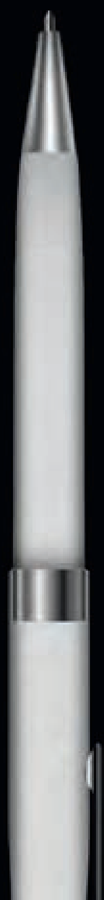
roadmap17
schönherr

pre**judices**



Since being launched in 2007, the annual Schoenherr roadmap has highlighted significant legal developments in our markets, presenting them in a special context created in partnership with a different artist each year. The concept for this year's roadmap is **prejudice.**

Simply put, prejudices are opinions not based on reason. The word prejudice presupposes a judgment which is premature. This year we look at tattoos as an art form, and at the prejudices some people hold in respect of the bearers of tattoos despite tattoos having become more popular. In a legal context, and very generally speaking, prejudice is linked to bias, or a lack of impartiality on the part of a judge or presiding officer when deciding on a matter in a legal forum. The principle of justice requires that legal decisions are based on objective criteria, and not on the basis of prejudice.

Broadly speaking, debunking prejudices requires looking at the facts. Gaining insight into other peoples' preferences, being open to exploring differences between oneself and others, and being as impartial as possible when considering these contrasts (including the choice whether to have body art or not). In an attempt to examine the prejudices surrounding tattoos, we consider the question of whether tattoos can be considered works of art. If one considers a tattoo to be a work of art, one may agree that the exceptional thing about the work of a tattoo artist is the nature and ephemerality of the art – for the canvas is the human skin. Each pigment that is inked under the skin becomes a living, life-long part of the wearer. Yet, with the death of the wearer, the tattoo "dies" as well – the artwork has a natural expiration date. Roadmap17 artist Marian Merl, is of the view that the difference between tattoos as art objects, or as pure service to clients, lies in the distinction between the approach and methods of the tattoo artist. Merl chooses which client concepts to carry out, and his motifs are the culmination of a creative process in which he lets his own ideas and interpretations flow into his work.

Art or not, and societal prejudice aside, tattoos transcend the continuum of time and culture, and are a means of communication that show a part of an individual's identity. What matters is the personal significance tattoos hold for the bearer.

Very suspicious individuals

Cabinet photograph, by Eisenmann, of a young man with his entire chest and arms tattooed. New York, circa 1890. *(Photo by Transcendental Graphics/Getty Images)*

How all tattooed individuals became criminals, although they were only wearing tattoos

It wasn't difficult to become a "suspicious individual" in the 19th century, when a receding forehead, protruding ears, or tattoos were often enough to justify condemnation. Austrian architect and cultural publicist Adolf Loos, in his polemic pamphlet *Ornament und Verbrechen* (Ornament and Crime), described one of the more common prejudices of the time: "Tattooed individuals who are not in prison are latent criminals or degenerate aristocrats. When a tattooed individual dies in freedom, he dies only a few years before he got the chance to commit murder."

This was, historically speaking, a fairly new conclusion. After all, tattooing is a phenomenon that is intertwined with human history and which came about at the same time as the discovery of art. Traces of this cultural technique were found on ancient Chinese and Greenland mummies – even Ötzi, Europe's oldest known human mummy, had tattoos. From the times of the Scythians, the early Christians, the Pacific Islanders and the Papua New Guineans, up to the 19th century European nobility, the Punks and Hippies of the 60s, and all the way to the currently nearly 10 % of Germans, tattoos have been present almost everywhere in the world.

Still, in the 19th century, in Europe, Loos was not alone. Indeed, At the same time, the emerging science of criminology also found tattoos a convincing marker for criminal behaviour. Thus, when researcher Cesare Lombroso was looking for the "born criminal" in Italian prisons, he determined that tattoos – very much like scars – were in fact signs of degeneration and disease. Although Lombroso's theories of "born criminals" were controversial from the very beginning, they have popped up repeatedly, and assumptions about people with tattoos continued to linger.

It was not inevitable that Lombroso's theories would become popular. Indeed, as a result of the discovery voyages of James Cook and other explorers in the 18th century, tattoos were already regaining some popularity in the European and American cultures, and experienced a virtual boom not only among the lower classes, but also with the nobility and the upper classes.

