility that those measures will be enforced again – due to Covid-19 or some other hardly predictable reason. Thus, we strongly advise Croatian legislator to amend Croatian legislation on virtual and hybrid shareholder meetings to make it more flexible and suitable to fulfil the needs in regular and extraordinary occasions.

33 Ibid., 17.

34 Ibid., 17.

35 Ibid., 17-18.

36 Ibid., 13-16.

Considering the experiences from practice (especially from Delaware) as well as comparative legislation on virtual shareholder meetings, we suggest following amendments to be implemented into the Croatian Companies Act:

Firstly, when it comes to hybrid meetings, the right to use remote communication means in order to attend shareholder meeting does not deprive shareholders from their right to participate at the meeting in person. Thus, the possibility to "activate" this supplementary right shall not be conditioned by any requirements other than those related to identification and security issues.

Secondly, when it comes to exclusively virtual shareholder meetings, the management board shall be authorized to convene shareholder meeting in an exclusively virtual environment whenever outstanding circumstances (such as pandemic or epidemic) prevent or significantly limit the possibility to organize an in-person meeting.

Thirdly, in regular occasions, shareholder meetings may be held exclusively in virtual form only if shareholders gave their consent on depriving them from the right to vote in person. If respective condition is met, virtual shareholder meeting shall be deemed to be valid. Though, it would be quite hard to reach aforementioned consensus and to organize a virtual meeting in regular occasions in companies with a large number of shareholders; companies with smaller number of shareholders are likely to satisfy this condition quite easily – what may be of importance especially when it comes to fast growing companies from IT sector, whose shareholders are (generally) prone to use modern technologies.

Virtual meetings organized in extreme occasions, as well as those organized in ordinary occasions - under shareholders' consent, shall be considered to be valid only if electronic communication means allow real time communication; if video technology is used – providing information on non-verbal communication; if identification of shareholders is verified and stability of connection secured; if shareholders are allowed to ask questions without unreasonable restrictions and if members of the board are obliged to provide answers. To sum it up; the legislative framework must be flexible enough to allow shareholder meetings to be held in exclusively virtual form whenever extraordinary circumstances or the shareholders themselves require so. But, on the other hand, the legislative framework must be strict enough to sanction manipulative practices that can occur during virtual meetings – e.g. muting shareholders when asking questions via audio communication channel or excluding questions submitted by shareholders in textual form. Only such a legislative framework can remove the fear of virtual general meetings that is still present in part of the public, and it is the absence of fear that is a prerequisite for virtual general meetings to become the leading form of shareholder gatherings.

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# Regulation of the Legal Institute of Trustworthiness in the Financial Intermediation Act and Challenges for Application Practice: Evidence from Slovakia

**Andrea Slezáková, Mária Veterníková**

JUDr. Andrea Slezáková, LL.M., PhD.
andrea.slezakova@euba.sk
Assistant Professor, Department of Commercial Law
Faculty of Commerce, University of Economics in Bratislava
Bratislava, Slovakia

JUDr. Mária Veterníková, PhD.
maria.veternikova@euba.sk
Assistant Professor, Department of Commercial Law
Faculty of Commerce, University of Economics in Bratislava
Bratislava, Slovakia

***Abstract:***
The Act No. 186/2009 Coll. On Financial Intermediation and Financial Advisory Amending and Supplementing Certain Acts as Amended is regulating dominantly financial agents and financial advisors. Financial agents provide financial intermediation and financial advisors provide financial advisory. The distribution of financial services represents performing of a business on the financial market. Due to the risk that is being connected with this activity, the legislator incorporates certain conditions in the regulatory framework that need to be met by persons intending to start this business. One of them is represented by the legal institute of trustworthiness. The paper focuses on the correlation between selected legal rules of financial and economic law. The authors analyze whether deleveraging influences the trustworthiness of financial agents.

***Key words:*** *financial agent, trustworthiness, deleveraging, instalment plan*

## INTRODUCTION

Since the end of the 20th century, we have witnessed a transformation in the sale of financial services; the 1990s are associated with a change in the focus of attention.[1] This attention has shifted from the financial services to the client; the development in question can be attributed to globalisation and increased competition.[2]

When looking for a suitable service, the client incurs transaction costs (e.g. to secure the necessary information); financial intermediation or financial advisory is used to reduce these costs.[3] The performance of these activities is being regulated by Act No. 186/2009 Coll. on Financial Intermediation and Financial Advisory Amending and Supplementing Certain Acts, as amended (hereinafter referred to as the "Financial Intermediation Act").

Due to the fact that the distribution of financial services involves a certain degree of risk, the currently valid legislation requires a range of conditions to be met before performing this business, including trustworthiness.

The legal institute of trustworthiness under the Financial Intermediation Act consists of a set of legal rules. This set of legal rules includes also the requirement of not having acted within the last ten years in a function defined by the legislator in a financial institution or in a financial agent or in a financial advisor that has been declared bankrupt, whether the bankruptcy petition has been dismissed for lack of assets or the bankruptcy has been annulled on the grounds that the assets are insufficient to pay the expenses and remuneration of the bankruptcy trustee within a period of time that includes any point in time within the one-year period prior to the declaration of the bankruptcy. In this case, the legislation has determined the legal consequence. The regulation leads to the conclusion that natural persons in functions defined by the legal frame lose trustworthiness.

In application practice, an open question rises that is concerning the impact of deleveraging on the trustworthiness of financial agents, as one of the basic legal conditions for the performance of financial intermediation.

In order to draw conclusions, the authors analyze the current Slovak legislation; the opinion of the National Bank of Slovakia.[4] They use the scientific method of research, namely analysis.

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## 1. TRUSTWORTHINESS AS AN ESSENTIAL LEGAL INSTITUTE ENSURING ACCESS TO BUSSINESS ON THE FINANCIAL MARKET (DISTRIBUTION OF FINANCIAL SERVICES)

Trustworthiness can be characterised as one of the essential legal institutes contained in specific legislation regulating individual sectors of the financial market, ensuring a certain standard of fair business conduct.[5]

The legal institute of trustworthiness corresponds to the concept of reputation.[6] It follows the European guidelines on good repute in English,[7] in German "guter Leumund".[8]

The term trustworthiness, as introduced by the legislator in specific legislation regulating different sectors of the financial market and will always be broader than the term integrity.[9] Integrity is in practice understood primarily as criminal integrity.[10]

Trustworthiness is one of the conditions for the performance of financial intermediation and financial advisory and appears in financial market regulation together with the requirement of professional competence.[11] These conditions are designed to ensure that natural persons operating in the financial market perform their duties responsibly, reliably and to an appropriate professional standard.[12]

The trustworthiness requirement is also intended to protect clients from persons whose activities show signs of criminal activity.[13]

If the natural person does not meet the conditions of trustworthiness, it is not possible to remedy or remove this fact.[14] This is an opposite of professional competence, the requisite level of which can be attained by completing specific financial training or by passing a professional examination.[15]

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5 SLEZÁKOVÁ, Andrea et al. *Samostatný finančný agent ako dohliadaný subjekt finančného trhu*. Bratislava: Wolters Kluwer, 2016, 148 p. 9788081684975.

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12 KRAVECOVÁ, Dana. *Finančné sprostredkovanie. Ako podnikať legálne*. Bratislava: IURIS LIBRI, 2016, 90 p. 9788089635252.

13 ŠKOPOVÁ, Věra, and Radoslava MUSILOVÁ, Hana KRUPIČKOVÁ. *Zákon o pojistných zprostředkovatelích a samostatných likvidátorech pojistných událostí a předpisy související. Komentář*. Praha: C.H.Beck, 2006, 291 p. 8071794767.

14 BARINKOVÁ, Milena. Bezúhonnosť zamestnanca. Personálny a mzdový poradca podnikateľa. 2015, 20(9–10), 42–54.

15 SLEZÁKOVÁ, Andrea et al. *Zákon o finančnom sprostredkovaní a finančnom poradenstve. Komentár*. Bratislava: Wolters Kluwer, 2020, 496 p. 9788057101932.

Trustworthiness is a criterion that takes into account compliance with legal and ethical rules, as well as moral profile and integrity.[16] A person's trustworthiness lies in his or her integrity, professional and business integrity.[17]

The legislator bases the legal definition of trustworthiness on the cumulative fulfilment of exhaustively specified requirements, which are determined by the Financial Intermediation Act.

In its legal definition of trustworthiness, the Financial Intermediation Act relies on a negative definition containing the following areas, namely:

- the absence of a final conviction for selected offences defined by the applicable legal framework;
- not having acted in the last ten years in positions defined by the legislator in financial institutions whose authorisation to carry out activities has been revoked or in legal persons whose licence to carry out financial intermediation has been revoked, respectively to carry out financial advisory has been revoked, or not having acted as a natural person-entrepreneur in the last ten years as a financial agent or financial advisor whose licence to carry out financial intermediation or financial advisory has been revoked or whose registration in the register has been revoked, within a period of time that includes any point in time within the period of one year prior to the revocation of the licence to carry out financial intermediation or financial advisory services or the revocation of the registration in the register;
- not having acted in the last ten years in a position defined by the legislator at a financial institution placed in receivership for a period of time that includes any point in time within one year prior to the imposition of the receivership;
- not having acted within the last ten years in a position defined by the legislator with a financial institution or with a financial agent or financial advisor that has been adjudicated bankrupt, whether the bankruptcy petition has been dismissed for lack assets, or the bankruptcy has been set aside because the assets are insufficient to pay the bankruptcy trustee's disbursements and fees during a period of time that includes any point in time within one year prior to the adjudication of the bankruptcy;
- the non-imposition of the sanction of withdrawal of an authorisation granted until 31 December 2009 authorising the provision of insurance by an insurance agent, the provision of insurance by an insurance broker, the provision of reinsurance by a reinsurance intermediary, the pursuit of the activities of an investment services intermediary and the provision of supplementary pension saving within the last ten years;

16 ŠOVAR, Jan et al. *Zákon o investičních společnostech a investičních fondech. Komentář*. Praha: Wolters Kluwer, 2015, 1720 p. 9788074787836.

17 Ibid.

- the non-imposition of a fine of an amount determined by the regulatory framework in the last ten years;
- the proper exercise of functions and business in the last ten years in accordance with generally binding legislation.[18]

During the COVID-19 pandemic, face-to-face meetings between the client and the financial agent could not take place. Until the outbreak of the pandemic, this interaction could be considered as the dominant way of performing financial intermediation. In particular, financial agents who were unable to adapt their business to innovation and were unable to implement their business in an online environment faced a reduction in the number of clients. A lower number of clients logically entailed lower profits. In specific case, it could also lead to losses and insolvency.

## 2. DELEVERAGING (PERSONAL BANKRUPTCY)

The term "personal bankruptcy" is not found in any Slovak legislation, yet it is very often used in newspapers, magazines, news reports, various publications and in common parlance to refer to the process of going into debt. Deleveraging can be characterised as a legally permissible opportunity for an insolvent debtor who is a natural person, whether an entrepreneur or a non-entrepreneur, to get rid of part of his or her debts through a process that is carried out under the supervision of a court.

The Act No. 7/2005 Coll. On Bankruptcy and Restructuring and on Amendments and Supplements to Certain Acts, as amended (hereinafter also referred to as the "Act on Bankruptcy and Restructuring") entered into force on 1 January 2006. Deleveraging is provided in Part Four of this Act. The original legislation on insolvency was very brief, containing only six paragraphs. Deleveraging always had to be preceded by bankruptcy or insolvency proceedings governed by Part Two of the Act on Bankruptcy and Restructuring. If the reason for the annulment of the bankruptcy was that the debtor's assets were insufficient to pay the claims against the substance, the deleveraging was inadmissible.

The essence of the Slovak concept of deleveraging, which is regulated in the fourth part of the Act on Bankruptcy and Restructuring, originally consisted in a separate court proceeding following the end of the bankruptcy proceedings, which are regulated in the second part of the Act on Bankruptcy and Restructuring. Hence, the law originally conceived of deleveraging as an institute which must always be preceded by a bankruptcy proceeding in which the claims of creditors were at least partially satisfied. If the bankruptcy was annulled on the ground that the debtor's assets were insufficient to pay the claims against the substance, the law did not allow for deleveraging. That legislation was ineffective because

18 Article 23 Paragraph 1 of the Financial Intermediation Act.

those, to whom it was addressed, namely natural persons, hardly made use of it. The reason for the lack of interest was solely due to the inadequacy of the legislation and not to the socio-economic situation of the debtors.[19]

A fundamental change in the legislation on deleveraging occurred in 2017. The Act No. 377/2016 Coll., amending the Act on Bankruptcy and Restructuring, entered into force on 1 March 2017. Since the entry into force of this relevant amendment deleveraging is not preceded by bankruptcy proceedings regulated in the second part of the Act on Bankruptcy and Restructuring. Natural persons have a choice of two permissible forms of deleveraging, either bankruptcy or instalment plan.

Both forms of deleveraging are regulated in Part Four of the Act on Bankruptcy and Restructuring. Thus, there is a duplication of the regulation of bankruptcy in the second part of the Act on Bankruptcy and Restructuring and also in its fourth part.

A petition for the declaration of bankruptcy or for the determination of an instalment plan may only be filed by a debtor – a natural person whose property is the subject of an execution or similar enforcement proceedings, in particular tax enforcement proceedings or enforcement proceedings conducted by the Social Insurance Institution.

In the case of a deleveraging by bankruptcy, the execution or similar enforcement proceeding must have been pending against the debtor's property for at least one year.

The debtor may not seek deleveraging until ten years have elapsed after the bankruptcy has been declared or the instalment plan has been determined.

The Act on Bankruptcy and Restructuring distinguishes three categories of claims. The first category includes claims that can be satisfied in bankruptcy or by an instalment plan. These are claims that arose before the calendar month in which the bankruptcy was declared or the protection from creditors was granted (this date is considered the so-called decisive date), in addition, future claims of guarantors, co-debtors or other persons who will incur a claim against the debtor if they perform for the debtor an obligation that arose before the decisive date, and claims that arise in connection with the termination of the contract or withdrawal from the contract, in the case of a contract concluded before the declaration of bankruptcy.

The second category consists of claims that are excluded from satisfaction. These are, for example, costs incurred by the parties in connection with their participation in bankruptcy proceedings for the determination of an instalment plan.

The third category consists of intact claims. The debtor has to repay them even after the deleveraging. Intact claims include, for example, non-monetary claims.

19 ĎURICA, Milan. Osobné bankroty. Bulletin slovenskej advokacie. 2017, 23(4), 30–53.

Deleveraging cancellation is also an option. Any creditor who has been affected by the insolvency may seek the annulment of the insolvency because of the debtor's dishonest intention. He must do so within six years of the declaration of insolvency or the establishment of an instalment plan, by means of an application against the debtor or his/her heirs, lodged with the court which decided on the insolvency.[20]

### 2.1 Deleveraging in the Form of Bankruptcy

Only a debtor who is a natural person may file for bankruptcy in accordance with the fourth part of the Act on Bankruptcy and Restructuring. The debtor must be represented by the Legal Aid Centre when filing the petition. The delivery of the petition on the court starts the bankruptcy proceedings.

If the statutory conditions are met, the court declares bankruptcy within 15 days of receipt of the petition. In the bankruptcy order, the court appoints a trustee, invites creditors to file their claims and decides on the debtor's insolvency.

Bankruptcy is deemed to have been declared upon publication of the decision to declare bankruptcy in the Commercial Gazette. No execution proceedings or similar enforcements proceedings may be commenced or conducted against the bankrupt's assets during the bankruptcy proceedings. The declaration of bankruptcy shall be a ground for the discontinuance of pending execution or similar enforcement proceedings.

Creditors shall register their claims in the bankruptcy proceedings by submitting an application to the trustee on the prescribed form, at the latest until the trustee announces in the Commercial Gazette that he/she is going to draw up a schedule of the proceeds. The claims lodged may be contested only by another creditor who has lodged a claim.

In view of the requirement of informality, speed and economy of the procedure, the law does not foresee a classical structure of creditors' bodies.[21]

For the purpose of exercising creditors' rights, only the representative of creditors' acts in bankruptcy, but the law also allows for a procedure without a representative of creditors. The convening of a meeting of creditors is only optional.

The trustee examines the debtor's circumstances, ascertains the debtor's assets and liabilities. Within 60 days of the declaration of bankruptcy, he/she must draw up an inventory of the assets of the bankruptcy substance. The bankruptcy shall be subject to the assets belonging to the debtor on the date of the declaration of bankruptcy as well as the proceeds obtained from the administration and monetization of such assets, as well as assets by the debtor after the declaration of bankruptcy by the trustee's procedure for exercising rights under contracts in which retention of

20 MANÍK, Rudolf. Konanie o oddlžení po novom – správcaako alter ego dlžníka? Bulletin slovenskej advokacie. 2017, 23(4), 21–29.

21 ĎURICA, Milan. *Zákon o konkurze a reštrukturalizácii. Komentár*. Praha: C. H. Beck, 2021, 1210 p. 9788074008467.

title has been agreed or under contracts the subject of which is a financial lease, as well as assets subject to security rights, if provided for in the Act on Bankruptcy and Restructuring. Secured property becomes part of the bankruptcy substance only in the cases provided for in Article 167k of the Act on Bankruptcy and Restructuring.

The bankruptcy substance is also defined negatively in Article 168h Paragraph 3 and Paragraph4 of the Act on Bankruptcy and Restructuring. Third-party assets on which security rights are attached are not subject to bankruptcy.

The bankruptcy substance does not include the so-called non-dischargeable value of a dwelling, i.e. the part of the value of a single habitable asset with accessories, including any built-up and adjacent land, which the debtor has designated as a dwelling in his schedule of assets. The unaffected part of the dwelling consists of an amount of EUR 10 000, the debtor being entitled to dispose of that amount only to the extent of EUR 250 per month.[22]

The debtor's assets that cannot be seized in execution are also not subject to bankruptcy. The bankruptcy substance also does not include property on which security rights are attached, except in the cases provided for in Article 167k of the Act on Bankruptcy and Restructuring.

The law differentiates the methods of monetization of the bankruptcy substance according to the type of property and its legal nature. For example, real estate subject to bankruptcy of a higher value, within the meaning of Article 167n Paragraph 1 of the Act on Bankruptcy and Restructuring, may only be realised by the trustee by auction.

The entitled persons, i.e. a sibling, spouse or the municipality in whose cadastral territory the property is located, have the right to redeem any part of the property at any time and with the consent of the debtor, under the conditions set out in Article 167r of the Act on Bankruptcy and Restructuring.

Creditors are satisfied on the basis of a plan of the proceeds drawn up by the trustee. The trustee must draw up the schedule without undue delay after the bankruptcy substance has been liquidated and all disputes which may affect the distribution of proceeds have been concluded, but not earlier than 60 days after the declaration of bankruptcy.

After the distribution of the proceeds has been fulfilled or after the trustee has ascertained that the bankruptcy substance will not cover the costs of the bankruptcy, the trustee shall, without undue delay, announce in the Commercial Gazette that the bankruptcy is terminated. This shall also apply if the trustee finds that no creditor has applied within 90 days of the declaration of bankruptcy or if the status of all creditors as parties to the proceeding has ceased. The death of the debtor is not a basis for termination of judicial of judicial enforcement. The court shall continue the proceedings with the persons who may reasonably be presumed to be the heirs.

22 FLOREKOVÁ, Júlia, and Sára TARNOCIOVÁ. K niektorým otázkam inštitútu oddlženia. Justičná revue. 2019, 71(8–9), 833 – 842.

### 2.2 Deleveraging in the Form of an Instalment Plan

Only a debtor, a natural person, may file a petition for the establishment of an instalment plan; when filing the petition, the debtor must be represented by an attorney appointed by the Legal Aid Centre.

If the statutory conditions are met, the court declares bankruptcy within 15 days of receipt of the petition. In the order declaring bankruptcy, the court appoints a trustee, invites creditors to file their claims and decides on the debtor's insolvency. If the application fulfils the statutory conditions, the court shall issue a decision granting protection from creditors, appointing a trustee and ordering the debtor to make an advance payment on the trustee's account for flat-rate remuneration and flat-rate reimbursement of the necessary costs associated with the conduct of the proceedings. If the debtor fails to do so within seven days of the trustee's request, the trustee shall publish a notice about this fact in the Commercial Gazette. The notice in the Commercial Gazette shall put an end to the proceedings.

The granting of creditor protection suspends any execution proceedings pending against the debtor in respect of claims that can only be satisfied by instalment plan or claims excluded from satisfaction. If the court subsequently determines by its decision an instalment plan, this shall be a ground for stopping the execution. The decision to grant legal protection from creditors also protects the debtor from further auctioning of his/her home.

The trustee must draw up the draft instalment plan within 45 days of the advance payment of the flat-rate remuneration and the flat-rate reimbursement of the costs of the proceedings. Before drawing up an instalment plan, he/she must in particular examine the debtor's assets and determine whether it is possible to draw up an instalment plan.

Satisfaction of unsecured creditors' claims must be at least 10 % higher than in bankruptcy and at the same time must not be less than 30 % of the unsecured claim according to Article § 168c Paragraph 4 and Paragraph 5 of the Act on Bankruptcy and Restructuring. This quota also applies to a secured claim that is secured only by the property of a third party. The Act on Bankruptcy and Restructuring thus sets a lower limit (30 %) and indirectly also an upper limit (100 %) for the satisfaction of creditors' claims.

The draft instalment plan must be drawn up in such a way that it is feasible in the light of the debtor's means. The upper limit for instalments must not exceed the debtor's expected income. The expected income will be reduced by the necessary expenses for the provision of housing and the basic needs of life of the debtor and his/her dependants, for the fulfilment of the debtor's maintenance obligation and for the fulfilment of claims not affected by the debt relief. If the trustee finds that it is not possible to draw up an instalment plan according to the above-mentioned conditions, he/she shall announce this in the Commercial Gazette. On publication of the trustee's notice in the Commercial Gazette, the proceedings for the determi-

nation of the instalment plan shall be terminated and the effects of the protection against creditors shall cease.