Still, the vast majority of the population remained uninterested in tattoos, which remained more common on the fringes of society for a long time. Until recently, the belief that tattooed individuals are bad for society, deviant, or mentally ill persisted and was reflected in some scientific studies. Nowadays, although tattooed individuals are no longer regarded as mentally ill, they are often seen as being more prone to engaging in risky behaviour such as unprotected sexual intercourse, sexual promiscuity, drug abuse, and "sensation seeking" activities.

However, this view is only partially reflected in reality: according to recent studies, about 10–20 % of people in Europe have tattoos. There are many reasons for this change, the most important being that tattoos have been a part of pop culture for several decades. Tattooing is not only a highly specialised craft, which continues to improve with better tools and colours, more hygienic equipment, and more information about the craft in general, but is also increasingly viewed as an art form.

Nonetheless, prejudices about tattoos have not disappeared entirely, although they are now aimed almost exclusively at the people who are heavily tattooed or those who wear tattoos that go beyond the "T-shirt barrier" – hence, the tattoos that cannot be concealed. Be that as it may, tattoos are now widespread, and the reasons behind the choice to obtain them are diverse. In indigenous societies, a tattoo may show that its wearer is a full-fledged member of society. Tattoos can show status, influence, power, lineage, and affiliation to a group. They allowed for boundaries to be drawn. Tattoos were – and still are – a rite of passage. But tattoos are also helpful at a different level: when one feels beautiful and comfortable in one's skin, one's feeling of self-worth also improves. Whether one feels good because one wants to be rebellious, belong to a certain group or scene, immortalise personal memories on one's body, emphasise one's individuality, or turn one's body into a work of art, the essential element of tattoos is the positive effect they have on the individual. Lombroso and his kind were wrong. Tattooed individuals are not "born criminals" or degenerates. They are as normal as anyone else.

Original text in German by Igor Eberhard

Art on the skin

Why tattoos can be more than just decorations

Maud Wagner, sideshow artist and first known female US-tattoo artist. Tattooed by her husband Gus Wagner. Toned photograph, 1907. *(Photo by GraphicaArtis/ Getty Images)*

It is very often said that tattoos are not art forms. For many, that is a fact, since tattoos are seen as mass productions that are often badly drawn, subject to fleeting trends, and often not particularly original. That much is true. What is also true is that tattoos always convey something about the wearer: their preferences, tastes, fears or aspirations, but also about their character. But is a tattoo really art? This idea is not as easy to unpack.

First of all, the medium is the skin. Skin is unusual. It changes. The life of the wearer is reflected on the skin: time spent in the sun, certain habits, but also age, illnesses and accidents can be visible on the body's largest organ. Even our character and identity can be read on our skins. Skin is as individual as we humans are. The author Jean Améry once wrote in his essay "Beyond guilt and atonement" about trauma, trust and boundaries, by using skin as an extension of the self: "The boundaries of my body are also the boundaries of myself. My skin surface shields me against the external world: if I am to have trust, I must feel on it only what I want to feel." The author also describes how the external shell – the skin – can be built to be protective armour. But skin is much more than an external shell. It protects and helps preserve one's internal balance, and influences the body's immune system and metabolism. For all these reasons, skin is immensely important for one's identity and for other people's perceptions of oneself.

It is no wonder that artists such as tattooists are enthusiastic about skin as an art medium. Tattoos and art have more in common than enthusiasm: both fulfil a deep, fundamental human need. To shape a body, to change it forever and to leave a mark – or even to overcome societal boundaries through art – one discovers that tattoos are a particularly suitable form of artistic expression. Several well-known artists have discovered the exceptional diversity of tattoos. Artists such as Wim Delvoye, Valie Export, Flatz or Santiago Sierra can illustrate, through this change in the skin's surface, existential statements about power and powerlessness or about one's own body.

The borderline between art and just rendering a service to a client is still fluid. Viennese tattoo artist Marian Merl also emphasises that "it starts as a service and can always turn into art." An entire segment of tattooists practice tattooing as a craft, but a very special, artistic craft. Marian Merl says: "I don't do all tattoos. One can spend ten years doing fashion tattoos, such as, lettering, stars, infinity symbols, and so on, and make a living from that. But, I would rather have less money and do what seems right to me."