If the debtor's assets allow the trustee to draw up a draft instalment plan, the trustee is obliged to announce its drawing up without undue delay, indicating the percentage in which he/she proposes to satisfy the unsecured creditors, e.g. 40 %. Anyone claiming to be a creditor shall have the right to inspect the instalment plan and, if he/she may be affected by the repayment schedule, shall be entitled to lodge an objection with the trustee within 90 days of the publication of the notice in the Commercial Gazette. After the expiry of the objection period, the trustee shall be obliged to submit the draft instalment plan together with the objections to the court. If the court finds that the debtor's circumstances do not permit the determination of the instalment plan; it shall terminate the proceedings and publish this fact in the Commercial Gazette.

If the instalment plan proposal complies with the rules laid down in the Act on Bankruptcy and Restructuring, the court shall determine the instalment plan. The total amount in which the claim will be satisfied is spread over 5 years. The terms of the instalments are determined by law according to the total amount of the claim. Fulfilment of the instalment plan shall begin on the first day of the calendar month following the calendar month in which the instalment plan was determined. If the debtor dies during the proceedings to determine the instalment plan, the court shall close the proceedings.

## 3. THE IMPACT OF DELEVERAGING ON THE TRUSTWORTHINESS OF FINANCIAL AGENTS

During the period the new rules were in force, the interest of individuals in deleveraging increased enormously. By comparison, in 2016 (before the change of the insolvency rules), 497 insolvency petitions were filed and 147 insolvencies were granted. In 2017, the Legal Aid Centre filed 8 954 petitions for deleveraging.[23] In 2021, 9 063 bankruptcies were declared and 149 instalment plans determined on the basis of bankruptcy petitions filed or instalment plans determined.[24]

Deleveraging influences not only the personal life of an individual, but also affects his/her entrepreneurial activities.

In application practice, questions have been raised concerning how to perceive the trustworthiness of financial agents and individuals acting for financial agents as an employee carrying out an activity whose content is financial intermediation or as a professional guarantor in relation to their personal bankruptcy. In this re-

23 Legal Aid Centre website. [online]. Available from: https://www.centrumpravnejpomoci.sk/aktualita/72-osobny-bankrot-uz-po-mohol-tisickam-ludi [Accessed 07 Sep. 2022].

24 Legal Aid Centre website. [online]. Available from: https://www.centrumpravnejpomoci.sk/files/prilohy/zakladne.dokumenty/VS%202021%20final.pdf [Accessed 07 Sep. 2022].

gard, an opinion of the Capital Market Department of the National Bank of Slovakia dated 08.11.2021 was issued.[25] The purpose of the opinion was to clearly and unambiguously define the perception of the National Bank of Slovakia when assessing trustworthiness under the Financial Intermediation Act in relation to bankruptcy.

In our context, this is in particular the legal regulation in Article 23 Paragraph 1 Letter d) of Financial Intermediation Act. The National Bank of Slovakia claims that the conditions of trustworthiness should also apply to a natural person operating under the Financial Intermediation Act, as no one can be favoured and the same conditions must apply to all. This will also achieve the objective intended by the Financial Intermediation Act, namely that a natural person operating under the Financial Intermediation Act should not be a person who is unable to manage his/her own income and expenditure.

The supervision authority considers as trustworthy a natural person who has not been declared bankrupt in the last ten years or has not had a petition for bankruptcy dismissed for lack of assets. If a natural person operating under the Financial Intermediation Act resolves his/her debt by declaring bankruptcy, he/she shall be considered untrustworthy for the purposes of the Financial Intermediation Act for a period of 10 years from the declaration of bankruptcy.

The supervisory body also presents in its opinion that in case of the determination of an instalment plan, a natural person operating pursuant to Financial Intermediation Act is not deemed to be untrustworthy and may continue to carry out financial intermediation. An overruling of this approach without changing the law is not possible.

The authors have an opposing legal opinion to this. Although rising from the currently valid legal frame, the opinion of the supervisory body does not reflect on the principle for creating a level playing field and equality of opportunity in competition. If the purpose of the Financial Intermediation Act is to ensure that an individual operating under this act is not a person who is incapable of managing his or her own finances and that the same conditions should apply to all, then, in our view, a person to whom a court has approved an instalment plan within the last ten years should also be deemed to be untrustworthy. Because, as in the case of deleveraging in form of bankruptcy, only a natural person in financial difficulties (insolvent) whose property is subject to execution or enforcement proceedings may file a petition for instalment plan. Persons interested in deleveraging in form of bankruptcy agree to monetize their assets. As a rule, only minor assets are involved. However, a person who has no assets and a low income can also be made bankrupt. Individuals, who are able to repay their monetary obligations every month from their income and do not want to lose their property are inter-

25 Website of the National Bank of Slovakia. [online]. Available from: https://nbs.sk/dohlad-nad-financnym-trhom/legislativa/legislativa/detail-dokumentu/stanovisko-odboru-dohladu-nad-kapitalovym-trhom-narodnej-banky-slovenska-zo-dna-8-11-2021-k-doveryhodnosti-financnych-agentov-a-financnych-poradcov-fyzickych-osob-v-konkurze/ [cited 07. 09. 2022].

ested in an instalment plan. For example, the property is a family house or an apartment, which is very often owned jointly by the spouses.

Changing the current legislation can only be achieved by amending the Financial Intermediation Act. This act, especially when regulating trustworthiness, should follow the currently valid Act on Bankruptcy and Restructuring. Indirect amendments to the law are being frequently used, when regulating business on the financial market and in this case, they could bring an "easy and quick" remedy.

## CONCLUSION

The Act on Bankruptcy and Restructuring provides for deleveraging (personal bankruptcy) in the form of bankruptcy or an instalment plan. Bankruptcy may be recommended for natural persons whose liabilities exceed their assets or who have no assets and low income. Deleveraging in the form of an instalment plan may be recommended for natural persons who have income and assets which they wish to preserve. In both cases, the debtor's property must be subject to execution or similar enforcement proceedings.

The prerequisite for deleveraging is always the debtor's unfavourable financial situation, which is usually due to incorrect decisions, ignorance or an unfavourable combination of circumstances. As far as the performance of financial intermediation and the financial agent´s trustworthiness is concerned, the current regulation in the Financial Intermediation Act is based on rules from the Act on Bankruptcy and Restructuring which were in force before 1 March 2017.

*De lege ferenda* it is necessary to amend the Financial Intermediation Act, in particular the provision of Article 23 Paragraph 1 Letter d) of the Financial Intermediation Act, so that it clearly follows that a trustworthy person for the purposes of this act is a person whose property has not been declared bankrupt in the last ten years, as regulated in the second part of the Act on Bankruptcy and Restructuring or in the fourth part of the Act on Bankruptcy and Restructuring.

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# ESG and recent changes in EU legislation within financial markets

**Simona Heseková**

JUDr. Simona Heseková, PhD.
simona.hesekova@flaw.uniba.sk
https://orcid.org/0000-0002-8758-7224
Assistant professor at the Department of Financial Law
Comenius University in Bratislava, Faculty of Law
Bratislava, the Slovak Republic

***Abstract:***
ESG (environmental, social and corporate governance) plays important role in the financial markets and can be assumed that it will have an increasing influence on the participants of the financial markets in near future. The paper deals with the issue of ESG from the perspective of recent changes in EU legislation. The paper analyses the proposal for CSRD and changes which this proposal will bring to financial market. In order to provide comprehensive conclusions, the paper also evaluates the selected issue from the point of view of financing provided by banks. The conclusion of the paper is based on the verification of the established hypothesis: *"compliance with the ESG requirements will become important in the short term for most undertakings, regardless of whether they fall under the new extended framework of the proposal for CSRD or the existing SFDR".*

***Key words:*** *ESG, EU, financial market, CSRD, SFDR*

## INTRODUCTION

The issue of climate change and socially responsible business is currently resonating strongly not only on a societal scale, but is also growing in importance on the financial markets, to such an extent that it is possible to identify with the statement that environmental protection and the promotion of socially responsible business is becoming one of the integral objectives of the emerging legislation regulating the functioning of entities on the financial market.[1] In this

1 KOMARNICKA, Anna, and Michał KOMARNICKI. Challenges in the EU Banking Sector as Exemplified by Poland in View of Legislative Changes Related to Climate Crisis Prevention. *Energies* [online]. 2022, 15, 699 [viewed 24 September 2022]. Available from: doi:10.3390/en15030699, The European Green Deal, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the RegionsAction Plan: Financing Sustainable Growth COM/2018/097 final.

context, there is a growing emphasis on the shift of the private capital into more sustainable investments but this requires a comprehensive change in the way the financial system operates.[2] This shift in thinking, which represents a shift from dealing with environmental issues from the political level to the economic level, has automatically created pressure for the need for new legislative changes. This approach has resulted in to the formulation and development of the ESG criteria, the abbreviation referring to the environmental, social and governance criteria.[3] These criteria are currently being discussed, in particular in the context of the draft Corporate Sustainability Reporting Directive (hereinafter referred to as the "CSRD"), but also in the context of other legislative changes to the existing EU legislation.

Also due to the dynamic increase in the preference for ESG as non-financial performance indicators, it is possible to encounter inconsistent approaches in legislation as well as identified problems that several authors link to the current state of the ESG issues. When analysing the available literature sources using the method of opinion confrontation, the most significant issues associated with the currently set ESG framework can be mentioned:

i) the complexity and lack of clarity of the measures adopted; and

ii) their inconsistency.[4]

Despite the issues identified, we are of the opinion, which also forms the scientific hypothesis of the presented paper, that *"compliance with the ESG requirements will become important in the short term for most undertakings, regardless of whether they fall under the new extended framework of the proposal for CSRD or the existing SFDR"*.

Based on the hypothesis thus determined the aim of the paper is to identify the most significant changes in the current legislative tendencies at the EU level, to identify their potential impact on credit institutions and to verify the hypothesis in the context of financing of undertakings by credit institutions.

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2 Of the same opinion ZIOLO, Magdalena, et al. How to Design More Sustainable Financial Systems: The Roles of Environmental, Social, and Governance Factors in the Decision-Making Process. *Sustainability* [online]. 2019, (11), 1–34 [viewed 24 September 2022]. Available from: doi:10.3390/su11205604, p. 1.

3 ESG is an acronym developed in a 2004 report by 20 financial institutions in response to a call from Kofi Anon, Secretary-General of the United Nations (GILLAN, Stuart L., Andrew KOCH, and Laura T. STARKS. Firms and Social Responsibility: A Review of ESG and CSR Research in Corporate Finance. *Journal of Corporate Finance* [online]. 2021, **66**, 1–16 [viewed 25 September 2022]. Available from: doi:10.1016/j.jcorpfin.2021.101889, p. 2) To the difference with the term Corporate Social Responsibility (CSR) more closely also GILLAN, Stuart L., Andrew KOCH, and Laura T. STARKS. Firms and Social Responsibility: A Review of ESG and CSR Research in Corporate Finance. *Journal of Corporate Finance* [online]. 2021, 66, 1–16 [viewed 25 September 2022]. Available from: doi:10.1016/j.jcorpfin.2021.101889.

4 KOMARNICKA, Anna, and Michał KOMARNICKI. Challenges in the EU Banking Sector as Exemplified by Poland in View of Legislative Changes Related to Climate Crisis Prevention. *Energies* [online]. 2022, 15, 699 [viewed 24 September 2022]. Available from: doi:10.3390/en15030699, p. 1, BILLIO, Monica, et al. Inside the ESG ratings: (Dis)agreement and performance. *Corporate Social Responsibility and Enviromental Managment* [online]. 2021, **28** [viewed 25 September 2022]. Available from: doi:10.1002/csr.2177, MONCIARDINI, David, Jukka Tapio MÄHÖNEN, and Georgina TSAGAS. Rethinking Non-Financial Reporting: A Blueprint for Structural Regulatory Changes. *Accounting, Economics, and Law: A Convivium* [online]. 2020, **10**(2) [viewed 25 September 2022]. Available from: doi:10.1515/ael-2020-0092

Several research methods were used to achieve the stipulated aim of the paper. One of the basic methods of research is the method of scientific explanation, which is connected to (and at the same time interwoven with) the method of scientific prediction. In addition to these methods, methods of description, analysis and synthesis were used in the preparation of the paper. These methods were used to verify the established hypothesis. Identification of areas that remained unanswered or which are suitable for further scientific research are included in the conclusion of the paper.

## 1. RECENT CHANGES IN THE ESG LEGISLATION AT THE EU LEVEL

Significant milestones that have influenced the impact of ESG on financial markets include the adoption of the European Green Deal and the Commission's Action Plan on Sustainable Finance[5], which put sustainable finance at the center of the legislative agenda.[6] To achieve the objectives set out in the European Green Deal, the EU has adopted a number of measures in line with the Commission's Action Plan on Sustainable Finance. The EU's sustainable finance strategy is built on the principle of reporting sustainability information. This reporting of sustainability information is to be provided by fulfilling the obligations under the EU legislation listed below, which are interlinked. These are:

i) the Non-Financial Reporting Directive (hereinafter referred to as the "NFRD")[7],

ii) the Sustainable Finance Disclosure Regulation (hereinafter referred to as the "SFDR")[8], and

iii) the Taxonomy Regulation[9],

iv) Commission Delegated Regulation (EU) 2022/1288 published in OJ L 196 on 25 July 2022[10]

5 Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions Action Plan: Financing Sustainable Growth.

6 sustainable finance' also refers to the process of taking due account of environmental and social considerations in investment decision-making, leading to increased investments in longer-term and sustainable activities. 'Environmental considerations' refer to climate change mitigation and adaptation, as well as the environment more broadly and related risks (e.g. natural disasters). 'Social considerations' may refer to issues of inequality, inclusiveness, labor relations, investment in human capital and communities, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions Action Plan: Financing Sustainable Growth.

7 Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups.

8 Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector.

9 Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088.

10 Commission Delegated Regulation (EU) 2022/1288 of 6 April 2022 supplementing Regulation (EU) 2019/2088 of the European Parliament and of the Council with regard to regulatory technical standards specifying the details of the content and presentation of the information in relation to the principle of 'do no significant harm', specifying the content, methodologies and presentation of information in relation to sustainability indicators and adverse sustainability impacts, and the content and presentation of the information in relation to the promotion of environmental or social characteristics and sustainable investment objectives in pre-contractual documents, on websites and in periodic reports.

v) Commission Delegated Regulation (EU) 2021/2178 published in OJ L 443 (hereinafter referred to as the "DDA").[11]

The NFRD, which amended the Accounting Directive, introduced a requirement for large companies, as defined by the Directive, to report information relating to, at a minimum, environmental, social and employment matters, human rights and anti-corruption and anti-bribery matters. This information should take the form of a non-financial statement which should also include information on the due diligence policies applied by the companies. [12] The NFRD thus reflects the concept of double materiality, which is based on communicating information on how sustainability issues affect a company's performance, position and development (the "outside-in" perspective), while at the same time communicating information on the impact of companies on people and the environment (the "inside-out" perspective).[13]

From historical point of view, the NFRD legally amended Accounting Directive on financial reporting, adopting thereby its generic definition of materiality according which "material" means the status of information where its omission or misstatement could reasonably be expected to influence decisions that users make on the basis of the financial statements of the undertaking."[14] Material information is defined here in terms of what could influence a person's decisions. In 2017 Guidelines on Non-financial Reporting, pointed out how important materiality is in non-financial reporting[15]. The guidelines first discussed materiality as a generic term, as it is being commonly used in financial reporting, referring to the earlier Accounting Directive that the NFRD amended.[16] The Guidelines on Non-financial Reporting: Supplement on Reporting Climate Related Information, issued in 2019, openly addresses the "double materiality perspective" of the NFRD, covering "both financial materiality and environmental and social materiality". The double materiality perspective of the NFRD in the context of reporting climate-related information contains financial materiality (to extend necessary for an understanding of the company s development, performance and position) and environmental and social materiality (impact of its activities).[17]

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11 Commission Delegated Regulation (EU) 2021/2178 of 6 July 2021 supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by specifying the content and presentation of information to be disclosed by undertakings subject to Articles 19a or 29a of Directive 2013/34/EU concerning environmentally sustainable economic activities, and specifying the methodology to comply with that disclosure obligation.

12 The Non-Financial Reporting Directive – NFRD (6).

13 BOSSUT, Mathilde, et al. What information is relevant for sustainability reporting? The concept of materiality and the EU Corporate Sustainability Reporting Directive. Sustainable Finance Research Platform [online]. 2021, 7, 1–16 [viewed 25 September 2022]. Available from: doi:10.1515/ael-2020-0092,

14 Article 2(16) NFRD.

15 European Union /2017/ C 215/01, Guidelines on Non-financial Reporting (Methodology for Reporting Non financial Information).

16 RAITH, Dirk. The contest for materiality. What counts as CSR? Journal of Applied Accounting Research [online]. [no date] [viewed 5 November 2022]. ISSN 0967-5426. Available from: doi:10.1108/JAAR-04-2022-0093

17 European Union/ 2019/C 209/01, Guidelines on Non-financial Reporting: Supplement on Reporting Climate Related Information.

The SFDR regulates how financial market participants[18] (including asset managers and financial advisors) should report sustainability information to end investors and asset owners, thereby enabling them to make informed investment decisions, supporting the thesis of the importance of shifting private capital into sustainable investments outlined in the introduction of the article. The regulation aims to achieve greater transparency in the reporting of the inclusion of sustainability risks in investment decisions and investment advice by financial market participants and financial advisors. Transparency is therefore mainly aimed at raising awareness among the end investors. To achieve this objective, financial market participants who are obliged to report sustainability information in the financial services sector need to have adequate information from the companies in which they invest. The ESG criteria thus become an essential part of ensuring transparency in financial decision-making, including the context of the NFRD.

The Taxonomy Regulation established a system for classifying environmentally sustainable economic activities and established criteria for determining whether an economic activity qualifies as environmentally sustainable for the purpose of determining the level of environmental sustainability of investments.[19] The Taxonomy Regulation thus contains uniform criteria for companies and investors regarding economic activities that can be considered environmentally sustainable. It is important to emphasize that investors are left free to invest as they see fit; the regulation is primarily aimed at increasing transparency in the investment decision-making process. An adequately set system of classification of environmentally sustainable economic activities is also important in terms of reducing the risk of greenwashing.[20] Greenwashing means the selective disclosure of positive sustainability information, without full disclosure of negative information.[21] The link between the Taxonomy Regulation and the NFRD is found in Article 8 of the Regulation, which requires companies covered by the NFRD to report information on how and to what extent their activities are related to economic activities identified as environmentally sustainable under the technical screening criteria.

DDA specifies the content, methodology, and presentation of the information to be disclosed by both non-financial and financial undertakings required to report about the alignment of their activities with the EU Taxonomy alignment. DDA thus specifies which information referred to in Article 8(1) of the Taxonomy Regulation shall be disclosed by credit institutions. DDA lays out the definition and scope of the calculation of the green asset ratio (hereinafter referred to as the „the GAR").

18 Article 2 SFDR.

19 'environmentally sustainable investment' means an investment in one or several economic activities that qualify as environmentally sustainable under this Regulation; Article 2 the Taxonomy Regulation

20 PACCES, Alessio M. Will the EU Taxonomy Regulation Foster Sustainable Corporate Governance? Sustainability [online]. 2021, 13(21) [viewed 25 September 2022]. Available from: doi:10.3390/su132112316

21 KITZMUELLER, Markus, and Jay SHIMSHACK. Economic Perspectives on Corporate Social Responsibility Journal of economic literature . 2012, 50(1), 51–84.

The GAR represents financial assets considered „green" (in line with taxonomy activities). It is important to stress out that exposures to undertakings that are not obliged to publish non-financial information pursuant to Article 19a or 29a of NFRD shall be excluded from the numerator of the GAR.

As the issue of increasing the impact of ESG on the financial market has been addressed by several studies, also in terms of successive legislative steps or tendencies, to achieve the stated objective of the presented article, we will focus on recent legislative steps in relation to the changes to the NFRD.

Due to the ongoing problems of ambiguity and inconsistency of legislation aimed at sustainable financing, the European Commission adopted a package of regulations in the field of sustainable financing in April 2021, which consists of

i) proposal for a Corporate Sustainability Reporting Directive (CSRD)
ii) EU Taxonomy Climate Delegated Act
iii) six amending Delegated Acts on fiduciary duties, investment and insurance advice will ensure that financial firms.

The draft CSRD aims to remove ambiguity and inconsistency in reported sustainability information. The need to clearly define a framework for reporting sustainability information (and ensuring its comparability) needs to be seen from several perspectives:

i) from the perspective of end investors, NGOs, potential partners for whom this information may be relevant for investment decisions, cooperation decisions or for monitoring the impact of companies on a societal scale,
ii) in terms of fulfilling the obligations of financial market participants under the SFDR. Financial market participants need to have adequate information from the companies in which they invest to ensure that they fulfill their obligations to report information on sustainability in the financial services sector to end investors (which can also be individuals or households). It should be noted that the end investors may or may not be the same as the investors referred to in the previous point (due to the definition of financial market participant in the SFDR, which also affects the nature of the end investor);
iii) from the point of view of fulfilling the obligations set out in the Taxonomy Regulation. The information reporting requirements for companies need to be in line with the Taxonomy Regulation. It should be emphasized that the delegated regulation adopted in April 2021 specifies the technical screening criteria for determining whether certain economic activities are significantly contributing to climate change mitigation and adaptation, and also for determining whether economic activities are significantly undermining the achievement of any of the other relevant environmental objectives.
iv) clarification of the scope of the sustainability information to be reported is also necessary for the companies themselves, which are under this obligation,

also because of the setup of internal processes, the costs they incur, and the reduction of greenwashing and related unfair practices that may occur in a competitive environment.

The objective of the CSRD is to set rules for reporting publicly available information on the risks posed to companies by sustainability issues, as well as on the impact of companies themselves on the people and the environment, and to make this information comparable, reliable and accessible.[22] The main changes introduced by the draft CSRD are the extension of the obliged entities that have to report this information, the screening of sustainability information (in the form of assurance on the reporting of sustainability information), the establishment of common rules for the reporting of sustainability information (but also for its assurance), the provision of publication of reports in digital and machine-readable format (due to the need to ensure their easier accessibility).

Following the stated hypothesis, we will look more closely at the changes introduced by the draft CSRD only in terms of the extension of the entities that are obliged to report sustainability information. This obligation applies to large companies[23] and, from 1 January 2026, to small[24] and medium-sized companies[25] which are governed by the law of a Member State and whose transferable securities are admitted to trading on a regulated market of any Member State. The wording of the NFRD imposes this obligation only on large companies which are public interest entities and which, as at the balance sheet date, show that they have exceeded the criterion of an average number of 500 employees during the accounting period. The draft CSRD will also apply to insurance companies and credit institutions (banks), regardless of their legal form.

The new regulation thus extends the obligation to report sustainability information to all large companies and all companies with listed securities on the EU regulated markets, except for micro companies.[26] This is a substantial expansion of the range of entities that must report sustainability information, which includes environmental, social and governance (ESG) components.

22 Explanatory memorandum of CSRD.

23 Large undertakings shall be undertakings which on their balance sheet dates exceed at least two of the three following criteria: a) balance sheet total: EUR 20 000 000; (b) net turnover: EUR 40 000 000; (c) average number of employees during the financial year: 250.

24 Small undertakings shall be undertakings which on their balance sheet dates do not exceed the limits of at least two of the three following criteria: (a) balance sheet total: EUR 4 000 000; (b) net turnover: EUR 8 000 000; (c) average number of employees during the financial year: 50.

25 Medium-sized undertakings shall be undertakings which are not micro-undertakings or small undertakings and which on their balance sheet dates do not exceed the limits of at least two of the three following criteria: (a) balance sheet total: EUR 20 000 000; (b) net turnover: EUR 40 000 000; (c) average number of employees during the financial year: 250.

26 Undertakings which on their balance sheet dates do not exceed the limits of at least two of the three following criteria: (a) balance sheet total: EUR 350 000; (b) net turnover: EUR 700 000; (c) average number of employees during the financial year: 10.

## 2. ESG IN THE CONTEXT OF ACTIVITIES OF CREDIT INSTITUTIONS

One of the reasons for extending sustainability reporting obligations to credit institutions is that they play a key role in the transition to a fully sustainable and inclusive economic and financial system in line with the European Green Deal and can have a significant positive and negative impact through their lending, investment and underwriting activities.[27] The impact of ESG on the activities of banks is visible in several ways.[28] The Basel Committee on Banking Supervision issued in June 2022 principles for the effective management and supervision of climate-related financial risks.[29] In May 2022 EBA issued the discussion paper about the role of environmental risks in the prudential framework.[30]

We think that the impact of credit institutions on the widespread relevance of the ESG criteria on financial markets should also be seen through their lending activities. While the reporting of sustainability information, which includes ESG criteria, for making investment decisions is fairly well covered through the draft CSRD and the SFDR (given the definition of obliged entities in both pieces of legislation), the assessment of ESG in lending is a particular challenge for banks, as not all borrowers are large or listed companies obliged to report relevant ESG information. At the same time, the concept of double materiality is also strongly manifested in credit institutions.[31] This creates a gradual push to incorporate the ESG into the lending assessment process. ECB issued in May 2020 Guide on climate-related and environmental risks Supervisory expectations relating to risk management and disclosure. In the Guide ECB stated that institutions are expected in their credit risk management to consider climate-related and environmental risks at all relevant stages of the credit-granting process and to monitor the risks in their portfolios.[32] This approach is in line with the EBA Guidelines on loan origination and monitoring[33].

According to the EBA Guidelines on loan origination and monitoring, credit institutions should take into account the ESG criteria as well as the related risks when

27 (23) CSRD.

28 BIRINDELLI, Giuliana et al.. Banks' governance and risk management frameworks: how to integrate ESG and climate risks. *RISK MANAGEMENT MAGAZINE* [online]. 2022, 17(1) [viewed 25 September 2022]. Available from: doi:10.47473/2020rmm0103

29 Basel Committee on Banking Supervision: Principles for the effective management and supervision of climate-related financial risks, June 2022.

30 The role of enviromental risks in the prudential framework discussion paper EBA/DP/2022/02 2 May 2022.

31 CERRONE, Rosaria. Banking Regulation for ESG Principles and Climate Risk. In: *Banking and Accounting Issues* [online]. 2022 [viewed 25 September 2022]. Available from: doi:10.5772/intechopen.104110

32 Expectation 8, Guide on climate-related and environmental risks Supervisory expectations relating to risk management and disclosure.

33 EBA/GL/2020/06) of 29 May 2020 Guidelines on Loan Origination and Monitoring [online]. Available from: https://www.eba.europa.eu/regulation-and-policy/credit-risk/guidelines-on-loan-origination-and-monitoring

assessing credit risk.[34] The issue of an environmentally sustainable lending strategy and the incorporation of procedures and tools that would achieve the required level of such an approach are also coming to the fore in the context of the EBA Guidelines on loan origination and monitoring. In this respect, it is important to emphasize that the ESG assessment has an impact on the credit institution in two ways: firstly, it presents risks that are on the borrower's side (e.g. risks related to climate change and the impact on the borrower's business), and secondly, it is linked to the role of the credit institution on the financial market in promoting sustainable financing (the bank's "moral" role in environmentally sustainable lending). However, there are a number of technical, informational and organizational issues associated with the integration of the ESG into the lending process which, in our view, will over time create pressure for the need to harmonize standards at a legislative level.

In order to verify the stipulated hypothesis, it is important to point out recent actions taken by EBA. On 24 January 2022 EBA published final draft implementing technical standards (hereinafter referred to as the „ITS") on Pillar 3 disclosures on ESG risks (standards setting out requirements for European banks' reporting on key ESG risks, particularly climate change). Legal background is based on the Capital Requirements Regulation which mandates the EBA to develop draft implementing technical standards specifying uniform disclosure formats, and associated instructions. In the ITS the EBA requires credit institutions to disclose information on their GAR and also to provide additional information for the purpose of calculating a separate a banking book taxonomy alignment ratio hereinafter referred to as the „BTAR"). The BTAR provides similar calculation methodology as GAR for undertakings without NFRD requirements. The additional and separate information on the BTAR shall apply from June 2024, which means that institutions will include this additional and separate key performance indicators in their end of June 2024 disclosure reference date Pillar 3 reports for the first time.

We believe that the importance of taking the ESG criteria into account in lending will gradually increase, also in view of the recent evidence adopted by the EBA and the ECB in this area. This approach to incorporating the ESG into the lending process will continuously raise awareness of the importance of ESG on the financial markets, even from the perspective of entities outside the scope of the draft CSRD. This will put pressure on entities that, although not required to report sustainability information under the draft CSRD (they are not large companies or listed companies), will be interested in bank financing (or more favorable financing) as part of their business activities.

34 EBA/GL/2020/06) of 29 May 2020 Guidelines on Loan Origination and Monitoring [online]. Available from: https://www.eba.europa.eu/regulation-and-policy/credit-risk/guidelines-on-loan-origination-and-monitoring

## CONCLUSION

Several studies conducted in different countries confirm the positive impact of the ESG reporting. Studies show that the ESG reporting has a positive impact on a company's financial performance.[35] The positive impact of the ESG reporting is also to make the investment more attractive to investors.[36] It is also worth emphasizing the fact that stakeholders today are looking for more information on how business operates in a world of limited natural resources. [37] Current legislative development in the form of the sustainable finance package creates a more comprehensive framework for the reporting of comparable, reliable and accessible sustainability information when making investment decisions, supporting the objective of promoting the shift of private capital to more sustainable investments and the importance of the role of the financial market in the fight against climate change. At the same time, we believe that it is possible to state the verification of the established hypothesis *"compliance with the ESG requirements will become important in the short term for most undertakings, regardless of whether they fall under the new extended framework of the proposal for CSRD or the existing SFRD"* and that because of the following reasons. ESG is also gradually becoming more important in bank lending. The ITS on Pillar 3 disclosures on ESG risks issued by EBA due to the BTAR (which covers extended information on the level of Taxonomy alignment of exposures towards non-financial corporates not subject to NFRD disclosure obligations). ESG thus becomes relevant also for those financial market participants who are not covered by the draft CSRD but are interested in lending. This puts notional pressure on financial market participants to report sustainability information, despite the absence of a legal obligation to report this information. At the same time, the ESG criteria are increasingly becoming more publicly known through this approach, increasing the interest of retail investors in the issue and creating the expectation that the relevance of the ESG criteria will be transferred to alternative forms of financing, which, although not covered by regulation, are very flexible in responding to the needs and demand of the financial market. ESG may thus become an integral part of capital movements on financial markets in the near future. The increasing role of environmental factors in housing lending, while not fully reflecting ESG, is also worthy of consideration, and also of possible scientific

35 PULINO, Silvia Carnini, et al. Does ESG Disclosure Influence Firm Performance? *Sustainability* [online]. 2022, 14(13). Available from: doi:10.3390/su14137595, ELLILI, Nejla Ould Daoud. Impact of ESG disclosure and financial reporting quality on investment efficiency. Corporate Governance [online]. 2022, 22(5), 1094–1111. ISSN 1472-0701. Available from: doi:10.1108/CG-06-2021-0209, SANG, Kim, and Zhichuan (Frank) LI. Understanding the Impact of ESG Practices in Corporate Finance. Sustainability [online]. 2021, 13(7). Available from: doi:10.3390/su13073746

36 CHEN, Zhongfei, and Guanxia XIE. ESG disclosure and financial performance: Moderating role of ESG investors. *International Review of Financial Analysis* [online]. 2022, 83, 1 [viewed 24 September 2022]. Available from: doi:10.1016/j.irfa.2022.102291.

37 PULINO, Silvia Carnini, et al. Does ESG Disclosure Influence Firm Performance? *Sustainability* [online]. 2022, **14** [viewed 25 September 2022]. Available from: doi:10.3390/su14137595, KHUEN, Wong Wai, and Teh Boon HENG. Revisiting External Stakeholders' Role in Environmental, Social and Governance (ESG) Disclosure: A Systematic Literature Review and Research Agenda. *The Asian Conference on Business & Public Policy 2021 Official Conference Proceedings* [online]. 2021 [viewed 25 September 2022]. Available from: https://papers.iafor.org/submission61038/

investigation, and falls within the concept of sustainable finance with implications for a broad group of borrowers (including households).[38] For the purpose of future research it will be appropriate to concern with the difference between GAR and BTAR (mainly in light of Opinion of the European Banking Authority on the European Commission's amendments relating to the final draft Implementing Technical Standards on prudential disclosures on ESG risks in accordance with Article 449a CRR and calculation of BTAR by using estimates or proxies). There are also inconsistencies connected with the Article 8 of the Taxonomy Regulation as well as formulation of terms in Taxonomy Regulation and SFRD, which may be the subject of further research in order to complete the analysed topic..

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38 The Energy Efficiency Financial Institutions Group (EEFIG) Working Group on Risk assessment found a positive correlation between energy efficiency and mortgage credit performance, as well as an upward influence of energy performance on house prices: Expectation 8.3-Institutions are expected to consider climate-related and environmental risks in their collateral valuations In Guide on climate-related and environmental risks Supervisory expectations relating to risk management and disclosure ECB. Opinion of the European Banking Authority on the European Commission request for technical advice on issues related to the Mortgage Credit Directive.

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# Combating modern-day Goliath? Competition and data-sharing in the EU digital economy

**Tinashe Kondo**

Dr Tinashe Kondo
tkondo@uwc.ac.za
https://orcid.org/0000-0001-6545-7552
Senior Lecturer/Competition and Investment Law, Department of Mercantile and Labour Law
Faculty of Law, University of the Western Cape
Cape Town, South Africa

***Abstract:***
This paper deals with the issue of data-sharing and its impact on competition law. Competition authorities in the European Union (EU) have been concerned that the lack of proper rules governing data-sharing has an adverse impact on fairness in the EU digital market. Access to data is key in the creation of new innovative aftermarket services and sustainable data economies. Current legislation has however not been tailormade to address these modern-day developments. The paper explains and analyses the legislative developments with regards to data access and sharing in the European Union.

***Key words:*** *big data, competition law, digital economy, data-sharing, data access*

## INTRODUCTION

This paper focusses on the issue of access to and data-sharing and its relation to the competitive environment in European Union (EU). Digitisation has transformed the manner in which existing markets work, while at the same time creating new opportunities and markets. This has led to the creation of what has been termed the 'digital economy' – which has its own unique markets and platforms.[1] These markets, however, present opportunities for new types of misconduct.

It has been argued that firms may exploit data-sharing agreements to share competitively sensitive information such as output levels, pricing strategies, marketing and new product developments. Firms may also stonewall certain competitors by refusing to exchange information with them, while dealing with others.

1 HUANG, Lei, et al. A multi-sided market of personal data resource allocation: An empirical study of China's car-hailing platform. Competition and Regulation in Network Industries [online]. 2021, 22(3-4), 190.

The result of this would be that these excluded firms would be unable to compete with those that are part of the data-sharing agreement.

The paper seeks to traverse the legislative developments in EU competition law with regards to the governance of data-sharing agreements. It seeks to understand whether the current rules are suited to curtail the mischief that may arise from data-sharing agreements in the business to business (B2B) context. This assessment is valuable in that inadequate competition rules in the regulation of data-sharing agreements presents a *lacuna* in the law that may be exploited by businesses to the detriment of consumers – whose duty competition law is to protect. Most traditional competition laws are unsuited to address the developing laws with regards to data and competition law.[2] Furthermore, while data protection and privacy regulations have been canvased in greater detail, the relevance of these frameworks for competition law is still unexplored.

## 1. DATA-SHARING

In the digital economy, data has been described as the 'new oil'. Data is a symbol set can be quantified or qualified. Data is collected by observation and takes many forms such as characters, symbols, numbers and sounds. Once collected, it can be processed into information. Data is often representative and takes the form of measurements of a phenomenon such as a person's age, weight, opinions, habits, location and colour amongst others. It is important to understand that there are different types of data. More broadly, data that is handled by a business can be classified as business data and personal data. Business data is that data which relates to the business itself such as its operation. This can include sales numbers, employee data, process data, process data, customer feedback data, marketing data, analytics data, consumer data and inventory and supply chain data. However, some of the information about the business such as information about its customers, employees, directors or partners can be classified as personal information. This is because this information can be used to personally identify them. Non-personally identifiable data such as IP addresses, device IDs and web-browser cookies is also included as forming a part of personal data.

Data is a non-rival social and economic good that can be replicated at little to no cost. There is no easy way to describe the sharing of data. A general understating is that data-sharing involves the practice furnishing access to collaborators to information they do not possess in their own firms.[3] Data-sharing is a commercial reality that is usually prevalent in competitive markets where information

2 KIRA, Beatriz, Vikram SINHA, and Sharmadha SRINIVASAN. Regulating digital ecosystems: bridging the gap between competition policy and data protection. Industrial and Corporate Change [online], pp. 1338.

3 Data sharing however should be distinguished from data integration that involves the unification of data from various firms on the basis of common data fields.

exchange is considered to be a vital ingredient for a competitive market.[4] Owing to the importance of data-sharing in the business context,[5] restrictions on data sharing ought to be removed as the practice is beneficial to society. However, this cannot be done in a vacuum, but must rather be done in a manner consistent with related rules. While data-sharing can take place in many contexts, this paper focuses on data-sharing between competitors.

### 1.1 Data-sharing and competition law

As can be derived above, the practice of data-sharing has competitive consequences for the digital single market (DSM). These effects can pro-competitive and anti-competitive. Pro-competitive gains occur when the exchange of information amongst competing firms results in welfare gains and increased efficiency. This is because, as data is a non-rival good whose use by one user, does not preclude another.[6] Data sharing is beneficial in saving costs (to re-collect data) and in promoting innovation, product standardisation, benchmarking, reduced inventory costs, improved business logistics, better managed consumer demand, reduced search costs, amongst others. – the benefits of which are all can be passed to the consumer.

Furthermore, data-sharing enables the development of new goods and services as well as the enhancement of existing ones.[7] Aside from the benefits that accrue to firms who are competitors, data-sharing also has value for firms who are not direct competitors. Herein, data secured by one firm may be shared with another downstream, thereby serving as an input in another industry. For example, data collected from cellphone towers, short-range positioning beacons and global positioning systems can be integrated for use by location-based services. However, this is subject to permission from the user.

This thinking has been accepted by the European Commission (EC) which noted in paragraph 57 of the 'Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements' that information exchange was a common-place in competitive markets and led to efficiency gains for market players.

The above notwithstanding, data-sharing may also lead to anti-competitive outcomes. Herein, the sharing of data may result in collusion amongst rival firms. This may be done by reducing the strategic uncertainty that exists between rival

4 CHAPTER FIVE. How "Open" Is the Future of Banking? Data Sharing and Open Data Frameworks in Financial Services. In: The Technological Revolution in Financial Services [online]. University of Toronto Press, 2020, pp. 129.

5 See TEECE, David. Information Sharing, Innovation, and Antitrust. Antitrust Law Journal. 1994, 62, 470.

6 MARTENS, Bertin, et al. Business-to-BBusiness data sharing: An economic and legal analysis. European Commission, 2020. JRC Digital Economy Working Paper 2020-05.

7 See ROUIBAH, Kamel, and Samia OULD-ALI. Dynamic data sharing and security in a collaborative product definition management system. Robotics and Computer-Integrated Manufacturing [online]. 2007, 23(2), 218.

firms.[8] It also The EC has noted that that the exchange of market information can potentially be anti-competitive.[9] This, it points out, would typically occur in cases where such exchanges result in undertakings becoming aware of their competitor's strategies.[10] It further creates opportunities for the enforcement of cartel agreements. The rationale behind this is that where there is enhanced transparency in a market, it provides firms in a collusive agreement the opportunity to monitor compliance with the cartel agreement and thus the opportunity to punish deviant members.

A good case in point is the South African case of *Woodlands Dairy (Pty) Ltd and Another v Competition Commission; Competition Commission v Clover Industries Limited and Others.*[11] In this matter, the parties were involved in a price information exchange in contravention of section 4(1)(b)(i) of the Competition Act 89 of 1998. The firms regularly collected pricing information which was shared between the firms. Some of the firms procured the services of a specialist who collated price comparison reports using price formulas used by the different firms. The sharing of such strategic data is inimical to competition and is severely detrimental to the welfare of consumers. Accordingly, such data/information-sharing should be heavily frowned upon. Even still, in cases where out and out collision does not exist, data sharing presents the risk of sustainable tacit collusion as a result of the increased transparency.[12]

Furthermore, data/information-sharing conducted amongst a few select competitors can then be used to foreclose existing competitors or potential entrants in the market. Aside from this, firms in possession of important data may consider it economically unviable to share this data in the fear of losing their competitive advantage. This wrongful appropriation of data could then land the firm in violation of competition rules. Inevitably, these practices harm consumers in the form of higher prices and reduced options for consumers.

8 The Competition Commission – 'a growing, deconcentrated and inclusive economy [online]. [no date] [viewed 3 October 2022]. Available from: https://www.compcom.co.za/wp-content/uploads/2014/09/The-role-of-information-exchange-dasNairMncube140809-2.pdf.

9 Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal cooperation agreements, para 58.

10 Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal cooperation agreements, para 58.

11 (103/CR/Dec06) [2009] ZACT 18 (17 March 2009).

12 EZRACHI, Ariel, and Maurice STUCKE. Artificial Intelligence & Collusion: When Computers Inhibit Competition. University of Illinois Law Review. 2017, 2017(5), 1778.

## 2. DATA PROTECTION

The concept of data protection is difficult to define. Early formulations of the idea of data protection focussed on the control over information.[13] In more recent times, data protection centres around the fair and lawful processing of personal data.[14] In the early 1990s, data protection became an internal market concern.[15] In response to these concerns, the EU Data Protection Directive (DPD) was enacted in 1995. The legal grounding for this Directive was provided for under Article 95 of the European Community Treaty (now Article 114 of the Treaty on the Function of the European Union). The DPD would become the first of many pieces of legislation that would provide a framework for the protection of personal data.

The DPD aimed to harmonise the legal protection afforded to the personal data of citizens of member states and remove barriers to the free movement of personal data in the EU. Under Article 1 of the DPD, data protection was viewed as an enforcement of the fundamental rights and freedoms of a natural person. Therefore, data protection under the DPD was not considered an independent right. This meant that data was, by and large, protected under the right to privacy.

It was only in 2009 when the Treaty of Lisbon came into force that data protection was elevated into a standalone right.[16] Article 29 of the Lisbon Treaty states that '[e]very one has the right to protection of personal data concerning them'.[17] Owing to the recognition afforded to data protection in the Lisbon Treaty, data protection was then recognised as a standalone right in Article 8 of the EU Charter of Fundamental Rights (EU Charter).[18] Article 8 of the EU Charter provides that everyone has the right to the protection of their personal data the protection of personal data and to have such data fairly and lawfully processed.

Noticeably, the right to data protection is distinguished from the right to privacy in Article 8 of the EU Charter.[19] It signals a move towards the fundamental rights approach where data protection is viewed as a right.[20] This is in contra-

13 MANTELERO, Alessandro. Defining a new paradigm for data protection in the world of Big Data analytics. In: CYBERSECURITY Conference. Carlifonia: Stanford, 27 April 2014, pp. 2.

14 MAXWELL, Winston J. Principles-based regulation of personal data: the case of 'fair processing'. International Data Privacy Law [online]. 2015, 5(3), 205.

15 TZANOU, Maria. Fundamental Right to Data Protection: Normative Value in the Context of Counter-Terrorism Surveillance. Bloomsbury Publishing Plc, 2019, pp 16.

16 TZANOU, Maria. Fundamental Right to Data Protection: Normative Value in the Context of Counter-Terrorism Surveillance. Bloomsbury Publishing Plc, 2019, pp 1.

17 Treaty of Lisbon amending the Treaty on European Union and the Treaty establishing the European Community, signed at Lisbon, 13 December 2007, Art 29.