Some tattoo artists – like Marian Merl – use the bodies of their clients as a sort of canvas. Tattoos are fashion pieces and mass products. But they can also be works of art. New, distinct styles, technical skills and the artistic background of the tattoo artists set the boundaries of their art techniques. The clients themselves become art objects. They become unique elements that present both themselves and the work of the tattoo artists. Just like a unique piece of art, some tattoo artists even sign their work. Good tattoos can be unique, coveted pieces.

What makes tattoos special is that this form of art has an expiration date: with the death of the wearer dies the art object as well. Throughout the life of wearer, the tattoo is subjected to constant changes as the image of the skin is altered. The image – as the skin- grows old, stretches, fades or may be distorted by scars. If the wearer perceives the tattoo as a work of art or as something personally valuable now, in time, the tattoo can lose its material or even sentimental worth.

The temporal nature of tattoos shows how extraordinarily authentic the skin is as a perishable and ever changing canvas for artists. Skin reflects identity and how one chooses to decorate it gives more insight into one's character and emotions, but also into the artistic vision of the tattoo creator. Beyond the personal worth that tattoos have to wearers, and their artistic value, what prevails is the emotion that tattoos bring to the people wearing them and to the artists who engrave them on their skin.

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More than just destruction and chaos

An interview with Marian Merl

Marian Merl's tattoo parlour "Zur Stecherei" (transl. To the stinger) looks inconspicuous from the outside with no reference to tattoos around. Only at a second glance is it evident. Similarly, Marian, the 31-year-old tattoo artist at "Zur Stecherei", comes across as being introverted and un-assuming. An event technician by trade, he has in the interim become one of Austria's most creative tattoo artists. Eight years of tattooing in various parlours have shaped him and helped him to bring his artistic vision to his clients in his own parlour. The years practising have helped him to hone his craft. In contrast to his neat, precise and primarily black tattoos, are others which stand out with their wild energy. He calls these unconventional tattoos the "destroyalas". They reflect more than destruction and chaos. In a conversation with Marian Merl, he takes us through his tattoo art vision and deconstructs the apparent destruction.

You have on occasion tattooed minimalistic tattoos, one in particular of a landscape which is simple and neat. What is so special about it?
Purely from a technical point of view this kind of tattoo is very intricate. To draw a straight line on a not so straight body is a technical challenge. One can see each blur to the left or to the right, each mistake, which cannot be corrected. High-end tattoos are moving more in this direction. While drawing, one needs to pay attention to one's breathing. When someone starts tattooing a line, they breathe in and breathe out very slowly. Just like a sharpshooter who holds his breath when taking aim, and only afterwards presses the trigger. With this form of tattoo there is no room for error. With a straight line one can see even a half a millimetre of error. The simpler the tattoo, the more difficult it is to create.

Is a good tattoo a minimalistic one?
No, not necessarily. In my opinion, for geometric tattoos or the "destroyalas" in fact, more can be better, in order to get that perfect look. This is definitely the case for the destroyalas.

What do you consider to be a "destroyala"?
Destroyalas are atypical tattoos. They consist of brush strokes, colour sprays, various planes or something similar to that. It's only that they work against the human anatomy. Good ol' fashion mandalas are a frequent and beloved motif. The destroyalas grew out of that style. In particular with the destroyalas, the combination of brush strokes and colour sprays work really well, and they need to be precise. This creates a cool feel of pure chaos.

Are tattoos art?
Tattooing starts as a service and can always become art. Most tattoo parlours provide a service. Personally, I have tried again and again to move away from the service aspect. It is clear that one pays for a service. But I think that what makes a difference is what the tattoo represents in and of itself. I try more and more to create works of art.

What does art represent to you?
Some would say that art is what lets itself be bought, because, fundamentally the art market determines what art is. This is a big question. I cannot really give you a clear answer to this.

When it comes to tattoos, what is of higher importance to you: the client's wish or your creative drive?
It's difficult to say. The drafting and the actual realisation of the tattoo are essential. Generally, clients have the basic concept in mind and they give me free range to execute it. We are somewhat different from normal tattoo parlours. I don't do all tattoos. One can spend ten years doing fashion tattoos, such as, letterings, stars, infinity symbols, and so on, and make a living from that. But, I would rather have less money and do what seems right to me.

How do your tattoos come about?
Two days before the appoint-ment, I begin to think about the tattoo. I search for reference materials on the internet or in books. The day before the appointment I do a sketch on paper, which is often not bigger than 5x15cm. This is generally sufficient for me to guarantee a good tattoo for my clients who know that they can trust me. I then sketch on the body and develop and adjust them.

Are tattoos unique pieces?
Of course.

Do you sign your own tattoos?
There were a few clients who request that I sign the tattoos once they are done. Then again, when is a tattoo done? At best, it grows further.

Interview of Marian Merl by Igor Eberhard

New Court Decisions on Banks' Own Funds Instruments

Peter Feyl

A bank suffering losses (and which may even be in the process of wind-down) may not be in a position to repay loss absorbing instruments in full, which it has issued in the past. Court decisions handed down in 2016 (one by the European Court of Justice and three by the Austrian Supreme Court) provide insight into questions of calculation of loss sharing, and how holders of certain loss absorbing instruments shall be treated in the event of a merger or demerger (which is often also a restructuring measure in the course of a wind-down)

The Austrian Banking Act *(Bankwesengesetz – BWG)*, as in force prior to Basel III (as adopted in the European Union by Regulation (EU) No 575/2013 (CRR)), provided for Upper Tier 2 capital of banks in the form of supplementary capital *(Ergänzungskapital)*. Supplementary capital under the *BWG* used to be loss absorbing, and a coupon was payable only in the event that the issuer showed a profit in the preceding financial year (annual surplus prior to movement of reserves). Banks suffering losses (or even in the process of wind-down) could therefore not pay the coupon on supplementary capital in many instances; in addition, the losses incurred over time reduced the amount repayable upon expiry (final maturity) of such instruments. The method of calculation of the loss sharing of supplementary capital has been subject to discussion among legal scholars. The Austrian Supreme Court has decided on how to calculate the sharing of losses by holders of supplementary capital.

It has also been discussed whether holders of supplementary capital (other than holders of participation capital) are creditors of the issuer or holders of securities other than shares which grant special rights in the event of a merger or demerger. This relates to the question whether in the event of a merger demerger holders of supplementary capital may be entitled to compensation by way of cash payment or an amendment to the terms and conditions of the instrument. The European Court of Justice *(ECJ)* and the Austrian Supreme Court dealt with that issue in 2016.

Qualification of supplementary capital as creditors' rights or as securities, other than shares, to which special rights are attached?

In its judgment of 7 April 2016 (C 483/14, *KA Finanz*) the ECJ had to deal with a cross-border merger of two credit institutions. The transferring company had issued subordinated debt with the proviso that interest on such subordinated debt may only be paid, if, after the interest payment is made, the credit institution still fulfils all own funds requirements under local law. In the course of the cross-border merger the subordinated loan was terminated (with no compensation) based on Art 226 para 3 of the Austrian Stock Corporation Act *(Aktiengesetz)*. Apart from the question whether Art 226 para 3 *Aktiengesetz* is fully consistent with Art 15 of the Merger Directive (Directive 78/855/EEC), the ECJ touched upon the question whether such subordinated instruments were even covered by the term *"securities, other than shares, to which special rights are attached"* pursuant to Art 15 of the Merger Directive, and consequently as jouissance rights *(Genussrechte)* under Art 226 para 3 *Aktiengesetz*. The ECJ held that only such instruments would qualify as granting special rights which are debentures exchangeable for shares, debentures conferring a right of pre-emption over share capital to be issued or truly profit sharing debentures. Consequently, only such securities are covered by Art 15 of the Merger Directive, which grant the holders rights which are broader than the mere reimbursement of debt and payment of stipulated interest, for instance, a right of the holders to exchange such securities into shares.

It follows from this ECJ judgment that supplementary capital does not fall within that category of securities to which special rights are attaching. Repayment is always limited to the par value of the instrument (no sharing in hidden reserves or good will). Payment of interest is subject to the issuer having earned profits but payment of interest at a fixed or floating right is just dependent upon such profits without sharing in the profits. In its subsequent decision of 20 July 2016 (6 Ob 80/16g) the Austrian Supreme Court followed the ECJ judgment.