18 Charter Of Fundamental Rights Of The European Union (2012/C 326/02).

19 TZANOU, Maria. Fundamental Right to Data Protection: Normative Value in the Context of Counter-Terrorism Surveillance. Bloomsbury Publishing Plc, 2019, 1.

20 TZANOU, Maria. Fundamental Right to Data Protection: Normative Value in the Context of Counter-Terrorism Surveillance. Bloomsbury Publishing Plc, 2019, 16.

distinction to other jurisdictions where data protection is interpreted under the right to privacy. In South Africa, for instance, the right to data protection is encompassed under the right to privacy (section 14 of the Constitution) and common law.

The fundamental rights approach has however been heavily criticised by academic scholars. Maria Tzanou, in her piece titled The *Fundamental Right to Data Protection: Normative Value in the Context of Counter-Terrorism Surveillance*, offered insight into this debate.[21] She noted that the right to privacy is a much broader concept which cannot be reduced to the aspect of personal information only.[22] She averred that while the rights to privacy and data protection can be viewed as being theoretically distinct, it is vital to recognise their intrinsic connection.

This connection was properly explained by the European Court of Human Rights (ECHR) in *Satakunnan Markkinapörssi Oy and Satamedia Oy v. Finland*.[23] The court in this matter noted that the protection of personal data is key to the enjoyment of a person's right to a private and family life as afforded for in Article 8 of the Charter. This entails individuals having self-determination with regards to their information.[24] The court in this matter went on to note that, even in cases where information was already in the public domain, this did not exclude it from protection under Article 8 of the EU Charter.[25] It is important to note that the ECHR is a regional court responsible for the interpretation of the European Charter.

Furthermore, in *P. G. and J. H. v. the United Kingdom*,[26] the court was of the view that even data of a public nature could be construed as forming part of the private life of an individual if it is stored in a systematic or permanent manner.[27] The case of what constitutes 'private life' has been one of significant academic interest. In Amann v. Switzerland,[28] the court suggested that the term 'private life' should not be interpreted restrictively.[29] It explained that the private life of an individual should be viewed as involving the right to establish and develop relationships with other human beings, including activities of a professional or business nature.[30]

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21 TZANOU, Maria. Fundamental Right to Data Protection: Normative Value in the Context of Counter-Terrorism Surveillance. Bloomsbury Publishing Plc, 2019.

22 TZANOU, Maria. Fundamental Right to Data Protection: Normative Value in the Context of Counter-Terrorism Surveillance. Bloomsbury Publishing Plc, 2019, 23.

23 Case C-73/07.

24 *Satakunnan Markkinapörssi Oy and Satamedia Oy v. Finland, The European Court of Human Rights*, 16 December 2008, Case C-73/07 (Finland), para 34.

25 *Satakunnan Markkinapörssi Oy and Satamedia Oy v. Finland*, para 134.

26 Application no 44787/98.

27 *P. G. and J. H. v. the United Kingdom, European Court of Human Rights*, 25 September 2021, (44787/98) (United Kingdom), para 57.

28 Application no. 27798/95.

29 *Amann v. Switzerland, European Court of Human Rights*, 16 February 2000 (Switzerland), para 65.

30 *Amann v. Switzerland*, para 65.

In 2016, the General Data Protection Regulation (GDPR) was published.[31] The GDPR however only came into force on the 25th of May 2018. The GDPR replaced the DPD and harmonised data protection across the EU. It is perhaps the most stringent data protection law in the globe. It supersedes all existing national laws[32] of the member states and imposes obligations on any firm worldwide which collects or processes data of people in the EU (regardless of their location in the world).[33] Its objective is to: (1) provide a framework for the lawful processing of personal data, (2) ensure the protection of fundamental rights and freedoms and (3) to facilitate the free movement of personal data within the EU.

The GDPR establishes 6 data protection principles, which are: (1) lawfulness, fairness and transparency, (2) purpose limitation, (3) data minimisation, (4) accuracy, (5) storage limitation, and (6) integrity and confidentiality. Accountability can be included as a 7th overarching principle. The most relevant principle for the purpose of this paper is possibly that of data adequacy and minimisation. Article 6(c) of the GDPR on data minimisation provides that compliance in processing of personal data is necessary in order for the data controller to meet their legal obligations.

Article 5(1)(c) of the GDPR further notes that data collected must be 'adequate, relevant and limited to what is necessary in relation to the purposes for which they are processed'. Therefore, the principle of data minimisation limits data-sharing as information can only be collected and used in a manner consistent with its purpose of collection. This is to ensure that personal data is appropriately handled.

Data-sharing could take place for a number of reasons including, (1) the sharing of personal data with a third party for joint purposes, (2) the passing of personal data to a third party for its own use and (3) the passing of personal data to a third party for storage.[34] Where the data-sharing takes place for joint purposes, Article 26 of the GDPR is then triggered. The two firms are then considered to be joint controllers of the data who have detailed roles and responsibilities in terms of the protection of that data.

In 2018, following the coming into force of the GDPR, the EU also enacted the Regulation on a framework for the free-flow of non-personal data in the EU.[35] The regulation aims to ensure the free-movement of non-personal data by addressing the rules related to localisation requirements. In so doing, the regulation pro-

31 Regulation 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data (General Data Protection Regulation).

32 See VLAHOU, Antonia, et al. Data Sharing Under the General Data Protection Regulation. Hypertension [online]. 2021, 77(4), 1029.

33 What is GDPR, the EU's new data protection law? - GDPR.eu. GDPR.eu [online]. [no date] [viewed 3 October 2022]. Available from: https://gdpr.eu/what-is-gdpr/.

34 Data sharing and using data processors | Information Compliance. Information Compliance | [online]. [no date] [viewed 3 October 2022]. Available from: https://www.information-compliance.admin.cam.ac.uk/data-protection/guidance/data-sharing.

35 2018/1807.

motes digital value chains and the cross-border exchange of data. It fills the gaps left by the GDPR that solely focusses on personal information. As a result, there is a proper framework for the free movement of data of across the EU, covering both personal and non-personal information.

In 2020, the EU legislators presented the first proposal for a new Data Act. The aim of the proposed Data Act is to harmonise the rules on fair access and the use of data.[36] The proposed Data Act has 6 objectives, 3 of which are relevant for data-sharing. Objectives 1, 5 and 6 have implications for data-sharing. Objective 1 seeks to enhance the legal certainty of data obtained through data-sharing.[37] It further aims to operationalise rules around fairness in data-sharing contracts.[38] Objective 5 attempts to eliminate barriers in data-sharing in order to facilitate the reuse of data through interoperability.[39] Objective 6 ensures that the use of data is done in accordance with existing rules on the processing of data such as the GDPR and the rules on the protection the private life and the confidentiality of communications.[40]

The Preamble of the proposed Data Act also speaks to the issue of data-sharing. The Preamble affords that data-driven technologies now have a central role to play in today's digital economy.[41] Accordingly, it is vital for data to be accessible and interoperable in order to enhance value chains. Key to this is the fact that data is reusable and therefore has unlimited potential in its uses. It is estimated that this would then increase competitiveness, innovation and ensure sustainable economic growth. The proposed Data Act highlights the nexus between data-sharing and competition law. It is noted that, in using data, data holders should refrain from using the data to determine the economic circumstances of its competitors in a manner that would weaken the commercial position of other competitors within the market. Furthermore, the data holder should refrain for utilising its market position to gain an advantage when sharing its data with a competitor.[42] More broadly, the proposed Data Act bars the Act from being applied or interpreted in a manner that is not consistent with competition law, in particular Article's 101 and 102 of the Treaty on the functioning of the EU (TFEU).[43]

Therefore, it is vital to understand that while data-sharing is primarily governed in terms of data protection laws such as the GDPR which speak the processing, storage and use of data, data-sharing can also be understood from com-

36 See Proposal for a Regulation Of The European Parliament And Of The Council on harmonised rules on fair access to and use of data (Data Act) 2022/0047 (COD).

37 See Data Act Proposal, pp 2.

38 See Data Act Proposal, pp 2.

39 See Data Act Proposal, pp 2.

40 See Data Act Proposal, pp 2.

41 See Data Act Proposal, pp 17.

42 See Data Act Proposal, Article 29.

43 See Data Act Proposal, Article 88.

petitive and anti-competitive positions.[44] As noted in the preceding section, for instance, while data-sharing agreements can level the playing field for businesses and generate opportunities for innovation, they can also facilitate collusion and foster exploitative environments for consumers. Consequently, the next section unpacks the competition law framework as it relates to data-sharing.

## 3. CURRENT COMPETITION LAW FRAMEWORK

Article's 101 and 102 of the TFEU (formerly Articles 81 and 82 of the European Community Treaty) provide the backbone of the EU competition framework. These provisions restrict firms from engaging in anti-competitive practices. The provisions are implemented through Council Regulation (EC) No 1/2003.[45] It is noted in this document that the aim of Article's 101 and 102 is to prevent the distortion of competition within the common market and to promote a culture of competition within the community.[46] Power is also given to competition authorities and national courts to be able to apply Articles 101(1), 101(3) and 102 of the TFEU directly in their jurisdictions.

Article 101 prohibits agreements, decisions of association of firms, and concerted practices which have the potential to prevent, restrict or distort competition in the internal market and affect trade between member states (restrictive practices).[47] Specifically, Article 101 prohibits conduct that fixes, direct or indirectly, the purchase or selling price or any other trading condition; limits or controls production, markets, technical development or investment; divides markets or sources of supply; places dissimilar trading conditions to similar transaction; and make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.[48]

The proper interpretation of Article 101 has been provided in the EU Horizontal Guidelines.[49] The Guidelines propose that competition is of a horizontal nature where it involves firms which are on the same level of the production chain and are actual or potential competitors.[50] Horizontal competition amongst non-competitors at the same level is also covered.[51] The Guidelines denote that hori-

44 See Data Act Proposal, pp 4.

45 See Council Regulation (EC) No 1/2003. of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty

46 See Preamble of Council Regulation (EC) No 1/2003.

47 See Article 101(1) of the Treaty on the Functioning of the European Union.

48 See Article 101(1) of the Treaty on the Functioning of the European Union.

49 Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements (2011/C 11/01).

50 Article 1 of the EU Horizontal Guidelines.

51 Article 1 of the EU Horizontal Guidelines.

zontal cooperation between competitors can be pro-competitive.[52] This is as such cooperation can be utilised to share risk, save costs, increase investments, share knowledge, maximise product quality, increase product baskets, and speed up innovation.[53]

Nonetheless, the Guidelines are alive to the fact that cooperation amongst rivals at a horizontal level may lead to competition challenges.[54] The Guidelines note that the practices listed in Article 101 of the TFEU such as price fixing, market allocation, bid rigging can occur as a result of a horizontal cooperation agreements.[55]

Article 103 of the Guidelines denotes the purpose of the Guidelines as being to provide an analytical framework for the most common horizontal cooperation agreements, including information exchange.[56] The second section of the Guidelines furnishes the general principles for the competitive assessment of an information exchange. An information exchange is understood as taking place when: (1) data is shared directly between competitors, and (2) data is shared indirectly through a common agency, a third party such as a marketing agent, or via the firm's suppliers and retailers.[57]

Information exchange, in terms of the Guidelines, is viewed as a normal feature of competition markets which leads to efficiency and welfare gains.[58] In general, exchanges of information would have anticompetitive effects where the objective is to fix prices or quantities,[59] when such an exchange exposes sensitive market strategies of competitors,[60] or when it leads to market coordination as a result of increased market transparency,[61] amongst other outcomes. Furthermore, anticompetitive foreclosure is also still possible in the case where 'the exchange of commercially sensitive information places unaffiliated competitors at a significant competitive disadvantage as compared to the companies affiliated within the exchange system'.[62]

52 Article 2 of the EU Horizontal Guidelines.
53 Article 2 of the EU Horizontal Guidelines.
54 Article 3 of the EU Horizontal Guidelines.
55 Article 3 of the EU Horizontal Guidelines.
56 Article 5 of the EU Horizontal Guidelines.
57 Article 55 of the EU Horizontal Guidelines.
58 Article 58 of the EU Horizontal Guidelines.
59 Article 59 of the EU Horizontal Guidelines.
60 Article 58 of the EU Horizontal Guidelines.
61 Article 66 of the EU Horizontal Guidelines.
62 Article 70 of the EU Horizontal Guidelines.

The EU Horizontal Guidelines are however currently under review.[63] The draft revised Guidelines published on the 1st of March 2022 seek to update the rules on information exchange – albeit, in a limited fashion. Importantly, a new chapter is included on the assessment of horizontal agreements pursuing sustainability objectives as well as new guidance on data sharing, the self-assessment of information exchange agreements, unilateral disclosure, the aggregation of information/data, and indirect information exchange mobile infrastructure sharing agreements and bidding consortia.

Interestingly also, two new drafts on Horizontal Block Exemption Regulations on Research & Development (R&D) and Specialisation agreements (R&D BER) were published simultaneously with the new draft Guidelines. The aim of these guidelines (collectively with Horizontal Guidelines) is to update current rules to match current economic and social developments that have been characterised with digital and green transitions.

This is commendable because new socio-economic and technological developments have challenged existing laws and polies in new and increasingly complex ways.[64] Lawmakers and competition authorities are thus required to be agile and flexible in ensuring that prevalent competition rules are fit for task. This involves, inter alia, the development of existing competition laws and policies, the creation of new principles suitable to the digital economy and the adoption of new lenses in the interpretation and application of existing competition rules.

The final documents emanating from these drafts will be eagerly waited for as they will have significant implications for not only broader horizontal cooperation,[65] but for data-sharing at a horizontal level. Moreover, the lifting of competition restrictions in the pursuit of sustainability will indeed be welcomed. This accords with the agenda to realise the United Nations (UN) Sustainable Development Goals (SDGs) such as goal goal 11 on the development of sustainable cities and communities, goal 13 on climate action, goal 12 on responsible consumption and production as well as goal 7 on affordable and clean energy.[66] While they are not binding, they will have a persuasive value for EU competition authorities who may be unwilling to deviate from the approach suggested by the EC.[67]

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63 See draft revised Guidelines on the applicability of Article 101 of the TFEU to horizontal co-operation agreements (the Horizontal Guidelines).

64 See KIRA, Beatriz, Vikram SINHA, and Sharmadha SRINIVASAN. Regulating digital ecosystems: bridging the gap between competition policy and data protection. Industrial and Corporate Change [online], pp. 1338.

65 See LIANOS, Ioannis, and Bruno CARBALLA SMICHOWSKI. Economic Power and New Business Models in Competition Law and Economics: Ontology and New Metrics. SSRN Electronic Journal [online]. 2021 pp 2.

66 See THE 17 GOALS | Sustainable Development. Home | Sustainable Development [online]. [no date] [viewed 3 October 2022]. Available from: https://sdgs.un.org/goals.

67 The EU's Draft Horizontal Guidelines: Chilling Innovation on Sustainability? Competition Policy International [online]. [no date] [viewed 3 October 2022]. Available from: https://www.competitionpolicyinternational.com/the-eus-draft-horizontal-guidelines-chilling-innovation-on-sustainability/.

Article 102 of the TFEU prohibits the abuse of a dominant position by any firm or firms within the internal market. This occurs in cases where a firm(s) is able to operate with some level of immunity from normal competition within the market.[68] Article 102 focuses on unilateral conduct, while Article 101 focusses on multilateral conduct. However, multilateral conduct is still possible and covered within the scope of Article 102, but is not a commonplace. Some of the major cases in the EU on abuse of dominance have focused on the case of data leveraging, where a dominant firm limits access to data that it controls due to its dominance to its competitors.[69] The effect of this is able to foreclose the market to its rivals as well as potential entrants within the market.[70]

In *Servizio Elettrico Nazionale*,[71] the court grappled with a case in which a dominant firm foreclosed its competitors as a result of assets (data resources) that emanated from its dominant position, which its rivals did not possess. The court noted the test for foreclosure, as with any case of abuse of dominance, was an objective test that does not require competition authorities to establish an intention by a firm to oust its competitors.[72] The objective of Article 102 was however noted as not being to preclude a firm from outshining its competitors on the basis of its strengths, or to prop less competitive firm to be able to remain in the market.[73] Rather, the aim was to prevent firms from making it difficult for equally efficient competitors to penetrate or maintain their market position through anticompetitive means.[74]

The case is important to the case of data-sharing because it highlights the importance of data liberalisation. While firms are permitted to take decisions to advance their own position within the market, they are prohibited from foreclosing their competitors and compartmentalizing the market. Furthermore, the fact that an anticompetitive practice can be replicated by competitors does not make it any less competitive. The case also reinforces existing concepts in competition law such as the harm must stem from the dominant position of the firm.

68 European Union: Abuse of dominance and article 102 of the TFEU. Global Competition Review [online]. [no date] [viewed 3 October 2022]. Available from: https://globalcompetitionreview.com/review/the-european-middle-east-and-african-antitrust-review/2023/article/european-union-abuse-of-dominance-and-article-102-of-the-tfeu.

69 See generally, European Union: Abuse of dominance and article 102 of the TFEU. Global Competition Review [online]. [no date] [viewed 3 October 2022]. Available from: https://globalcompetitionreview.com/review/the-european-middle-east-and-african-antitrust-review/2023/article/european-union-abuse-of-dominance-and-article-102-of-the-tfeu.

70 One must also note that there is also a practice of self-preferencing in which a vertically integrated firm preferences its own positions its platforms in its own favour, prejudicing rivals within the market.

71 Case C-377/20.

72 *Servizio Elettrico Nazionale and Others, Court of Justice*, 12 May 2022, C-377/20, para 64.

73 *Servizio Elettrico Nazionale*, para 73

74 *Servizio Elettrico Nazionale*, para 73

## CONCLUSION

The emergence of the digital technologies and the internet of things has created new ways of doing business and practices. Data-sharing has become a commonplace in many industries. Theoretically, data-sharing has many benefits such as cost saving, innovation, product standardisation, benchmarking, improved business logistics and better managed consumer demand and the development of new goods and services as well as the enhancement of existing ones. It is therefore beneficial to consumers as it promotes efficiency and can be experienced by consumers in the form of cheaper goods, a wider variety of products and more standardised goods. However, data-sharing, despite its benefits for competition may have serious anticompetitive effects. It may lead to a number of harmful anticompetitive practices such as reduced strategic uncertainty between rival firms, a platform to monitor compliance with cartel agreements as a result of increased transparency, market foreclosure as a result of restricted data-sharing between firms in a market, amongst others.

It was noted in the paper that significant progress has been made in regulating data-sharing form a data protection perspective. This is largely as a result of the efforts made through the Lisbon Treaty and the EU Charter towards a fundamental rights approach in adopting data protection as a standalone right. The result of this has been the promulgation of a number of instruments geared towards the free movement of data in a manner respective of data rights. These instruments, include, but are not limited to the GDPR (focussing on personal data), the Regulation on a framework for the free-flow of non-personal data in the EU. Focus has however been on the protection of personal data as covered by the GDPR.

Nonetheless, the EU continues to recognise that continuous socio-economic and technological developments continue to challenge existing laws in new and increasingly complex ways. One of such ways being the manner in which data-sharing poses a danger for competition with markets, especially the EU digital single market. As a result, to keep abreast with these developments, existing data rules should be amended to cater for these developments on the competition front. Accordingly, a proposal has been made for a new Data Act which, inter alia, address the nexus between competition law and data-sharing. It prohibits data-holders from using their data to weaken the position of competitors or from using their market position to gain an advantage when sharing their data. More so, the Act notes that its interpretation has to be done in a manner consistent with competition law.

However, progress relating to specific data-sharing rules for competition law has been slow. Lawmakers and enforcement authorities in the EU and are working on enhancing existing rules and developing new ones. The proposed rules which include the amendment of the EU Horizontal Guidelines, the Horizontal Block Exemption Regulations on Research & Development and Specialisation agreements

will go a long way in developing an understanding of how competition issues with regards to data-sharing should be treated. However, these rules are non-binding and do not form part of the primary laws of the EU. Therefore, a gap will still exist in the hard law on competition law and data-sharing. It is suggested that further work be done in formulating new binding rules to mitigate the anticompetitive outcomes of data-sharing agreements. This will certainly be on the agenda of EU enforcement authorities. Finally, the views and perceptions on data need to be changed. Data can be viewed as a necessary infrastructure that should be shared freely amongst rival – of course, subject to certain competitive limitations.[75]

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# A Step in the Right Direction: The Issue of Extraterritoriality in the Landscape of Deutschland's Competition Law and Policy


## Arnold Stanley, George Thomas Thevaril

Arnold Stanley
arnoldstanley41@gmail.com
3rd Year Law Student, St. Joseph's College of Law,
Faculty of Law, Karnataka State Law University,
Bangalore, India.

George Thomas Thevaril
georgenov2000@gmail.com
3rd Year Law Student, St. Joseph's College of Law,
Faculty of Law, Karnataka State Law University,
Bangalore, India.



***Abstract:***
This paper analyses the extraterritorial application of Germany's competition regulations in line with EU rules that apply to all enterprises in the EU's internal market. The extraterritoriality issue about Germany's anti-trust laws has gone through two separate chapters: the first one consisted of progressive development backed by a certain level of confidence in proposed solutions, while the second part is currently filled with debate and ambiguity. This study explores the extraterritoriality issue by answering two questions: first, does choice of law provisions require the proper execution of German law? The second question is whether German legislation violates PIL (Public International Law). Considering this, the authors analyse the conceptual restrictions German lawmakers have placed on the 'effects' principle and the use of PIL (Public International Law) to account the diverse interests of neighbouring nations towards extraterritoriality. Lastly, this research paper emphasizes the importance of multilateral debates at the OECD and WTO for Germany in competition law.