The judgment by the ECJ (dealing with a merger) was confirmed only recently by a judgment of the Austrian Supreme Court of 21 June 2016 (1 Ob 93/16g) dealing with a demerger. Art 13 of the Demerger Directive (Directive 82/891/EEC) covers the same instruments as Art 15 of the Merger Directive. Consequently, the Austrian Supreme Court has

held that, in the event of a demerger, the holders of instruments of supplementary capital are not entitled to any compensation (in cash) or that the terms and conditions of the supplementary capital be amended as a result of the demerger.

It follows from those decisions that holders of supplementary capital of an Austrian credit institution will be treated as creditors in the course of a merger or demerger of the credit institution and cannot request that they are compensated or that the terms and conditions of the instrument be amended as a result of the merger or demerger.

Calculation of loss sharing

As mentioned, supplementary capital issued under the *BWG* was a loss absorbing instrument. The *BWG* provided that a repayment of supplementary capital prior to liquidation of the credit institution may only be made subject to deducting *pro rata* net losses incurred during the term of the supplementary capital.

In its decision dated 30 May 2016 (6 Ob 87/16m) the Austrian Supreme Court set out how that loss shall be calculated. It is also clear from this Supreme Court judgment that the relevant provisions of Art 23 para 7 *BWG* and of the terms and conditions of the individual instrument, continue to apply for past issues, even if the relevant provisions of the *BWG* have been repealed by the *CRR*.

The Austrian Supreme Court concludes that the term net losses refers to the annual surplus (annual profit before reserves) or annual loss (before reserves) pursuant to the *solo* financial statements of the credit institutions. Movements of reserves shall be excluded, *inter alia,* because supplementary capital is not an instrument granting any interest in hidden reserves or good will and not a perpetual instrument. Reserves existing prior to the issue of the supplementary capital shall also be excluded. The Austrian Supreme Court explicitly states that losses shall not first be attributed to reserves or to the holders of higher quality own funds (such as share capital).

The share of the losses of holders of supplementary capital shall be assessed in the proportion of the par value of the relevant instrument of supplementary capital as compared to the par value of the other loss absorbing own funds instruments (prior to Basel III par value of Tier 1 capital and other supplementary capital).

See the following simplified (and hypothetical) example: Assume a share capital of 500 and supplementary capital of 500 (in total 1,000). Hence, share capital and supplementary capital each share 50 % of net losses. Assume a term of supplementary capital of eight years and that the credit institution had six years with an annual surplus (profit) of 10 each and two years with losses of 100 each. This results in a net loss of 140. The supplementary capital will share in those losses with the amount of 70 so that the amount repaid at maturity will be 500 minus 70, ie 430.

This matter of calculation follows a method of calculation of net losses as applied by a number of credit institutions in the past. The judgment by the Supreme Court provides legal certainty on that method of calculation. It may be noted that some Austrian credit institutions have suffered net losses exceeding the par value of the relevant instrument so that those instruments of supplementary capital had to be redeemed at zero.

> Still, many old (pre-CRR) supplementary capital instruments are in issue. They raise numerous legal questions. The ECJ and the Austrian Supreme Court have given some guidance in their 2016 decisions. In the event of a merger or demerger of a bank supplementary capital instruments will not be terminated and the holders are not entitled to compensation or an amendment of the terms and conditions. If the issuer has suffered net losses (which reduce the amount repayable), such losses shall be calculated on the basis of the earnings before reserves.

The EU Capital Markets Union – What Lies Ahead

Ursula Rath | Martina Hiebl

In the European Commission's recently published Communication regarding the Capital Markets Union (**"CMU"**), it urges other institutions to accelerate completion of a true single market for capital across all EU Member States, and announces its work programme for 2017.

At the beginning of 2015, the European Commission unveiled its plan to boost funding and growth across Europe through the creation of a single market for capital by issuing its Green Paper on Building a Capital Markets Union (the **"Green Paper"**) and launching a dedicated website.[1]

The CMU is not a legislative proposal, but a framework under which various legislative initiatives will be taken spanning areas as diverse as infrastructure investments, securitisation, changes to the prospectus regime to make it easier and less expensive for SMEs (small- and medium-sized enterprises) to raise capital, alternative sources of financing such as venture capital and crowdfunding, but also insolvency, corporate and tax law. It is a medium- to long-term project with some key early actions being expected in 2017.

The CMU Action Plan

Following up on its Green Paper and subsequent public consultations, the Commission released its CMU Action Plan in September 2015. Planning more than 30 specific actions that will be taken to complete the CMU by 2019, the CMU Action Plan identifies five key priority areas:

- providing more funding choices for Europe's businesses and SMEs;
- ensuring an appropriate regulatory environment for long-term and sustainable investment and financing of Europe's infrastructure;
- increasing investment and choice for retail and institutional investors;
- enhancing the capacity of banks to lend to the real economy; and
- dismantling barriers to cross-border investment and further developing capital markets in all Member States.

Call for acceleration of reforms under the CMU Action Plan

As part of its periodic status updates, in autumn 2016 the Commission reiterated the importance of implementing the objectives of the CMU as soon as possible, calling the EU Parliament, the Council, the Central Bank and the Social Committee and the Committee of Regions to accelerate reforms.[2]

First phase CMU measures to be finalised by 2017

According to the Commission, completion of the first phase CMU measures is essential in order to have a tangible impact on the economy. By 2017, the following key measures will have been implemented:

- an EU framework for simple, transparent and standardised (STS) securitisation to free up bank balance sheets, generate additional funding and enhance financial stability;
- an overhaul of EU prospectus rules to facilitate access to capital markets, in particular for SMEs, and generating more, and less costly financing opportunities; and
- measures to strengthen venture capital markets and social investments by revising the respective EU regulations (EuVECA/EuSEF) to boost investment into venture capital and social projects, such that the type of managers and the range of companies that can invest or be invested in is expanded.

Next phase CMU actions – 2017 and beyond

Given the Commission's push for reform and its plan to assess achievements and reassess priorities, 2017 will certainly be an exciting and intense year for regulation. Amongst others we expect:

- a legislative initiative on business insolvency, including early restructuring and second chance;
- a benchmarking review of loan enforcement regimes;
- proposals for removing withholding tax refund barriers to encourage best tax practices in promoting venture capital and innovative companies, and to facilitate equity financing through changes in taxation frameworks to overcome the "debt/equity" bias; and
- amendments to the Solvency II and CRR framework to reduce capital charges for infrastructure investments and SME loans to unlock institutional investment in infrastructure.

Developing further priorities

Further priorities in relation to which steps will be taken in the course of 2017 include
- publication of an action plan on retail financial services;
- development of a green finance strategy to support investment in clean technologies and to contribute to a low-carbon, climate-resilient economy;
- development of a simple, efficient and competitive EU pension product;
- promoting the development of the FinTech sector in an appropriate regulatory environment;
- legislative changes to support the development of covered bond markets throughout the Union; and
- promotion of cross-border funds distribution by further eliminating barriers in the asset management sector.

> The Commission's CMU Action Plan set out the key changes needed to further strengthen EU capital markets, expand funding options for businesses, incentivise infrastructure investments and remove structural barriers in diverging tax systems, insolvency and securities laws. Midway through the proposed implementation timeline, 2017 will prove crucial for the successful implementation of the CMU Action Plan and the delivery of its full potential to support growth in Europe.

[1] http://ec.europa.eu/finance/capital-markets-union/index_en.htm
[2] http://ec.europa.eu/finance/capital-markets-union/docs/20160913-cmu-accelerating-reform_en.pdf

Developments in Financial Documentation used in Bulgaria

Tsvetan Krumov

The documentation of credit facilities and hedging agreements under Bulgarian law has in recent years become increasingly aligned with international market standards.

Credit facilities

The type of documentation used in Bulgarian credit transactions largely depends on the specific circumstances. Short-form documentation is widely used by Bulgarian banks for the purpose of financing local businesses, where no syndication is envisaged. Syndicated and large-scale financings with an international element (eg, if the lenders are foreign banks) are usually documented by long-form agreements following the forms published by the London Loan Market Association (**"LMA"**) and subject to English law and to the jurisdiction of English courts. In syndicated financings with no international element, however, the parties' freedom to choose a foreign system of law is significantly restricted and, most importantly, the choice of a foreign court in such circumstances would not be enforceable in Bulgaria.