***Key words:*** *Competition Law, Public International Law, Extraterritoriality, EU*

## INTRODUCTION

One of the most divisive issues in international law is the extraterritorial reach of antitrust laws. The international legal community has failed to develop jurisdictional principles that meet the needs of regulating states while also being discriminatory enough to avoid infringing on the legitimate interests of other states. German antitrust restrictions have become stricter. It has used PIL to reduce the "effects" concept's influence on nations whose territory is increased by German extraterritoriality. This paper aims to describe extraterritoriality in Germany and link it to the necessity to find international law solutions to a crisis that could grow into a worldwide conflict.

## 1. DOES THE RELEVANT CHOICE OF LAW RULE SEC 185 (2) MANDATE THE APPLICATION OF GERMAN ANTITRUST LAW?

### 1.1 The Effects Principle and its application under German Antitrust Law

German antitrust law's extraterritoriality argument centres on a few simple points. Sec 185 (2) of the GWB states, "The provisions of Parts 1 to 3 of this Act shall be applied to all restraints of competition having an effect within the area of application of this Act, even if they were caused outside the area of application of this Act."[1] This provision has been at the centre of discussions in German antitrust law outside Germany and is regarded as a blanket provision on all "competition constraints with domestic ramifications" that would fall under Sec 185 (2), regardless of where or by whom they were agreed upon or caused.

Therefore, extraterritoriality could supposedly have only two limits:

(1) German courts' capacity to consider foreign-party cases

(2) the limits of international law

Subparagraph (2) is broad. Because it doesn't limit what counts as an "impact," we can say it's "pure." Sec 185(2) is the sole "pure" effects theory, developing the German effects principle. Since Germany never passed a wide antitrust statute, international jurisdictional problems were overlooked. After the GWB's (Gesetz gegen Wettbewerbsbeschränkungen) substantive provisions were tightened and international legal relations evolved, the problems with depending entirely on this premise became clear.[2]

1 FEDERAL MINISTRY OF JUSTICE, Federal Office of Justice. Act against Restraints of Competition (Competition Act – GWB). *Gesetze im Internet* [online]. 9 July 2021 [viewed 5 October 2022]. Available from: https://www.gesetze-im-internet.de/englisch_gwb/englisch_gwb.html

2 The Extraterritorial Application of the German Antitrust Laws. *The American Journal of International Law* [online]. 1963, **77**(4), 28 [viewed 3 October 2022]. Available from: https://www.jstor.org/stable/2202533

### 1.2 The Effects Principle & the limitation in its application

The extraterritoriality discussion has been largely centred on the effects principle. The GWB wouldn't apply to any violations that might affect Germany. German academics linked the effects principle to the GWB's protective functions in general & to the GWB provision at question. The law aims to protect domestic competitiveness. Courts look at a statute's ***"sphere of protection"***. Sec 185 (2) requires a detrimental impact on the protected area. Infringement is only important if it "injures" or "invades" the protected domain. In 1973, the Oil Field Pipes decision[3] ruled that Sec 98(2) did not apply since the agreement had no "domestic ramifications." The case is notable for enunciating the essential construction criteria for implementing sec 185 (2).[4]

## 2. APPLICATION OF ANTITRUST LAW WITH EU LAW (PIL): HAS THE EFFECTS PRINCIPLE PLAYED AN IMPORTANT ROLE IN THE EU INTERNAL MARKET?

### 2.1 Intel decision[5] and legal ramifications

The CJEU's support of the effects principle helped restrict foreign behaviour that damaged the EU internal market's competitiveness. Despite expanding globalisation, where unilateral behaviour can have cross-national implications, the legal backing, and practical ideas for controlling such conduct remain inadequate. The CJEU ultimately recognised the effects principle as a legal basis for exercising jurisdictional authority, allowing for greater reach. Both the FTAIA's (Foreign Trade Antitrust Improvements Act) effects principle and the CJEU's qualified effects criteria need foreseeability, substantiality, and immediacy for extraterritorial application of competition legislation. The international pushback to US extraterritorial case law suggests adopting the effects principle with prudence. Concerns have been expressed that the notion could violate the sovereign rights of other states by regulating behaviour with a tight territorial link. There's a narrow line between defending national competition and invading other states' sovereign rights. CJEU was less eager to address these concerns.[6]

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4 German competition law update: New revised act against restraints of competition entered into force. *Norton Rose Fulbright | Germany | Global law firm* [online]. [no date] [viewed 5 October 2022]. Available from: https://www.nortonrosefulbright.com/en/knowledge/publications/d11d3849/german-competition-law-update-new-revised-act-against-restraints-of-competition-entered-into-force

5 Judgment of the Court (Grand Chamber) of 6 September 2017. Intel.Corp v.European Commission, Case T-286/09 {online} In EUR-Lex. {accessed on 2022-10-05}. Available from: https://eurlex.europa.eu/legal-content/EN/TXT/?uri=CELEX:62014CJ0413

6 GRÜNWALD, Andreas. Significant Competition Law Changes In Germany – Trade Regulation & Practices - Germany. Welcome to Mondaq [online]. 20 March 2017 [viewed 5 October 2022]. Available from: https://www.mondaq.com/germany/trade-regulation-practices/578358/significant-competition-law-changes-in-germany

### 2.2 Extraterritoriality vs. territoriality

The CJEU's emphasis on the single economic unit and implementation principles in its jurisdictional analysis explains why it is reluctant to apply balancing tests. It has never evaluated actions conducted outside Europe without a territorial nexus to the EU internal market. CJEU would rule that the Commission's authority over these actions is consistent with international law. .

The effects principle gives federal courts extraterritoriality where the Intel judgement was based on EU legislation. This separation caused issues. MNCs integration of different markets produces a situation where a legal entity's actions in one market have implications in others due to new supply chains in a globalised environment where a particular behaviour causes cross-border victims. As global markets grow more linked, more market behaviours fulfil the principle's criteria, making it a jurisdictional barrier. Without extra constraints, most anticompetitive conduct outside EU would be national. EU legislation was never limited until the CJEU ruled that applying EU competition law to overseas operations via the qualifying effects test extraterritorially imposed its power. Hence international comity and reason can be used to judge foreign conduct in the EU internal market.[7]

### 2.3 Strategic conduct in the market

In Intel, the Court recognised its behaviour as part of an overarching strategy when evaluating the immediate and severe effects of Intel-Lenovo practise. Applying overall strategy to jurisdictional and extraterritorial challenges is consistent, say the authors. In EU competition law, a firm's behaviour combines distinct sets of behaviour pursuing the same goal. Not adopting this technique could artificially segment a firm's business. A consistent reading of the CJEU's reasoning is feasible because it supports the purpose of a coherent norm on an enterprise's behaviour, which is relevant for competition law application or jurisdiction creation.[8] The authors back Intel's CJEU ruling. Using behaviour as a jurisdictional and extraterritorial tactic makes sense. It creates clear standards for judging a firm's competition-related behaviour or jurisdiction. The effects technique of establishing EU jurisdiction appears valid when analysing behaviour as part of an overall strategy under Article 102 TFEU. This method looks up to globalization's challenges because as per Intel verdict, novel problems may require new ways of thinking and conceptualising, which can be evaluated by German antitrust authorities.[9]

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7 ANKARA AVRUPA CALISMALARI DERGISI. EXTRATERRITORIAL APPLICATION OF EU COMPETITION LAW: THE NEW STANDARD-BEARER OF LEGAL IMPERIALISM. 2021 [viewed 3 October 2022].

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9 EU Competition law and extraterritorial jurisdiction – a critical analysis of the CJEU's judgement in Intel. *Taylor & Francis* [online]. [no date] [viewed 5 October 2022]. Available from: https://www.tandfonline.com/doi/full/10.1080/17441056.2020.1840844

# 3. CONDUCTING MULTILATERAL DISCUSSIONS AT THE OECD & WTO: THE CONVERGENCE OF COMPETITION LAWS FOR THE FUTURE

## 3.1 Competition Law & OECD

There are two main areas of competition law. The first area is competition advocacy. Competition authorities must take the lead & encourage other branches of government to adapt to their policies, especially when it comes to the formulation of regulations, and minimum interference with market competition. The second area of competition law is with respect to its enforcement.[10] As law enforcement agencies, competition authorities should investigate, prosecute, or prohibit agreements that exclude competitors or replace collusion with competition. This will also prohibit any potential abuse of a monopoly or dominant position by a company to unilaterally limit its actual or potential competitors in the market. Finally, competition authorities must prospectively review mergers to ensure that they are not used as a means of eliminating or restricting competition. Almost all competition law enforcement agencies need access to large amounts of highly specific and often confidential information about the actual market and the functioning of individual companies. It also requires careful judgment and trade-offs regarding the economic impact of various actions and mergers.[11]

## 3.2 Need for a multilateral competition agreement?

The intersection of commerce, consumers, and competition policy is not new in today's world. Adam Smith was the first author to write extensively about this dynamic. His book The Wealth of Nations (Volume 2) explores the evils of monopoly commerce. He observed that exclusive trade monopolies such as the British and Dutch East India Companies lowered the rates; they paid poor inhabitants in emerging countries and found it profitable to overcharge European consumers. His final criticism was addressed at the government of the day, which had not only tolerated but built these toxic monopolies, allowing them to exploit the average. At the same time, the phenomenon of globalisation had created new opportunities for new players to enter the market in a bid to challenge the 'fixed' dominance of big market players who always felt safe in their respective comfort zones. According to Smith, the remedy for this tremendous problem was not 'in regulating' rather it was in dismantling such monopolies. While it was obvious that some traders would merge, the focus was that all such traders would end up competing for the same market

10 OECD Reviews of Regulatory Reform. *OECD library* [online]. [no date] [viewed 5 October 2022]. Available from: https://www.oecd-ilibrary.org/governance/oecd-reviews-of-regulatory-reform_19900481

11 Antitrust law in Germany during Covid-19 | CMS Expert Guides. *CMS in Germany – International Law Firm* [online]. [no date] [viewed 5 October 2022]. Available from: https://cms.law/en/int/expert-guides/cms-expert-guide-to-antitrust-law-and-legislation-during-covid-19/germany

rather than a separate one, and this healthy, fair, and just competition would inevitably help offer the best prices to both European consumers and overseas suppliers. [12]

## 4. ADJUDICATION OF DISPUTES WHEN THE GWB BECOMES 'EXPANSIVE' IN APPLICATION

### 4.1 Exercise of jurisdiction by German Courts

If a conflict of law rule requires application of the GWB and does not prohibit the exercise of international jurisdiction. German courts may apply German antitrust law if the court has 'international jurisdiction'. In other words, the said German Court must be 'internationally competent' to have jurisdiction over a particular case. Further, it must be noted that although German anti-trust law traces much of its inspiration from their American counterparts, the concept of international jurisdiction in Germany functions similarly to the concept of personal jurisdiction as mandated by US law. It also must be made very clear that the GWB extraterritoriality issue is different from the concept of international jurisdiction as envisaged by German lawmakers. This additionally refers to the requirement that a court must give due importance to the relevant facts of a particular case to decide the question of law in dispute. It is here, that domestic German law comes into play which ultimately focuses on factors such as whether the defendant has sufficient contact with the state to be subjected to its judicial power.[13]

### 4.2 The ICJ's appellate jurisdiction thereby transforming it into a 'law-formative agency'

The main argument emerging here is that the ICJ's (International Court of Justice) role as a law-formative agency and that this depends more on external variables rather than the internal variables of jurisprudence. Whether or not the Court wants to, it is influential where it is being provided with an opportunity to regularly pronounce judgments on a particular area of law, and that these very pronouncements may turn into precedents and at the same time are open to judicial development, and where it faces little or no competition by other courts of legal development. The ICJ should use this aspect to its advantage to hear more appeals in a given calendar year thereby increasing its authority while deciding matters of PIL.[14]

12 HANNAH L. BUXBAUM. German Legal Culture and the Globalization of Competition Law: A Historical Perspective on the Expansion of Private Antitrust Enforcement. 2005 [viewed 3 October 2022].

13 GLOBAL COMPETITION REVIEW. Post-pandemic antitrust – what to expect and what to do. *Hogan Lovells* [online]. 15 July 2021 [viewed 5 October 2022]. Available from: https://www.hoganlovells.com/-/media/hogan-lovells/pdf/2021-pdfs/2021_07_02_gcr_post-pandemic-antitrust_what-to-expect-and-what-to-do.pdf

14 TAMS, Christian J. The ICJ as a 'Law-Formative Agency': Summary and Synthesis. *OUP Academic* [online]. 12 September 2013 [viewed 5 October 2022]. Available from: https://academic.oup.com/book/10167/chapter-abstract/157753712?redirectedFrom=fulltext

# 5. CONCLUSION AND WAY FORWARD

## 5.1 Modifying the 'effects principle' - a bold step

The GWB's drafters learned from the American experience and proposed in 1957 that overseas anticompetitive activity that "influences" domestic competition be subject to German antitrust legislation. International law justifies such jurisdiction. Germany's GWB did not limit impact principles. Even little ramifications in Germany seemed to warrant extraterritorial legal enforcement. In the US, the effects principle had mystical powers: its sheer presence seemed to solve the extraterritoriality problem. German legislators rapidly realised that deciphering the effects principle as stated exceeded internationally allowed boundaries. Anti-competitive behaviour overseas may be a fair basis for extraterritorial law applicability under specific conditions. German law has taken a big step by modifying the GWB's working premise to minimise its extraterritorial scope. Anti-competitive behaviour of a specific size and intensity and its impacts would be deemed grounds for German jurisdiction.

## 5.2 Adoption of the two-dimensional test

German law introduced a two-dimensional test that considers both foreign and domestic interests and this test was thus, designed to minimize external conflicts. The test as the name suggests comprises of two components. The first is the aforementioned 'effects principle' – that gives basis to the extraterritorial jurisdiction only when there does exist substantial materially adverse 'effects'. The second component relates to the problem of a Member State going beyond its borders by interfering with the interests and sovereignty of another Member State which ultimately undermines international law.

## 5.3 Usage of balancing-interests' concepts

The concept of balancing interests that have evolved under German law are highly codified. First, the principles of non-interference and misuse of jurisdiction are more applicable in legal than political settings. They call on judges to act as interpreters of legal ideas. This conclusion is reached because, ultimately, it is the judge's responsibility to comprehend the facts before them, interpret the laws at issue, and then choose which legal principles to apply and in what way. It is also important to notice that the interests that need to be balanced are well-defined. When applying the concept of non-interference, for instance, the "governmental interests" of the country doing the regulating are balanced against the "governmental interests" of other countries that may be impacted. Only these advantages are taken into account. The principle of misuse requires a similar balancing act between the national interests of the governing state and the foreign national interests and private interests of those involved in the merger deal.

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# Possibilities of application of rules of responsible public procurement

**Radek Jurčík**

Doc. JUDr. Ing. Radek Jurčík, Ph.D.
jurcik@mendelu.cz
ORCID: 0000-0001-6166-6525
Researcher ID: Q-8998-2016
Scopus Author ID: 17343873400
Department of Law and Social Science
Faculty of Business and Economics, Mendel University in Brno
Brno, the Czech Republic

***Abstract:***
The concept of "socially responsible public procurement" is now (from 1.1.2021) defined in legislation. It is an institution that is becoming increasingly important in public procurement. The given institute can be defined as a set of activities and procedures of the contracting authority, by which the contracting authority increases the benefit of the spent funds through a well-thought-out procedure, especially by purposefully supporting socially and environmentally beneficial areas. The subject of this paper is to introduce the purpose of the institute of socially responsible public procurement, a summary of the content of relevant provisions of legislation and a proposal of options for how to apply the institute and related procedures in practice. Another goal is to design procedures and guidelines for applying the principles of responsible public procurement to a specific public contract. First, an analysis of the possibilities of legal regulation and decision-making practice will be performed, then it will point out the experience with foreign ones. At the end of the article, the author will suggest appropriate ways to apply the principles of responsible public procurement. The contracting authority has the opportunity to take these procedures into account in the tender conditions, the supplier's competence and its evaluation. This fact is known. Less known are specific procedures to ensure this, which the author will analyse.

***Key words:*** *public procurement, responsibility, green procurement, innovation*

## INTRODUCTION

The concept of "socially responsible public procurement" is now (from 1. 1. 2021) defined in legislation. It is an institution that is becoming increasingly important in public procurement. The given institute can be defined as a set of activities and procedures of the contracting authority, by which the contracting authority increases the benefit of the spent funds through a well-thought-out procedure, especially by purposefully supporting socially and environmentally beneficial areas.[1] The subject of this paper is to introduce the purpose of the institute of socially responsible public procurement, a summary of the content of relevant provisions of legislation and a proposal of options for how to apply the institute and related procedures in practice.[2] Another goal is to design procedures and guidelines for applying the principles of responsible public procurement to a specific public contract. First, an analysis of the possibilities of legal regulation and decision-making practice will be performed, then it will point out the experience with foreign ones. At the end of the article, the author will suggest appropriate ways to apply the principles of responsible public procurement.[3] The contracting authority has the opportunity to take these procedures into account in the tender conditions, the supplier's competence and its evaluation. This fact is known. Less known are specific procedures to ensure this, which the author will analyze.

## 1. SOCIALY RESPONSIBILITY IN THE PUBLIC PROCUREMENT

The essence of socially responsible public procurement is primarily the effort to maximize the influence that contracting authorities can exert when awarding public contracts. This is because contracting authorities can support the solution of societal and environmental problems through the awarding of public contracts, in particular by setting appropriate tendering and contractual conditions, as well as by using evaluation criteria for the awarding of public contracts. In this way, it is possible to achieve that the public contract will be awarded only to those suppliers whose performance will guarantee the fulfilment of one of the elements of social responsibility.

## 2. CHANGES OF RESPONSIBLE PUBLIC PROCUREMENT

On December 23, 2020, Act No. 543/2020 Coll. was published in the Collection of Laws of the Czech Republic, which amends certain laws in connection with the adoption of the Act on Waste and the Act on End-of-Life Products (hereinafter referred to as "Act No. 543/2020 "). Part ten of Act No. 543/2020, specifically Article

1 See more ALHOLA, Katrina, and Sven RYDING, and Hanna SALMENPERÄ, and Niels Juul Bush. Exploiting the potential of public procurement: Opportunities for circular economy. J Ind Ecol. 2018, 23(1), 96–109. https://doi.org/10.1111/jiec.12770.

2 CZECH REPUBLIC. Act No. 134/2016 Coll., on public procurement [zákon č. 134/2016 Sb., o veřejných zakázkách].

3 CZECH REPUBLIC. Act No. 40/1956 Coll., on environmental protection [zákon č. 40/1956 Sb., o státní ochraně přírody].

XIV, amends the ZZVZ, effective as of January 1, 2021. The legislative vacation period was therefore really short. Even though Act No. 543/2020 amends only two provisions in the ZZVZ, it is a very fundamental provision, namely § 6 of the ZZVZ, which contains basic principles and to which a new paragraph 4 was added, and also § 28 paragraph 1 of the ZZVZ, which contains definitions and to which the letters p), q) and r) were added.[4]

So what exactly has changed? To the already functioning basic principles of public procurement, which are transparency, adequacy, equal treatment and the prohibition of discrimination, enshrined in the ZZVZ and the so-called principle 3E, i.e. efficiency, economy and purpose, enshrined in Act No. 320/2001 Coll., on financial control in public administration and on the amendment of some laws, another obligation was added to the contracting authorities. This is the observance of the principles of socially and environmentally responsible tendering and innovation (hereinafter referred to as the "New Principles") in the creation of tender conditions, the evaluation of tenders and the selection of suppliers, provided that this is possible due to the nature and purpose of the contract. The contracting authorities are then obliged to properly justify their procedure in relation to the New Principles. At the same time, the ZZVZ does not limit in any way what type of contracting authorities the above obligation falls on, so all contracting authorities, including subsidized contracting authorities, who are often recruited from among private entities, have it.[5]

**Tab. 1: Responsible public procurement according to § 6 ZZVZ**

| Type of responsible | Responsible authority | Obligation | Examples |
|---|---|---|---|
| Socially procurement | Ministry of Labour and Social Affairs | No | https://www.sovz.cz/<br>https://www.mzp.cz/C1257458002F0DC7/cz/setrna_verejna_sprava/$FILE/OFDN-Uvod-20180314.pdf.pdf |
| Ecological procurement | Ministry of the environment | No | https://ceske-socialni-podnikani.cz/images/pdf/P3_Spolecensky_odpovedne_zadavani_VZ.pdf<br>https://docplayer.cz/236338-Vztah-verejnych-zakazek-a-fair-trade-radek-jurcik.html |
| Innovation | Ministry of Industry and Trade | No | http://www.zeleneuradovani.cz/images/Odpovedne_verejne_zakazky_sanon/Sesit_Uvod_do_odpovednych_zakazek.pdf<br>https://portal-vz.cz/metodiky-stanoviska/metodiky-k-zakonu-c-134-2016-sb-o-zadavani-verejnych-zakazek/metodiky-specialni-k-zadavacim-rizenim/metodiky-socialni/<br>https://portal-vz.cz/metodiky-stanoviska/metodiky-k-zakonu-c-134-2016-sb-o-zadavani-verejnych-zakazek/metodiky-specialni-k-zadavacim-rizenim/odborne-metodiky/ |

Source: Own preparation.[6]

4 GELDERMAN, Cees J., and Janjaap SEMEIJN, and Frank BOUMA. Implementing sustainability in public procurement: the limited role of procurement managers and party-political executive. J Public Procurement. 2015, 15(1), 66–92 https://doi.org/10.1108/JOPP-15-01-2015-B003 . ISSN 1535-0118.

5 HÁJEK, Oldřich. at all. Structural Funding and Disadvantage of Regions Public and Non-Public Beneficiaries Politická ekonomie. 2019, 67(2), 113–132 DOI. 10.18267/j.polek.1238.

6 CHIU, Iris H.-Y., and Joanna WILSON. *Banking Law and Regulation*. Oxford: Oxford University Press, 2019. 9780198784722.