In this respect, Schoenherr Bulgaria was recently mandated by several different banks to prepare long-form agreements, based on LMA models but with a choice of Bulgarian law and Bulgarian courts, and with the Bulgarian language prevailing in case of discrepancies with the English version. In such a contract drafting various English law concepts needs to be adapted to or even substituted by appropriate Bulgarian legal mechanisms serving similar purposes. However following the LMA models brings many additional benefits to the lenders – for example regulating the powers of the agent in detail and making exhaustive arrangements on changes to the lenders may later facilitate a transfer of the loans.

In-house lawyers at top Bulgarian banks say that these are the only examples of such drafting on the market, but it may be expected that the practice will grow, even in cases with an international element where the agent is a Bulgarian bank. The benefits of preparing LMA-based agreements subject to the law of the bank acting as the agent have already been recognised by other similar jurisdictions in CEE, where such drafting – following LMA models but subjected to local laws, is widespread.

Hedging agreements

Over-the-counter (**"OTC"**) derivative transactions – mainly plain vanilla FX and interest rates derivatives – are popular on the Bulgarian market as a hedge against important financial risks, such as interest rate and currency rate risks. The market practice when only Bulgarian parties are involved, is to use various local master agreements governed by Bulgarian law (for reasons similar to those outlined with respect to credit facilities). In recent years, we have seen a tendency among the largest local banks that are subsidiaries of important EU credit institutions, to replace their local master agreements with new documentation that closely follows the key provisions of the 2002 ISDA Master Agreement (the **"ISDA MA"**), but is subjected to Bulgarian law. For cross-border transactions, market participants normally use the ISDA MA, usually governed by English law, while taking into account certain aspects of Bulgarian law. The most important issue for banks in both local and cross-border OTC derivative transactions is to receive a clear opinion on the enforceability of the close-out-netting mechanism under the ISDA MA, since the ability to net allows banks to allocate capital only against the net figure they would have to pay on close-out rather than the gross amount under the transaction. In this respect, however, apart from some special legislation protecting netting when banks are in default, Bulgaria has no general netting-friendly legislation.

An effective netting mechanism

Nevertheless, Schoenherr Bulgaria has found a method to make close-out netting arrangements effective which is acceptable both for local and foreign banks dealing with Bulgarian counterparties that are not financial institutions. The method consists in the provision of financial collateral which must be appropriately linked to the derivative transaction, thus bringing into play the netting mechanism under the EU Financial Collateral Directive as transposed in Bulgaria. That netting mechanism may be negotiated as applicable to any mutual obligations of the counterparties, including their obligations under the derivative with respect to which a financial collateral arrangement has been entered into. Thus, the mutual obligations under a derivative may be effectively netted in case of a termination event under the relevant derivatives agreement. We believe it would be sufficient to grant a small fixed amount of cash as financial collateral to secure the potential (and thus uncertain) future obligation of a bank's counterparty to pay amounts (if any) under a derivative. The parties may agree that the financial collateral will be updated on certain dates (or only upon the bank's request, at its discretion) to account for fluctuations in the underlying interest rates or foreign currency exchange rates, which would require the counterparty to provide additional financial collateral, if necessary. Alternatively, the collateral may secure only a portion of the bank's exposure under the derivative (up to the amount of the collateral that was effectively provided), in which case there would be no need to update the amount of the financial collateral in the future.

> It may be expected that aligning local financial documentation with international standards will become even more widespread, as it is associated with important benefits for financial players.

Croatia: Selling an NPL but Buying a Business Unit – Can it be?

Ozren Kobsa

The sale of NPLs increased in Croatia in the last years. What could materially hit buyers is if an NPL sale ends up as a transfer of a business unit.

Transfer of a business unit – potential repercussions

Over the past two years, the sale of non-performing loans[1] (**"NPL"**) has gained momentum in Croatia, with a dozen NPL transactions initiated and quite a number completed. In 2015, banks alone sold EUR 500 million NPL claims (including off-balance sheet items). One of the legal issues that emerged in NPL transactions that could materially hit buyers is whether an NPL transaction can end up in a transfer of a business unit of a creditor. Some repercussions of this include extra liability of the buyer for debts of the business unit, automatic transfer of employees and different tax treatment (eg application of VAT).

Transfer of debts of a business unit to the acquirer arises out of the Croatian Civil Code of Obligations. Accordingly, the person to whom a business unit or a part of a business unit is contractually transferred shall be liable for debts pertaining to such unit or its part, jointly and severally with the previous holder, up to the value of assets of the business unit (whereas provisions on excluding or limiting liability in the agreement would produce no legal effect towards third-party creditors).