### 1.1 Obligation or non-obligation of socially responsible procurement

Responsible procurement in itself is not such a novelty, but until the end of 2020, consideration of social or environmental circumstances was only an option for selected contracting authorities, this year it has become an obligation, an obligation placed on an equal footing with other basic principles affecting all types of contracting authorities. In addition, it is worth reminding that all the basic principles of public procurement, as stated in § 6 ZZVZ, should complement each other. It is therefore not admissible for them to be mutually exclusive in any way, the contracting authority must always take into account all the stated principles and, in the case of the New Principles, it is obliged to apply them if it is possible due to the nature and purpose of the contract, which the contracting authority must properly justify. Although the ZZVZ does not contain a requirement for a written justification, the preparation of a written record of the possibility of taking the New Principles into account appears to be appropriate, primarily for the purposes of a possible later control of the contracting authority, especially by the Office for the Protection of Economic Competition.[7]

The Government Resolution No. 531 of 24 July 2017 on the Rules for the Application of a Responsible Approach in the Awarding of Public Contracts and Government and Local Government Purchases (hereinafter referred to as the "Government Resolution") also testifies to the fact that socially responsible procurement is not such a novelty. deals with this topic. Rule No. 3 is worth paying attention to, according to which the state and local governments must inform the public about their environmentally friendly and socially responsible behavior and motivate the private sector by their example. Currently, it is thus already possible to find examples of good practice that can be inspired by contracting authorities.[8]

### 1.2 The principle of socially responsible procurement

The definition of the individual New Principles can be found in the provisions of § 28, paragraph 1 of the ZZVZ. The principle of socially responsible procurement is defined first, namely in § 28 paragraph 1 letter p) ZZVZ, which stipulates that socially responsible procurement means "procedure according to this law [i.e. ZZVZ], in which the contracting authority is obliged to take into account, for example, employment opportunities, social inclusion, decent working conditions and other socially relevant aspects connected with a public contract. disabled persons, persons with an individual action plan drawn up by the employment office, unqualified or low-skilled persons, persons over 55 years of age, persons after the end of parental

7 HAHN, Tobias, an Frank FIGGE, and Jonatan, PINKSE, and Lutz PREUSS. Trade-offs in corporate sustainability: You can't have your cake and eat it. Business Strategy and the Environment. 2010, 19(4), 217–229 DOI:10.1002/bse.674.

8 See more IOSSA, Elisabeta, and Michael WATERSON M. Maintaining competition in recurrent procurement contracts: a case study on the London bus market. Transport Policy. 2019, 75(C), 141–149 https://doi.org/10.1016/j.tranpol.2017.02.012.

leave, after release from serving a prison sentence or with an entry in the criminal record, and also graduates or young 24 years.[9]

The area of socially responsible contracting also includes the support of education, practice and retraining, for example in the form of student involvement in projects or the possibility of excursions for students. It is also appropriate to support dignified working conditions and job security by establishing conditions for compliance with the rules of work safety or a guaranteed minimum wage. Employers can also emphasize fair supplier relations, for example by setting binding deadlines of a few days in which the supplier must make payments to its subcontractors after receiving payment from the employer. Such a procedure should lead to the support of small and medium-sized enterprises, for which timely payments can be very important.[10]

At the same time, it is up to the contracting authority to assess, taking into account the nature of the public contract, which of the listed groups it will be possible to employ during the performance of a specific public contract and whether the employment of a person or persons from the said group will be required as a condition of participation in the public contract or will be subsidized as part of the evaluation offers. In any case, however, other basic principles must also be taken into account, especially proportionality and equal treatment and the prohibition of discrimination. In general, it can be stated that larger or longer-term public contracts for construction works or simpler services are suitable for supporting employment, where it is possible to assume that new jobs will be created, which can be at least partially occupied by persons disadvantaged on the labour market.[11]

### 1.3 The principle of environmentally responsible procurement

The principle of environmentally responsible procurement is defined in § 28 paragraph 1 letter q) ZZVZ, according to which environmentally responsible contracting means "procedure according to this law [i.e. ZZVZ], in which the contracting authority is obliged to take into account, for example, the impact on the environment, sustainable development, the life cycle of the supply, services or construction work and other environmentally relevant aspects associated with the public contract." Within the framework of environmentally responsible procurement, contracting authorities should focus on questions the impact of requested services or supplies on the environment and try to support environmentally friendly solutions, such as the supply of products or services that carry

9 More JURČÍK, Radek Public regulation of competition in sugar production. Listy cukrovarnické a řepařské. 2016, 132 (9–10), 308–311.

10 See in LADI, Stella, and Dimitris TSAROUHAS. International diffusion of regulatory governance: EU actorness in public procurement. Regulation & Governance. 2017, 11(4), 388–403 https://doi.org/10.1111/rego.12163.

11 More LUNDBERG, Sofia, and Per-Olov MARKLUND, and ElonSTRÖMBÄCK, and David SUNDSTRÖM. Using public procurement to implement environmental policy: an empirical analysis. Environmental Economics Policy Studies. 2015, 17(4), 487–520.

the label Ecologically Friendly Product or the EU Ecolabel, take into account the energy consumption of appliances or, in the case of construction work, require buildings with so-called passive building parameters, i.e. buildings with minimal energy consumption. Other important aspects may be sustainable development or the life cycle of the supply, with the fact that the contracting authorities may demand, for example, the take-back of products and recycling after the end of their life cycle, or the renovation of existing products and their subsequent integration instead of the demand for new goods.[12]

### 1.4 The principle of innovation in public procurement

The last New principle is the principle of using innovations. This is probably the most difficult principle to grasp, which is defined in the provisions of § 28 paragraph 1 letter r) ZZVZ so that innovation is understood as "the implementation of a new or significantly improved product, service or procedure related to the subject of a public contract." From the above it is clear that not all public contracts will be suitable for the application of the principle of using innovations, however, the contracting authority must always justify why he did not find any room for innovation in a specific order.

Directive 2014/24/EU of the European Parliament and of the Council of 26 February 2014 on the award of public contracts and on the repeal of Directive 2004/18/EC (hereinafter referred to as the "Procurement Directive") offers suitable guidance on how to generally support innovation in procurement documentation "), in which it is stated in paragraph 48 of the preamble that "because of the importance of innovation, contracting authorities should be encouraged to allow variants as often as possible. These contracting authorities should therefore bear in mind that before announcing that variants may be submitted, it is necessary to define the minimum requirements that these variants have to meet." In addition to the use of variants as a suitable way to enable innovative procedures, the Procurement Directive in paragraph 74 the preamble also refers to the possibility of using the technical specification in a way that supports innovative designs, namely that "developing technical specifications to set performance and function requirements generally allows this objective to be best achieved." Operational and performance requirements are also an appropriate means of supporting innovation in public procurement and should be used as widely as possible.'

12 ROSELL, Jordi. Getting the green light on green public procurement: Macro and meso determinants. Journal of Cleaner Production. 2021, 279, 123710 https://doi.org/10.1016/j.jclepro.2020.123710.

## 3. INSTRUCTIONS FOR USING THE POLICY RESPONSIBLE PUBLIC PROCUEMENT

It is not without interest that, while in the ZZVZ the New Principles are conceived as three separate principles, with each contracting authority having to evaluate each of them individually, i.e. innovations, the Procurement Directive in Article 2 paragraph 1 states that innovations are understood as "the application of new or significantly improved products, services or procedures, including production, construction or design procedures, a new way of marketing or a new organizational method of business procedures, the organization of the work environment or external relations, among other things, with the aim of contributing to finding answers to societal challenges or supporting the Europe 2020 strategy for smart, sustainable and inclusive growth'. At the European level, innovations are thus considered more as a means of achieving socially and environmentally responsible procurement than as a separate category, as they are considered in Czech law. However, for inspiration on how to proceed when awarding public contracts for innovative solutions, even Czech contractors can be inspired by the Guidelines for awarding public contracts for innovative solutions, which were issued in the form of a communication by the European Commission, and which are available in the Czech language on its website.

## CONCLUSION

Given that public contracts are a formal procedure that must be documented in writing, it can be recommended that contracting authorities justify the application of § 6, paragraph 4 of the ZZVZ in writing already in the procurement documentation. It is clear from the above that the New Principles will affect all contracting authorities in practice. They will have to deal with each of the New Principles separately, while it will be necessary for them to take into account the real possibilities of applying the New Principles in individual procurement procedures and then justify their procedure accordingly. Increased attention should be paid to the issue of the New Principles by contracting authorities who are used to repeatedly using sample procurement documentation. In connection with the outline of areas and procedures by which it is possible to achieve or contribute to socially responsible public procurement, the Government Resolution of 24/07/2017, No. 531, on the Rules for the Application of a Responsible Approach in the Awarding of Public Contracts and Government and Local Government Purchases.

According to the rules contained in this resolution, the state administration and self-government undertakes to strive in particular to reduce the consumption of energy, water, and raw materials, as well as to reduce the production of waste, pollutants released into the air, water and soil, and to reduce the carbon footprint; strive

to support the employment of people disadvantaged on the labor market, support education, practice and retraining, decent working conditions and work safety, access of social enterprises and small and medium-sized enterprises that have an impact on local employment, to public contracts, support of fair supplier relations , and respecting the principles of ethical procurement; and create an example for other public and private sector institutions and entities.

The mentioned provisions can be used as inspiration for in which areas and in what way socially responsible approaches can be implemented in the framework of public procurement.

Socially responsible public procurement represents a way in which the contracting authority can contribute to increasing the benefit from the financial resources spent, especially by supporting socially and environmentally beneficial areas. For such a procedure, the contracting authority can use both selected statutory provisions of the ZZVZ and internal procedures, which may include, in particular, an internal methodological document, consultations, education, sharing of good practice, as well as regular monitoring and evaluation of established procedures.

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# Comparison of the business judgement rule in the United States, Czech Republic and Slovak Republic

**Jan Škrabka, Lenka Vačoková**

Mgr. Jan Škrabka, M.A., M.Sc., M.Sc.
jan.skrabka@vse.cz
ORCID 0000-0003-4871-7257
PhD Candidate
Department of Business and European Law,
Faculty of International Relations
Prague, Czech Republic

JUDr. Lenka Vačoková, PhD.
lenka.vacokova@euba.sk
Assistant professor
Department of Business Law, Faculty of Commerce
University of Economics in Bratislava,
Slovak Republic

***Abstract:***
The paper focuses on the business judgement rule, an important (originally common-law) principle designed to protect the members of a corporation's governing bodies from frivolous lawsuits, thereby effectively allowing for appropriate and efficient decision-making of companies. The article uses a comparative method and builds on the comparison of different civil law jurisdictions (Czech and Slovak) and one common law jurisdiction (US). Moreover, the newly proposed legislation explicitly introducing the principle of business judgement rule in Slovakia is also compared with the current Slovak regulation of liability of corporation's statutory bodies. The authors find that current Slovak legislation includes three-elements test of business judgement rule and that the proposed Slovak regulation takes inspiration from the US and the Czech legislation, too. The comparison also shows that the business judgment rule in the US, unlike the continental regulation of this institute in the Czech Republic and the Slovak Republic, does not shift the burden of proof to members of corporate bodies, thus strengthening the protection of these members.

***Key words:*** *business judgement rule, fiduciary duties, duty of care, duty of loyalty, liability*

## INTRODUCTION

"Businessmen make business decisions. ... And when an issue comes to a board of directors, the process of discussion and decision is nothing like the lawyer's world of briefs and adversary argumentation. The decisions the businessman must make are fraught with risk, and he is quite accustomed to making these decisions in a hurry on the basis of hunch and manifestly sparse data. The businessman and the board of directors thrive or dive in a sea of uncertainty."[1]

Decision-making of corporate bodies is not always straightforward; on the contrary, it is often necessary to weigh different considerations, to choose between difficult-to-compare options with different consequences, or to make decisions under significant time pressure. Therefore, the law prepares appropriate framework to enable managers to make efficient decisions in these circumstances without being subjected to frivolous lawsuits by any stakeholders who would ultimately demand a different managerial decision. This framework is the business judgment rule, originally an Anglo-American principle associated with the fiduciary relationship, which sets a standard of duty for managers, against which they are protected against such suits.

In Europe, however, this rule is not yet a fully developed institution; on the contrary, it is gradually evolving and is being codified in some countries. In view of the upcoming change of this rule in Slovakia, the article compares the existing Slovak legislation, the proposed Slovak legislation, the Czech legislation and the American legislation of this institute. The central research hypothesis is that the proposed Slovak business judgement rule regulation takes inspiration from the Czech legislation rather than existing Slovak legislation. Therefore, it uses mainly comparative and analytical methods.

## 1. BUSINESS JUDGEMENT RULE IN THE US

The business judgement rule is not called a rule, but rather a standard. This is because the rule has received many formulations since its introduction in *Percy v. Millaudon* in 1829. In that case, the Louisiana Supreme Court held that a director could not be held liable for an act that resulted in a loss if that act was done prudently.[2] In *Aronson v. Lewis* (1984) it was defined by Delaware Supreme court as *"a presumption that in making business decisions directors of the corporations acted on an informed basis, in good faith and in the honest belief that the action taken was*

1 SOLOMON, Lewis D. Corporations, law and policy: Materials and problems. 2nd ed. St. Paul, Minn: West Pub. Co., 1988, p. 596. 0314361162.

2 SEENACHEERY, Mellisa K. Liability of Company Directors: The Business Judgement Rule as Developed in US and Adopted by Germany Compared to the Netherlands' Approach. *Amsterdam Law Forum* [online]. 2020, 12(1), pp.75–105. [viewed 29 September 2022]. DOI: http://doi.org/10.37974/ALF.345

*in the best interest of the corporation*".[3] In this case, the modern form of the rule has been expressed.

According to Solomon, the business judgement rule contains two fundamental fiduciary duties of directors, the duty of care and the duty of loyalty.[4] The duty to act in good faith is classified under the duty of loyalty. The duty to keep corporate information confidential also falls under the duty of care, loyalty and good faith. Other duties of the director include, e. g., the duty of confidentiality and the duty of disclosure.[5] In one of the most famous decisions, *Cede & Co. v. Technicolor, Inc. (1993)*, the Delaware Supreme Court defined fiduciary duties as follows: the duty of care, the duty of loyalty and the duty of good faith.[6]

With this triad of obligations is consistent the three-element test of the business judgment rule under the Czech Civil Code.[7] To be considered consistent with the triad of duties is also a duty of an executive under section 135a of the Slovak CC to act with due care and in accordance with the interests of the company and its shareholders.[8] The working draft distinguishes between a duty of loyalty and a duty to act diligently. The reverse version of the business decision relief reads as follows: diligently as a good manager acts a member of the body, who acts with knowledge of the facts and in the good faith that his action is in the interest of the legal entity.

In Gries Sports Enterprises, Inc. v. Cleveland Browns Football Co., Inc. (1986) the court held: "...The rule is a rebuttable presumption ... that the directors acted without self-dealing or personal interest and exercised reasonable diligence and acted with good faith. A party challenging a board of directors' decision bears the burden of rebutting the presumption that the decision was a proper exercise of the business judgement of the board."[9]

The business judgement rule is thus a procedural guide regarding the burden of proof to a specific relationship, e. g. between shareholder and director. The

3 SMITH, D. Gordon. The Modern Business Judgment Rule. Research Handbook on Mergers and Acquisitions, Forthcoming, B*YU Law Research Paper Series No. 15-09* [online]. 2015, p. 5 [viewed 29 September 2022]. Available at SSRN: https://ssrn.com/abstract=2620536

4 SOLOMON, Lewis D. *Corporations, law and policy: Materials and problems*. 2nd ed. St. Paul, Minn: West Pub. Co., 1988, pp. 1391. 0314361162.

5 SEENACHEERY, Mellisa K. Liability of Company Directors: The Business Judgement Rule as Developed in US and Adopted by Germany Compared to the Netherlands' Approach. *Amsterdam Law Forum* [online]. 2020, 12(1), pp.75–105. [viewed 29 September 2022]. DOI: http://doi.org/10.37974/ALF.345

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7 KOŽIAK, Jaromír. Pravidlo podnikatelského úsudku v návrhu zákona o obchodních korporacích (a v zahraničních právních úpravách). In: *Obchodněprávní revue*. 2012 (4), pp. 108–113.

8 See JABLONKA, Branislav. Odborná starostlivosť z pohľadu povinnosti štatutára pri výkone funkcie. In: Bratislava Legal Forum 2016. Bratislava: Comenius university, Faculty of Law, 2016, p. 18.

9 SOLOMON, Lewis D. *Corporations, law and policy: Materials and problems*. 2nd ed. St. Paul, Minn: West Pub. Co., 1988, pp. 1391. 0314361162.

burden of proof falls on the plaintiff[10] so, by the initiation of the process the rule plays the role of a shield for decisions made by the directors. This shield is a presumption that the directors in performing their duties acted with due care, loyalty and in good faith that they act in the best interest of the corporation. Once the shareholders have been successful in rebutting this presumption, the burden of proof moves from the plaintiff to the directors and the rule becomes a sword for a plaintiff.[11]

In Smith's view "the crucial feature of the business judgement rule, ..., is not a presumption that the directors have acted well, but rather a commitment not to question the substance of director action when there is no proof that the directors acted badly."[12]

## 2. BUSINESS JUDGEMENT RULE IN THE CZECH REPUBLIC

According to the Section 159 (1) of the Czech Civil Code, members of the company bodies are obliged to exercise their functions *with the necessary loyalty as well as with the necessary knowledge and care*.[13] The previous Civil Code[14] did not define the duty of due care, and therefore the content of this rule had to be derived from case law, which, however, did not always correctly define this requirement of due care. For example, in a 2006 Supreme Court decision,[15] it appears that this duty corresponds to the responsibility to take care of one's own property, even though the owner may intentionally destroy the property, which is obviously not the case in the relationship of a member of a corporate body to the company. Contrary to the Civil Code from 1964, the new Czech legislation provides the definitions of due care.

Together with these definitions, the main part of the legislation prescribing the rules of conduct of the members of the bodies of commercial corporations is contained in the Business Corporations Act.[16] Moreover, these rules also apply to company agents, proxy or insolvency administrators.[17]

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10 SMITH, D. Gordon. The Modern Business Judgment Rule. Research Handbook on Mergers and Acquisitions, Forthcoming, *BYU Law Research Paper Series No. 15-09* [online]. 2015, 18 p. [viewed 29 September 2022]. Available at SSRN: https://ssrn.com/abstract=2620536

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

14 CZECH REPUBLIC. Act No. 40/1964 Coll., the Civil Code [zákon č. 40/1964 Sb., občanský zákoník]

15 Decision of the Supreme court of the Czech Republic, dated on October 18, 2006, No 5 Tdo 1224/2006

16 CZECH REPUBLIC. Act No. 90/2012 Coll., Business Corporations Act [zákon č. 90/2012 Sb., zákon o obchodních korporacích]

17 BALÝOVÁ, Lucie. Péče řádného hospodáře ve volených orgánech obchodních korporací ve světle rekodifikace. Obchodněprávní revue. 2014, 6(7-8), 212–215.

According to Section 51, the core elements of the business judgement rule are the following: members of the company bodies are *"deemed to act with due care and the necessary knowledge in business-related decisions"* where:

1) "They act in good faith
2) They reasonably assume to be acting on an informed basis
3) They reasonably assume to be acting in justifiable interest of the business corporation".[18]
4) Their decision is not irrational[19]

In case these conditions are met, and the members of the corporate body acted with the required loyalty, they do not violate their legal obligations, and the court should decide that their decisions were adopted with due care.[20]

It is worth to note that the definition does not, however, say that the managers have to obtain all and every information (as it is often practically impossible, where managers have to solve various types of challenges frequently under time pressure), but rather informed decision making by a professional who undertakes business risk.[21] However, some authors dispute that and argue that it would be quite difficult to meet or interpret these rather vague formulations in practice.[22]

The authors of this article do not fully agree with such argument and highlight the section 52 of the Business Corporations Act provides the guidance to assess whether the member of company bodies acted with due care. According to it, the court has to take into account *"the care that would be exercised in a similar situation by another reasonably diligent person if they would be in the position of a member of a similar body of the business corporation."*[23] Different factors taken into account when assessing the duty of care, such as the size of the company, market situation, etc. Moreover, the required standard of the duty of care can be raised in case of appointing experts in relevant fields to corporate bodies, where he or she can use such qualification and experience (e.g. in the economic or legal field).[24]

With respect to the burden of proof in situations where a court is considering whether the decision of a member of a corporate body meets the statutory

18 CZECH REPUBLIC. Section 51 (1). Act No. 90/2012 Coll., Business Corporations Act [zákon č. 90/2012 Sb., zákon o obchodních korporacích]

19 LASÁK, Jan. in: LASÁK, Jan. et al. Zákon o obchodních korporacích: komentář [Business Corporations Act. Commentary]. 2nd ed. Praha: Wolters Kluwer ČR, 2021. p. 365

20 JOSKOVÁ, Lucie. The Business Judgment Rule in the Czech Republic. AUC IURIDICA [online]. 2022, 68(3), 37–47 [viewed 1 October 2022]. ISSN 2336-6478. Available from: doi:10.14712/23366478.2022.34

21 POKORNÁ, Jarmila et al. Obchodní společnosti a družstva. C. H. Beck, 2013. ISBN 978-80-7400-475-9. p. 96

22 KOŽIAK, Jaromír. Business judgement rule in Czech Corporations Act. *Juridical Tribune (Tribuna Juridica)* [online]. 2013, 3(2), 126–135 [viewed 2 October 2022]. Available from: http://www.tribunajuridica.eu/arhiva/An3v2/9%20Koziak.pdf

23 CZECH REPUBLIC. Section 52 (1). Act No. 90/2012 Coll., Business Corporations Act [zákon č. 90/2012 Sb., zákon o obchodních korporacích]

24 EICHLEROVÁ, Kateřina. The Duty of Care in the Czech Company Law. AUC IURIDICA [online]. 2022, 68(3), 23–35 [viewed 11 November 2022]. ISSN 2336-6478. Available from: https://karolinum.cz/data/clanek/10503/lurid_68_3_0023.pdf

requirement of due care, section 52(2) of the Corporations Act provides that the burden of proof is upon the relevant member of the corporate body (*reverse burden of proof*). However, the court may decide that bearing the burden of proof *"cannot be reasonably required from him or her,"* which might be for example the case where the necessary information is stored only within the IT systems of the company, which are not accessible to the (former) member of the corporate body.[25]

## 3. LIABILITY OF THE GOVERNING BODIES IN THE SLOVAK REPUBLIC

According to Section 135a (1) of the Slovak Act No. 513/1991 Coll. Commercial Code ("Commercial Code" or "CC"), members of the statutory body of a limited liability company are obliged to exercise their functions with due care and in compliance with the interests of the company and all its members. This means that they are under a special obligation:

1. to obtain all available information related to the subject matter of the decision and to take it into account in the decision-making process (the duty of professionalism),
2. to keep silent on confidential information and facts the disclosure of which could harm the company or threaten its interests or the interests of its members (the duty of confidentiality), and
3. not to favour their own interests, the interests of some members or third parties over the interests of the company in the exercise of their functions (the duty of loyalty).

On the other hand, the members of the board of directors of a joint-stock company and simple stock company are obliged to perform their activities with due diligence, which includes the duty to perform it with professional care and in compliance with the interests of the company and all its shareholders (Section 194 (5) CC).

Due diligence in a joint-stock company consists of two basic components, namely professional care and loyalty to the corporation and all its shareholders.[26] Due diligence is considered to be a broader concept than professional care.[27] Apart from the fact that the current law on the duties of members of statutory bodies in the performance of their functions and their liability for damages is fragmented in the specific provisions for individual corporations (§ 135a, § 194, § 234 CC), some authors see no justification for introducing a specific due diligence for a joint-

25 CZECH REPUBLIC. Section 52 (2). Act No. 90/2012 Coll., Business Corporations Act [zákon č. 90/2012 Sb., zákon o obchodních korporacích]

26 PATAKYOVÁ Mária. *Obchodný zákonník. Komentár.* 3th ed. Praha: C. H. Beck, 2010, p. 582.

27 OVEČKOVÁ, Oľga. *Obchodný zákonník. Komentár 1.* 3rd ed. Bratislava: Iura Edition, 2012, p. 888.

stock company[28], which we also tend to agree with. We consider it a reasonable solution to regulate the fiduciary duties of the members of the statutory bodies, as well as the liability for damages, in the general part of the proposed legislation.

### 3.1 Three-element test in the Commercial Code

If members of governing body violate their duties in the exercise of their office (e. g. by making a payment to the member of the company contrary to the CC), they are jointly and severally liable for the damage. The liability is objective, which means that there are three objective conditions, namely the breach of the duties of the governing body's member, the occurrence of the damage and a causal link between the breach of duty and the occurrence of the damage.

According to Section 135a (3) CC, *"an executive who has breached his duties shall not be liable for the damage if he proves that in the exercise of his office, he acted with due care and in the good faith to act in the interest of the company"*. Both conditions must be cumulatively fulfilled, and the burden of proof lies with the member of the executive body.[29] Executives shall not be liable for any loss suffered by the company if they have carried out a resolution of the general meeting (this shall not apply if the resolution is contrary to benefit of the company, against legal regulations, the memorandum or articles of association or in the case of the duty to file for insolvency).[30]

This is a liberate ground, that allows the application of the doctrine of business judgment rule in the Slovak corporate law, which means the exclusion of liability for damages, if the member of the statutory body could have assumed that he was acting on the basis of proper information in favour of the company when making business decisions.[31]

Despite the fact that the business judgement rule is not explicitly expressed in the current Slovak legislation, some authors suppose that the duty of the members of corporation's governing bodies to perform their duties with professional care and loyalty to the corporation and its shareholders is in line with the three-element test of professional care under this rule.[32] Similarly, Smalik is inclined to the view that the basic elements of the business judgement rule under the US doctrine overlap with the concept of due care of the statutory body of a capital

28 JABLONKA, Branislav. Odborná starostlivosť z pohľadu povinnosti štatutára pri výkone funkcie. In: Bratislava Legal Forum 2016. Bratislava: Comenius university, Faculty of Law 2016, p. 17; PETREK, Filip, and Maroš KATKOVČIN. Pravidlo podnikateľského úsudku v kontexte slovenského práva. *Acta Facultatis Iuridicae Universitatis Comenianae* [online]. 2018, 37(2), p. 231. [viewed 27 September 2022]. Available from: View of Vol. 37 No. 2 (2018) (uniba.sk)

29 PATAKYOVÁ, Mária. *Obchodný zákonník. Komentár*. 3rd ed. Praha: C. H. Beck, 2010, p. 417.

30 PATAKYOVÁ, Mária et al. The Legal Basis and Contextual Interpretation of the Duty of Care in Company Law in the Slovak Republic: from a "Gentlemanly Amateur" to a Professional Director? AUC IURIDICA [online]. 2022, 68(3), 87–103 [viewed 11 November 2022]. ISSN 2336-6478. Available from: https://karolinum.cz/data/clanek/10508/Iurid_68_3_0087.pdf

31 PALA, Radovan, FRINDRICH, Juraj, PALOVÁ, Ivana. Spoločnosť s ručením obmedzeným. In Ovečková Oľga. *Obchodný zákonník. Veľký komentár. Zväzok I*. 2nd ed. Bratislava: Wolters Kluwer, 2022, p. 1269

32 See JABLONKA, Branislav. Odborná starostlivosť z pohľadu povinnosti štatutára pri výkone funkcie. In: Bratislava Legal Forum 2016. Bratislava: Comenius university, Faculty of Law, 2016, p. 18.

company to a relatively large extent and that the rule is a closer specification of the concept of due care.[33]

### 3.2 Draft of the paragraph version of the Civil Code

Work on recodification of civil law has been going on in Slovakia since 1998. The goal of the recodification commission is to unify private law and introduce so-called legal monism into the Slovak legal system. The legal regulation of corporations is to be regulated in a separate act on commercial companies and cooperatives, as in the Czech Republic. The general legal regulation of legal persons including governing bodies, duties of their members and the liability of governing bodies' members is to be contained in the Civil Code. The proposed sectional version of the Civil Code was published in January 2021 and last amended on 7th July 2022.[34]

Working draft of the paragraph version of the Civil Code ("working draft") distinguishes between the duty of loyalty and the duty to act diligently. The duty of loyalty in the exercise of the functions of a member of a body includes in particular that *"he must maintain secrecy about the affairs of the legal person, the secrecy of which is in the interest of the legal person, even after termination of membership of the body, and that he must not misappropriate the assets of the legal person or otherwise place his or her own interests above the interests of the legal person."* (Section 18(1) Breach of duty of loyalty includes f. e. breach of confidentiality, taking advantage of a business opportunity of a legal person or transactions in conflict of interest. The proposed legislation builds on existing commercial law but corrects its incompleteness and the unjustified distinction between prohibition on competitive conduct and breach of duty of loyalty. It is necessary to adopt a specific provision on ban on competitive conduct in the Companies and Cooperatives Act.[35]

Within the meaning of Section 22 (2) the duty to act diligently as a good manager means that "a member of the body shall perform his duties with the knowledge, skill and care ordinarily required of reasonable persons in his position, and in accordance with the special care inherent in his position." "The member of the body shall not be in breach of his duty of care when making business decisions, if he acts with knowledge of the facts and in good faith in the interest of the legal person" (Section 23).

Section 23 of the working draft contains a business judgement rule. The rule applies only in relation to the duty to act diligently and not in relation to the re-

33 SMALIK, Matej. Doktrína pravidla podnikateľského úsudku v teórii a praxi. In: The Milestone of Law in the Area of Central Europe 2014. Bratislava: Comenius university, Faculty of Law, 2014, p. 387.

34 MINISTRY OF JUSTICE OF THE SLOVAK REPUBLIC. Recodification of Civil law – Ministry of Justice of the SR [online]. 2022 [viewed 26 September 2022]. Available from: https://www.justice.gov.sk/aktualne-temy/rekodifikacia-sukromneho-prava/

35 MINISTRY OF JUSTICE OF THE SLOVAK REPUBLIC. Recodification of Civil law – Ministry of Justice of the SR [online]. 2022 [viewed 26 September 2022]. Available from: https://www.justice.gov.sk/dokumenty/2022/08/Pravnicke-osoby_v2_12_7_2022_s-odovodnenim.pdf

quirement of loyal conduct. It does not apply in relation to the full scope of the duty of care, but only in relation to business decisions. Relief in business decision-making presupposes that the member of the body acted in an informed manner. The requirement of good faith presupposes that the member of the body had reason to believe that his conduct was right and proper and, conversely, that there was no reasonable ground in the given situation to believe that the conduct in question would be detrimental to the body corporate.[36]

Section 25 provides a liability of a member of a body for damage caused to the legal entity in the exercise of his powers. If the damage was caused by two or more members, they are liable together and severally. "The member of the body shall not be liable for damages, if he proves that he did not breach his duties by conduct in question, he had the consent of the appointing body or that body subsequently approved his conduct (Section 25 (3). According to Ruban, the reversal of the burden of proof to the person whose duty to act with due care is to be proved in the proceedings is intended to compensate for the informational advantage of persons who are under a duty to act with due care.[37]

Within the meaning of Section 25 (4) "if it can be assumed that the legal person and not the member of the body has the information that would prove that the member of the body did not breach his duties, or if other legitimate reasons justify it, the court may decide that the legal person must prove not only the occurrence of the damage, the causal link between the breach of the member of the body's duties and the occurrence of the damage, but also the breach of the member of the body's duties". In such a case, the burden of proof regarding the breach of the member's duties shifts from the member to the corporation. In the shifting of the burden of proof we can see an inclination of the Slovak proposed formulation to the US concept of the business judgement rule.

In contrast to the current wording of the commercial law facts, the proposed legislation expresses more clearly, that the breach of duty by a member of a body is not a condition for liability for damages, but its absence constitutes a ground for liberation. In the case of corporations, a stricter rule may be considered, e. g. a member of a governing body is not liable if he has carried out an instruction/order of the general meeting (this does not apply if it is contrary to the law and the governing body's member has informed the general meeting in advance etc.)[38]

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36 MINISTRY OF JUSTICE OF THE SLOVAK REPUBLIC. Recodification of Civil law – Ministry of Justice of the SR [online]. 2022 [viewed 26 September 2022]. Available from: https://www.justice.gov.sk/dokumenty/2022/08/Pravnicke-osoby_v2_12_7_2022_s-odovodnenim.pdf

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38 MINISTRY OF JUSTICE OF THE SLOVAK REPUBLIC. Recodification of Civil law – Ministry of Justice of the SR [online]. 2022 [viewed 26 September 2022]. Available from: https://www.justice.gov.sk/dokumenty/2022/08/Pravnicke-osoby_v2_12_7_2022_s-odovodnenim.pdf

## CONCLUSION

Unlike the US and the Czech legislation, the business judgment rule is not explicitly reflected in the Slovak legislation. Nevertheless, it can be stated that the duties of statutory bodies in the exercise of their powers (the duty to act with professional (due) care and the duty of loyalty), as well as the issues of liability for damages contain elements identical to the business judgment rule.

The three-element test typical of common law, which generally includes the duty of care, the duty of loyalty and the duty of good faith, is regulated in the Czech Civil Code and can also be applied to Slovak legislation. The working draft of paragraph version of the Civil Code separately regulates the duty of loyalty, which is linked to the non-competition obligation, and the duty to act diligently as a good manager. The exemptions to this duty are also regulated (namely informed conduct and acting in good faith). Although the burden of proving the duty to act diligently as a good manager lies with the statutory body, the court may decide that the burden of proof shifts to the corporation.

We consider the implementation of the business judgment rule in the new Slovak Civil Code to be a step forward towards ensuring the necessary standards in making business decisions by members of governing bodies. Considering that the decision-making process in business management is not a walk in the park, they often make the necessary decisions in time rush, under pressure, i. e. under less-than-perfect conditions, provided that they have acted with professional care, in good faith and in accordance with the best interests of the company and its shareholders, the rule provides them a safe harbour from liability for failure or loss in the company.

The rule thus strengthens the position of a governing body's member who acts diligently as a good manager. A member of the governing body, manager who can devote himself fully to the business and does not have to focus on the negative consequences and risks of his activities has a free hand and is therefore more effective for the company. We believe that in the near future the Slovak Republic will be able to adopt the Civil Code together with the Companies and Cooperatives Act and to implement explicitly the business judgment rule into the legal order (similarly to the Czech Republic). Then it will be necessary to wait for the application of the rule in practice.

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# Single Euro Payment Area Developments & Regulation vis-à-vis Efforts to Develop an Organic African Payment System

**Brighton M Mupangavanhu**

Brighton M Mupangavanhu, PhD: Commercial Law
ORCID 0000-0002-5160-3632
Associate Professor of Corporate & Financial Services Law,
Department of Mercantile & Labour Law, Faculty of Law,
University of the Western Cape
Cape Town, Republic of South Africa

***Abstract:***
The establishment of the Single Euro Payment Area (SEPA) by the European Union (EU) around 2009 was part of a strategy to accelerate regional economic integration. Following the adoption of a single currency, the Euro, within the EU years earlier in 1999, there was a need to create a single European market for payments across member states. This paper gives an appraisal of the development of the legal framework that harmonised and sought to standardise the European regional payment services. The paper further identifies the fundamentals underpinning the SEPA success, that is, the political drivers or the key institutions within the EU system that support the SEPA, and lauds the role of the public-private partnerships in the success of the SEPA initiative. The SEPA purposes, the pros and the cons will also receive attention in this paper. The experiences of the EU with the SEPA and related developments will provide lens for an evaluation or commentary on efforts by the African Union (AU) to establish a similar payment system for the AU economic region. The paper asks pertinent questions such as whether the AU, like the EU, will be able to organically develop a home-grown payment system that stems from truly African experiences. The paper considers the fundamentals that must be in place to enable the African dream of a continent-wide payment system to be realised. Yet another question is asked as to whether the SEPA experiences could offer any lessons for the proposed Pan-African Settlement System (PAPSS).

***Key words:*** *payment systems, European economic integration, harmonisation, African regional integration, AfCTA, RECs*

## INTRODUCTION

The Single Euro Payment Area (the SEPA) is a result of an incremental process of establishing a single and integrated payments market or payment system in Europe, within the geographical scope of the SEPA.[1] The SEPA initiative, a project of harmonising all payment systems of the EU Member States, was undertaken with the realisation that in order to accelerate regional economic integration, including enabling the free movement of goods, persons, services and capital, it was vital to dismantle all internal frontiers in the EU and to ensure the proper operation of a single market.[2] It is remarkable to note how the symbiotic and close public-private collaboration,[3] backed by an evolving relevant legal framework consisting of payment service directives and regulations passed by the EU institutions,[4] is responsible for the SEPA progress thus far.

It needs to be reiterated that the creation of a harmonised payment system within the EU, which is a part of the SEPA main goal, is a product of a long-term vision of the EU and the Eurosystem.[5] The Lisbon Agenda 2000 espoused the dream to make the EU's "the most competitive and dynamic knowledge-based economy in the world".[6] The vision of the Lisbon Agenda came on the backdrop of concerns within the EU that Europe was lagging behind other developed parts of the world such as the USA and Japan and that Europe needed an effective strategy for transformation of its economy and society.[7] Innovation through research and development and digitisation were considered important tools of the European strategy. It was felt that Europe needed to exploit knowledge and information communication technology and thus to change for the good of society, its approach to business, namely the way to produce goods and the way services were offered, with the end goal of both enhancing the European economy and improving customer experience.[8] These were the broader goals in Europe at the time. Prior to 2000, it is important to remember that the EU introduced the Euro as an official currency

1 The geographical scope of the SEPA currently covers 27 currently that are part of the EU, and includes other non-EU countries such as the United Kingdom (UK), Iceland, Norway, Liechtenstein, Switzerland, Monaco, San Marino, Andorra and Vatican City State/Holy See. See EUROPEAN Payment Council – Countries Applying the SEPA Schemes. Available from https://www.europeanpaymentscouncil.eu/about-sepa.

2 DIRECTIVE 2007/64/EC of the European Parliament and of the Council of 13 November 2007 on payment services in the internal market amending Directives 97/7/EC, 2002/65/EC, 2005/60/EC and 2006/48/EC and repealing Directive 97/5/EC.

3 Between the critical institutions of the EU (see more details in part 2 below about these institutions) and the private sector, in particular the banking sector as represented by the European Payments Council.

4 Namely the European Parliament (EU Parliament) and the European Council (Council).

5 The Eurosystem is made up of European Central Bank and the central banks of Member States of the EU.

6 ANDREI Laurențiu Dumitru & BREZEANU Petre, Single Euro Payments Area (SEPA) – Strategic Value on the High Degree of Interoperability For All Active Participants in the Financial Transaction Market. Economics Series Volume 24, Issue: 1/2014, page 1. August 2014. file:///C:/Users/Admin/Downloads/Single_Euro_Payments_Area_SEPA_-_Strategic_value_o.pdf.

7 JOHANSSON Börje, KARLSSON Charlie, BACKMAN Mikaela and JUUSOLA Pia, The Lisbon Agenda From 2000 to 2010. Electronic Working Paper Series. Paper No. 106, page 4. Available from https://citeseerx.ist.psu.edu/pdf/98d7bcd2ca6a62d4fe5c0d8236eb028d17bbe4e3

8 Ibid page 4–6.

of the regional economic community (REC).[9] The introduction of a single market and that of a single currency are two complementary developments in promoting trade liberalisation and economic integration in the EU.

## 1. PURPOSES OF & THE NEED FOR THE SEPA

### 1.1 The need for the SEPA

As early as 1999, the Eurosystem held the view that the introduction of the Euro was designed to give impetus to the completion of the Single Market in Europe.[10] Citizens and businesses within the EU complained around the time that the Euro was introduced as an official currency, that the introduction of the common currency had not provided benefits as expected[11] in the area of retail cross-border payments.[12] While the introduction of the Euro removed the costs of currency conversion within the EU, cross-border payments fees remained substantially and prohibitively higher than domestic fees.[13] The lack of harmonisation in payment systems within the EU area and the lack of parity in the treatment of cross-border and domestic payments frustrated the proper functioning of a Single Market and the ideals of the free movement of goods, persons, services and capital.[14] This challenge, coupled with the problem that execution times for cross border payments were longer than for domestic payments threatened to undermine the embracing of the Euro by the EU citizens.[15] The Eurosystem was, correctly so in my view, of the conviction that individuals and businesses alike would benefit from economic integration,[16] if they are able to transfer money as efficiently and affordably from one part of the EU as is the case with domestic transactions.[17]

9 ANDREI Laurențiu Dumitru & BREZEANU Petre, Single Euro Payments Area (SEPA) – Strategic Value on the High Degree of Interoperability For All Active Participants in the Financial Transaction Market. Economics Series Volume 24, Issue: 1/2014, page 1. August 2014. file:///C:/Users/Admin/Downloads/Single_Euro_Payments_Area_SEPA_-_Strategic_value_o.pdf.

10 IMPROVING Cross-Border Retail Payment Systems – The Eurosystem View, page 5. Available from https://www.ecb.europa.eu/pub/pdf/other/retailpsen.pdf.

11 Expectations came from the euphoria of the introduction of a single currency.

12 IMPROVING Cross-Border Retail Payment Systems – The Eurosystem View, page 5. Available from https://www.ecb.europa.eu/pub/pdf/other/retailpsen.pdf.

13 Ibid.

14 See DIRECTIVE 2007/64/EC of the European Parliament and of the Council of 13 November 2007 on payment services in the internal market amending Directives 97/7/EC, 2002/65/EC, 2005/60/EC and 2006/48/EC and repealing Directive 97/5/EC.

15 IMPROVING Cross-Border Retail Payment Systems – The Eurosystem View, page 5. Available from https://www.ecb.europa.eu/pub/pdf/other/retailpsen.pdf.

16 Especially the principles of the free movement of goods, services, capital and people.

17 IMPROVING Cross-Border Retail Payment Systems – The Eurosystem View, page 6. Available from https://www.ecb.europa.eu/pub/pdf/other/retailpsen.pdf.

### 1.2 Purposes served by the SEPA and its impact to date

The SEPA initiative was one of those efforts to promote economic integration of the EU Member States which exemplifies the public-private collaboration. The Eurosystem chose to trust the banking industry as represented by the European Payment Council to manage the process of creating a single payments market in Europe. The Eurosystem decided to play the role of catalyst by initiating regular discussions with the banking and payment service industry in order to enhance the project of a Single Market, and to improve the environment for retail cross-border payments, especially in the field of standardisation.[18] The Eurosystem called upon the payment industry to develop a set of harmonised payment schemes and a framework for electronic euro payments.[19] The industry was called upon to make the necessary investments needed in order to bring the efficiency level of retail cross border payment systems closer to that of domestic payment system.[20]

The specific purposes and goals of the SEPA initiative can be summarised as follows:

a) to harmonise electronic payments in Europe.[21] It is vital to point out that the industry responded and the EPC, which represents payment service providers (PSPs),[22] successfully created four Euro payment schemes (the SEPA Credit Transfer (SCT), Direct Debit (SDD) Core, Business-to-Business and Instant Credit Transfer (SCT Inst) schemes);[23]

b) to make it possible for EU citizens to be able to choose any payment services provider in Europe, depending on their own requirements for quality of service, their content and the costs involved;[24]

c) for consumers to be able to only need one bank account to initiate credit transfers and direct debits in euros anywhere within the geographical scope of the SEPA, in the same conditions as at national level;[25]

d) as was noted by the Eurosystem, the purpose was to improve efficiency, and to achieve simplicity and flexibility (convenience) for the customer. For example the customer will be able to use the same card for all Euro payments

18 Ibid at page 6.

19 SEPA goals and benefits – A project to harmonise electronic payments in Europe. Available from https://www.europeanpaymentscouncil.eu/about-sepa/sepa-goals-and-benefits.

20 IMPROVING Cross-Border Retail Payment Systems – The Eurosystem View, page 6. Available from https://www.ecb.europa.eu/pub/pdf/other/retailpsen.pdf.

21 POLASIC Michal, HUTERSKA Agnieszka, IFTIKHAR Rehan, MIKULA Stepan. The impact of Payment Services Directive 2 on the PayTech sector development in Europe. Journal of Economic Behaviour & Organisation,Volume 178, 2020, page 387.

22 The EPC is not part of the institutional framework of the EU.

23 SEPA goals and benefits – A project to harmonise electronic payments in Europe. Available from https://www.europeanpaymentscouncil.eu/about-sepa/sepa-goals-and-benefits.

24 ANDREI Laurențiu Dumitru & BREZEANU Petre, Single Euro Payments Area (SEPA) – Strategic Value on the High Degree of Interoperability For All Active Participants in the Financial Transaction Market. Economics Series Volume 24, Issue: 1/2014, page 3. August 2014.

25 Ibid.

anywhere in the SEPA under same conditions for retail cross-border payments as for domestic payments. The use of cards for payments eliminates the need to carry cash;[26]

e) establishment of a single payments market promotes innovation as new services can be developed and offered to customers regardless of national boundaries. Examples of such services to date include electronic invoicing, initiating payments via mobile phone or the internet, electronic plane ticket payment, credit notifications or electronic reconciliation.[27] As a result, consumers will spend less time making payments – the more beneficial SEPA is for customers.

As already highlighted above, the benefits of the SEPA project for the individual consumers and businesses are enormous. For the consumer, there is convenience, simplicity and flexibility in making domestic or cross-border payments. For businesses there is increased competition say for example, among PSPs, and the opportunity to innovate allows companies to develop new products and services and thus diversify their business offerings.

## 2. INSTITUTIONAL FRAMEWORK & SEPA REGULATIONS

### 2.1 SEPA Institutional Framework

There are four institutions which support the work of the SEPA. These are the European Commission (the Commission), the European Central Bank (ECB) and the Eurosystem, the European Parliament (Parliament) and the Council of the EU (Council).

The Commission is the main executive body of the EU and represents common interests of the EU. It fulfils the role of initiating laws in form of Directives and Regulations.[28] These proposals for laws are then debated and passed by the Parliament and the Council. The Commission is also mandated with ensuring that laws are applied correctly and provides information and guidance on how the EU operates.

The ECB and the Eurosystem. The ECB is the central bank of the EU. The ECB and the Eurosystem are responsible for stabilising prices in the Euro zone, for the monetary and exchange rate policy and for supporting EU economic policies. The ECB and the Eurosystem played the role of catalyst for the integration of the Euro payments market[29] through the efforts of the industry led by the EPC

26 Ibid

27 Ibid.

28 TYPES of institutions and bodies. Available from https://european-union.europa.eu/institutions-law-budget/institutions-and-bodies/types-institutions-and-bodies_en.

29 SEPA Political, legal and regulatory framework. Available from https://www.europeanpaymentscouncil.eu/about-sepa/sepa-political-legal-and-regulatory-framework

and in line with its (the ECB's) mandate to promote the smooth operation of payment systems.[30] While the private sector payment industry developed a set of harmonised payment schemes and a framework for electronic euro payments, the ECB politically steered the SEPA process since its inception. One critical leadership role that the ECB played in 2013, was to set-up the Euro Retail Payments Board (the ERPB). The ECB chairs the ERPB. The ERPB is a natural progression from the SEPA Council,[31] a body of industry stakeholders who together developed a set of harmonised payment schemes and a framework for electronic Euro payments. The ERPB is a high-level strategic body tasked with fostering the integration, innovation and competitiveness of Euro retail payments in the European Union.[32]

### 2.2 The SEPA Legislative framework

For purposes of relevance and in the interest of brevity, it is important to point out that what we have come to know as the 'SEPA Regulation',[33] that is Regulation (EU) No 260/2012,[34] is a product of an evolving legal framework within the EU on cross-border transfers. Regulation (EU) No 260/2012 defined the deadlines for EU countries to use SEPA credit transfers and direct debit schemes when making Euro transactions. The SEPA Regulation facilitated the harmonisation of payment systems and officialised the creation of a single payment system. It set deadlines for important milestone in the SEPA project. Importantly it set a deadline by which all Euro countries had to replace national Euro credit transfers and direct debits (except 'niche products') by Credit Transfer (SCT) and Direct Debit (SDD). The initial deadline was 1 February 2014, but was revised to 1 August 2014.35 SEPA migration was completed by 1 August 2014. The deadline for all transitional arrangements within the EU membership, for example the derogation for the International Bank Account Number or IBAN and for 'niche products', was 1 February 2016. For non-EU countries' compliance with the SEPA Regulation when making Euro credit transfers and direct debits, the deadline was 31 October 2016.

30 The ECB and the Eurosystem's competence in the area of payment systems is based on Art 105(2) of the Treaty Establishing the European Community. See IMPROVING Cross-Border Retail Payment Systems – The Eurosystem View, page 5. Available from https://www.ecb.europa.eu/pub/pdf/other/retailpsen.pdf.

31 The main objective of the Single Euro Payments Area (SEPA) Council was to promote the realisation of an integrated Euro retail payments market by ensuring proper stakeholder involvement at high level and by fostering consensus on the next steps towards the realisation of SEPA. See The SEPA Council: Description and Functioning. Available from https://www.ecb.europa.eu/paym/groups/erpb/shared/pdf/SEPA_Council_description_functioning.pdf

32 Euro Retail Payments Board. Available from https://www.ecb.europa.eu/paym/groups/erpb/html/index.en.html

33 SEPA Political, legal and regulatory framework. Available from https://www.europeanpaymentscouncil.eu/about-sepa/sepa-political-legal-and-regulatory-framework.

34 REGULATION (EU) No 260/2012 of the European Parliament and of the Council of 14 March 2012 establishing technical and business requirements for credit transfers and direct debits in euro and amending Regulation (EC) No 924/2009.

35 Amended by REGULATION (EU) No 248/2014 amending Regulation (EU.) No 260/2012.

An earlier Regulation (EC) NO 924/2009,36 was important for cross border payments within the EU. This regulation has been hailed for having enhanced financial integration in the EU and was good for implementation of the SEPA too. Provisions of this regulation remain important both for financial integration and for standardisation within the EU. For example, Regulation (EC) NO 924/2009 was significant in the following ways:

i) it standardised the pricing of euro cross-border direct debits. As of November 2009 pricing of euro cross-border direct debits were aligned with those of local transactions (credit transfers and card transactions had already been aligned);[37]

ii) it set interchange fees for cross-border direct debit transactions;[38]

There were further developments with respect to the Regulation (EC) NO 924/2009. In 2012, the provisions regarding direct debit interchange fees set out in Regulation (EC) 924/2009 were amended.[39]

In 2019, the Regulation was amended again,[40] in a manner that aligns the costs of cross-border payments in euros between euro and non-euro countries and increases the transparency of charges related to currency conversion services across the EU.

In addition to the two Regulations discussed above, there are two EU Directives which can be regarded as having driven innovation in European payments generally. These are the Payment Service Directive (PSD) otherwise known officially as Directive 2007/64/EC,[41] and the Directive (EU) 2015/2366, popularly known as PSD2.[42] For ease of reference I will refer to PSD and PSD2 as indicated in this paragraph. PSD was implemented by EU Member States by 1 November 2009. The focus of the PSD was to regulate or rather to establish a modern and comprehensive set of rules applicable to all electronic payment services. It advocates for standardisation, full harmonisation of payment systems within the EU, makes provision for PSPs and consumer protection. Hence it has been described

36 REGULATION (EC) No 924/2009 of the European Parliament and of the Council of 16 September 2009 on cross-border payments in the Community and repealing Regulation (EC) No 2560/2001

37 Art 3 of the REGULATION (EC) No 924/2009 of the European Parliament and of the Council of 16 September 2009 on cross-border payments in the Community and repealing Regulation (EC) No 2560/2001.

38 Art 6 of the REGULATION (EC) No 924/2009 of the European Parliament and of the Council of 16 September 2009 on cross-border payments in the Community and repealing Regulation (EC) No 2560/2001.

39 Amended in accordance with 'Regulation (EU) 260/2012 establishing technical and business requirements for credit transfers and direct debits in euro and amending Regulation (EC) 924/2009'.

40 Amended by "Regulation (EU) 2019/518 amending Regulation (EC) 924/2009 as regards certain charges on cross-border payments in the Union and currency conversion charges

41 DIRECTIVE 2007/64/EC of the European Parliament and of the Council of 13 November 2007 on payment services in the internal market amending Directives 97/7/EC, 2002/65/EC, 2005/60/EC and 2006/48/EC and repealing Directive 97/5/EC

42 DIRECTIVE (EU) 2015/2366 of The European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC.

as "one of the most significant and comprehensive pieces of financial services legislation in relation to the payments market" in the EU.[43] The PSD has been said to be of particular relevance with respect to the roll-out of SEPA direct debit services due to its introduction of common rules for the authorisation and revocation of direct debits. The PSD is credited for making it possible for the creation of or introduction of two new entities, electronic money institutions (EMI) and payment institutions (PI).[44]

The PSD2 was introduced to carry forward the advances in technology in the single payment market. It is said that digitalisation of the European economy has steadily progressed since the implementation of PSD, creating new players who offer new services for online payments (the fintech start-ups like the EMI and PI as stated above).[45] The PSD2, in terms of its timeline, was supposed to be transposed into national laws of the EU Member States by 13 January 2018, but was expected to fully come into force by 14 September 2019.[46] PSD2 also "provides the legal framework for retail payments innovation by setting rules for third--party payment service providers".[47] To the list of binding services that can be provided by the credit institutions and the payment institutions, the PSD2 added (i) payment initiation services (PIS) and (ii) account information services (AIS). The AIS is defined by the Regulation (the PSD2) as "an online service to provide consolidated information on one or more payment accounts held by the payment service user with either another payment service provider or with more than one payment service provider".[48] The essence of the PIS service has been described as "the ability to initiate a payment transaction by a third party at the request of the payer from an account maintained by the payment service provider".[49] The implementation of PSD2 relies on the six Regulatory Technical Standards (RTS) and five sets of Guidelines related to that the European Banking Authority has been mandated to develop. One particular RTS that grabs attention is on strong customer authentication and common and secure communication.

43 SEPA Political, legal and regulatory framework. Available from https://www.europeanpaymentscouncil.eu/about-sepa/sepa-political-legal-and-regulatory-framework.

44 POLASIC Michal, HUTERSKA Agnieszka, IFTIKHAR Rehan, MIKULA Stepan. The impact of Payment Services Directive 2 on the PayTech sector development in Europe. Journal of Economic Behaviour & Organisation,Volume 178, 2020, page 387.

45 SEPA Political, legal and regulatory framework. Available from https://www.europeanpaymentscouncil.eu/about-sepa/sepa-political-legal-and-regulatory-framework.

46 POLASIC Michal, HUTERSKA Agnieszka, IFTIKHAR Rehan, MIKULA Stepan. The impact of Payment Services Directive 2 on the PayTech sector development in Europe. Journal of Economic Behaviour & Organisation,Volume 178, 2020, page 387.

47 MERSCH Yves. Lending and payment systems in upheaval: the fintech challenge. European Central Bank (2019). Available from https://www.ecb.europa.eu/press/key/date/2019/html/ecb.sp190226~d98d307ad4.en.html.

48 Article 4 (16) of the PSD2 Directive.

49 Per Article 4 (15) of the PSD2 Directive.

## 3. THE DREAM OF A PAN-AFRICAN PAYMENT SYSTEM

### 3.1 Brief background – the AfCFTA

On the 21st March 2018 in Kigali Rwanda, the Heads of States of the African Union (AU) officially signed what is widely regarded as a historic Agreement establishing the African Continental Free Trade Area (AfCFTA).[50] The agreement came into force on 30 May 2019. At the time of writing, 54 of the 55 Member States of the AU had signed the Agreement, with 43 ratifications.[51] All indications in this regard are that this is considered a watershed moment for the African regional economic community. By all counts, this appears like a momentous period of the renewal of the African Renaissance, perhaps similar to the European mood during the late 1990s and early 2000s, a period which coincided with the launch of the Euro as official currency for the EU, and the setting of the Lisbon Agenda 2000, referred to above.[52] Now, where Europe had the Lisbon Agenda 2000, Africa has its on Agenda 2063 and the AfCFTA seems to properly align itself with this Agenda's aspirations of:

> a continental market with the free movement of persons, capital, goods and services, which are crucial for deepening economic integration, and promoting agricultural development, food security, industrialisation and structural economic transformation.[53]

Some of the AfCFTA's general objectives tie in well with the Agenda 2063, such as the creation of a single market for African goods and services, and free movement of people in order to enhance economic integration of the continent.[54] There is a similarity here with the EU with respect to motivations for establishment of a single market in the EU and more specifically, the need for harmonisation of European payment systems through the SEPA initiative.[55] It is in the spirit of renewal ignited by the exciting AfCFTA that Africa is already dreaming of a Pan-African payment system, and there appears to be suggestions already of what this payment system will be called. At the launch of the operational phase of the AfCFTA during the 12th Extraordinary Summit of the African Union, held on 7 July 2019 in Niamey, it was suggested that the Pan-African Payment Settlement System (PA-

50 AGREEMENT Establishing the African Continental Free Trade Area. Available from https://au.int/en/treaties/agreement-establishing-african-continental-free-trade-area.

51 Ibid.

52 See Introduction above.

53 AGREEMENT Establishing the African Continental Free Trade Area. Available from https://au.int/en/treaties/agreement-establishing-african-continental-free-trade-area.

54 See the PREAMBLE to the African Free Continental Trade Area (AfCFTA) Agreement. Available from https://au.int/sites/default/files/treaties/36437-treaty-consolidated_text_on_cfta_-_en.pdf.

55 Compare with part 1.2 above.

PSS) be introduced.[56] The purpose of the PAPSS, it is stated, is to offer foreign exchange and settle transactions in a timely manner in local currency in order to improve confidence in the payment system.[57] This PAPSS, is said to be "the first continent-wide payment digital system focused on facilitating intra-African trade payments for goods and services".[58] It is further hoped that this proposed PA-PSS will facilitate payments, formalise trade, offer alternatives to correspondent banking and facilitate low-cost, low risk clearing and settlement in intra-African trade.[59] It is not clear how these lofty goals will be achieved by the proposed PA-PSS. What is clear however, is that there is no solid plan yet from the AU for the mooted African-wide payment system, except what looks like an exciting dream.

### 3.2 Suggestions and way forward for the AU

It is in light of the reality that the PAPSS remains a dream only at this stage, that I make the following suggestions. To develop a truly Pan-African payment system or any payment system for that matter, it takes a solid vision, a clear plan and strategy to actualise that vision. The AU can always take a leaf from developments and experiences of other regions such as the EU. The following lessons can be drawn from the EU experiences:

i) Fundamentals in place. The general suggestion I wish to make is that fundamentals need to be in place in order to actualise the AU dream of a Pan-African Payment Settlement System. It is a great dream to think of a single or harmonised payment system in order to "create a single market for goods, services" as per the Agenda 2063. However, certain fundamentals need to be in place to provide building blocks towards attaining that dream;

ii) Appropriate Institutional Framework supporting a Pan-African Payment Settlement System. One such fundamental which needs to be in place is a proper and effective political institutional framework at the level of the AU to drive the project of harmonisation of African payment systems. At the moment, Africa has a fragmented payment system, based on the sub--regions. However, the AU can seek to take advantage of the organisational strengths of these sub-regional payment systems to build a truly African payment system. Throughout the continent there are five (5) sub-regional payment systems, some of which are ineffective at the moment. There is a

56 AFRICAN UNION. Operational phase of the African Continental Free Trade Area. Available from https://au.int/en/articles/operational-phase-african-continental-free-trade-area-launched.

57 Ibid.

58 MONYE Ogochukwu, MONYE Ebelechukwu. Regional integration in Africa: Proposals for an Africa-wide payment system. *Law, Democracy and Development*. 2022(26) 203.

59 AFRICAN UNION. Operational phase of the African Continental Free Trade Area. Available from https://au.int/en/articles/operational-phase-african-continental-free-trade-area-launched.

very promising East Africa Payment System (EAPS);[60] the Southern Africa Development Community (SADC) Real-Time Gross Settlement (SADC-RTGS) whose effectiveness is not yet clear;[61] the COMESA Regional Payment and Settlement System (REPSS);[62] Star-UEMOA (Système de Transfert Automatisé et de Règlement de l'UEMOA);[63] Economic and Monetary Community of Central Africa (CEMAC).[64] Africa requires an AU institutional framework that drive the process of harmonisation of all these payment systems in order to make them effective and responsive to African challenges of access to a single market. In the EU, the ECB and the Eurosystem drove the process of engaging the banking sector and the SEPA initiative has yielded great results which see a harmonised and digitised payment system supported by effective Regulations and Payment Service Directives driven by the relevant institutions such as the European Parliament and the Council of the European Union.[65] As it stands it is not clear if the AU has such institutions to effectively drive the process of harmonisation of a payment system. The AU needs an African Central Bank to drive the process of establishing a single payment market for Africa. A regional central, which does not yet exist, will develop productive working relationships with central banks of member states. The member states central banks obviously have good networks with the banking sector, and such a public-private partnership will ensure that there is standardisation in the system.

iii) Single African currency. It appears logical that a single currency will make it easier to facilitate a single market and a harmonised payment system. The introduction of the Euro in 1999 as the official currency of the EU66 laid the foundation for a more organic harmonised market in general and a harmonised payment system in the EU. The multicurrency environment posed great challenges of inefficiency and a cost burden in cross-border payments;67

iv) Harmonised legal framework to drive the economic integration in Africa and the

60 For more information see BUKUKU E. Launch of the East African Payment System (EAPS). (2014) Euro Asia News. Available from https://www.tralac.org/news/article/5782-launch-of-the-east-african-payment. Also see MONYE Ogochukwu, MONYE Ebelechukwu. Regional integration in Africa: Proposals for an Africa-wide payment system. Law, Democracy and Development. 2022(26) 197.

61 SADC SADC-RTGS. Available from https://www.sadcbanking.org/payments-project/. Also see MONYE Ogochukwu, MONYE Ebelechukwu. Regional integration in Africa: Proposals for an Africa-wide payment system. *Law, Democracy and Development*. 2022(26) 198.

62 COMESA. COMESA banks governors push for regional payment and settlement system. (2017) . Available from https://www.tralac.org/news/article/11507-comesa-banks-governors-push-for-regionalpayment-and-settlement-system.html. Also see MONYE Ogochukwu, MONYE Ebelechukwu. Regional integration in Africa: Proposals for an Africa-wide payment system. *Law, Democracy and Developmen*t. 2022(26) 200.

63 MONYE Ogochukwu, MONYE Ebelechukwu. Regional integration in Africa: Proposals for an Africa-wide payment system. *Law, Democracy and Development*. 2022(26) 200-202. Also see CMA "Real time gross settlement system for West African countries" available at https://www.cma.se/sites/all/themes/cma/gui/pdf/casestudybceaov3.pdf.

64 CENFRI. Payment systems in sub-Saharan Africa Note 2: Case studies of national and regional payment systems market development. 2018. Available at https://cenfri.org/wp-content/uploads/2018/12/Payment-systems-in-SSA-Note-2.pdf.

65 See parts 1 and 2.1 above.

66 ANDREI Laurențiu Dumitru & BREZEANU Petre, Single Euro Payments Area (SEPA) – Strategic Value on the High Degree of Interoperability For All Active Participants in the Financial Transaction Market. Economics Series Volume 24, Issue: 1/2014, page 1. August 2014.

67 IMPROVING Cross-Border Retail Payment Systems – The Eurosystem View, page 5. Available from https://www.ecb.europa.eu/pub/pdf/other/retailpsen.pdf.

establishment of a Pan-African Payment and Settlement System. I established in this paper that the effective political and institutional framework within the EU system ensured that the development of a legal framework supporting the SEPA initiative was incremental. Today the legal framework creates standardisation, ensures economies of scale, efficiency in the system, collaborated customer protection in the EU and fosters innovation through research and development;

v) Public-private collaboration. This is possible where there is a clear vision and a political drive to ensure stakeholder consultation and participation in order to produce an organic payment system that is supported by all and is responsive to wide stakeholder needs.

## CONCLUSION

The paper examined the establishment of the Single Euro Payment Area (SEPA) by the European Union and the conditions which have seen the EU create a harmonised single market and a harmonised payment system responsive to contemporary needs of customers and businesses. The role of the effective institutional framework, analysed and discussed in part 2 above, has been lauded for a well-coordinated approach to the establishment of not only a single market in general but a harmonised payment system. The ECB and the Eurosystem on one hand, the Parliament and the Council of the European Union on the other,68 respectively played and still play significant roles of ensuring standardisation and developing a legal framework that is responsive to contemporary challenges and opportunities. Today in 2022, the EU system has facilitated the creation of an integrated market for electronic payments in Euro, with no distinction between national and cross-border payments, which is necessary for the proper functioning of the internal market.

The EU experiences have been used to make proposals for what the AU should consider in order to realise the dream of a Pan-African Payment and Settlement System. This paper at the outset, asked questions such as whether the EU with the SEPA and related developments/experiences, can provide lens for an evaluation or commentary on efforts by the African Union (AU) to establish a similar payment system for the AU economic region. The answer at this stage is a resounding yes. Sculpting an organic payment system cannot happen overnight without a solid strategy, political will and the creation of effective and relevant institutions to drive the process of harmonisation of payment system built on a bedrock of a single currency and a single market. It has been suggested in this paper that the AU needs to consider effective political drivers such as a central bank,69 working together with the central banks of Member States and the banking industry in Africa. It has also been suggested that the multi-currency environment currently prevailing in

68 See part 2.1 above.

69 Africa still needs to establish a central bank. This has been noted in this paper as fundamental for the creation of a single payment system for the continent.

Africa does not help the vision of creating a single market for goods and services, facilitated by movement of persons in order to deepen the economic integration of the African continent. In order to actualise the Pan African Vision of "an integrated, prosperous and peaceful Africa" as enshrined in the Agenda 2063, fundamentals such as a central bank, a single currency and effective institutions must be put in place first.

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