The transfer of a business unit's employees to the acquirer arises out of the Croatian Labour Act. Thus, if a legal transaction results in the transfer of a business unit/undertaking, businesses or parts thereof (retaining their economic integrity), all employment contracts of the workers employed with that business unit or part thereof – or of those who are connected with the business or part of business being transferred – shall be transferred to the new employer (the buyer). The affected workers shall retain the rights arising from their employment with the previous employer, including rights under applicable collective bargaining agreements, patronage of workers' council, if any, etc. In addition, the new and the old employer shall be jointly and severally liable for obligations to the employees that arose prior to the transfer.

Defining a business unit

In the absence of a civil/corporate law definition of a business unit, such a definition shall be sought in Croatian legal texts (traditionally relying on German law and legal writings). Accordingly, a business unit shall be regarded as a conglomerate of **objective, subjective** and **organisational** components, with objective components being the assets without which the business unit cannot operate, subjective components being eg the skills of the employees, and organisational components being the platform interconnecting objective and subjective components (managers, business plans, budget, etc.). It is an organised economic and legal unity – a living organism, without prejudice to the importance of any of the components for the life of the unit. In addition, a business unit needs to have a market presence (with permanent direction) and the goal of making a profit.

Among local laws, only the Croatian General Tax Code provides a definition of a "business unit", calling it an aggregate of all assets and obligations which, in an economic and organisational sense, make a standalone entity/unity capable of independently carrying out its activities. Further tax regulations define "transfer of business unit" as a transfer of the assets, claims, rights and obligations that make up the short-term and long-term assets of the business (enterprise) so that it can continue to independently carry out its activities as a going concern.

The management of an NPL portfolio can easily be regarded as a living organisation on a standalone basis through the cited components: objective (loans and assets), subjective (manpower handling the portfolio) and organisational (separate part of workout department of the creditor, assigned personal, budget, IT support, etc). Nevertheless, it is certain that a material number of NPL transactions will not trigger this issue, nor was this the original intention of the Croatian regulator of the banking sector – the Croatian National Bank. Yet, over and above the regulations, a due standard of professional care in NPL transactions implies legal, financial and tax analyses via facti on a case-by-case basis.

Therefore, the answer to whether or not an NPL sale has the potential to lead to the transfer of a business unit lies in a proper due diligence. Some of the parameters to be examined are: the structure of the portfolio, the percentage of the portfolio (compared to the entire size of the creditor's portfolio), the percentage of the creditor's employees handling the portfolio (compared to the entire size of the creditor's staff), the percentage of non-performing clients of the creditor (among all the creditor's clients), etc. While the risk of business transfer is latent in most NPL transactions, it lies in the hands of the potential buyer and must be carefully addressed.

“Nevertheless, it is certain that a material number of NPL transactions will not trigger this issue, nor was this the original intention of the Croatian regulator of the banking sector – the Croatian National Bank. Yet, over and above the regulations, a due standard of professional care in NPL transactions implies legal, financial and tax analyses via facti on a case-by-case basis.

[1] Commonly covers all exposures to the client where at least one claim is due for more than 90 days or it is deemed probable that the borrower will not meet its obligations in full.

Limitation Periods in Financial Services Litigation: A Shift in Austrian Jurisprudence?

Klara Kiehl | Philipp Wetter

In a recent judgment, the Austrian Supreme Court softened its settled case law on the uniform beginning of the limitation period for damages incurred by investors.

Starting point of the limitation period for investors' damages

According to sec 1489 of the Austrian Civil Code *(Allgemeines Bürgerliches Gesetzbuch),* damage claims are time-barred within three years from the day the damage and the tortfeasor are known to the damaged party. Only, if the damage results from a wilfully committed criminal offence which can be sanctioned with at least one year of imprisonment, the statute of limitations will be prolonged to 30 years.

The Austrian Supreme Court regularly defines damage as any monetary disadvantage of the damaged party. An investor either has already suffered an actual financial loss or liability has arisen or is very likely to arise. Knowledge of the damage and the liable party is assumed as soon as the damaged party is able to successfully file a claim against the damaging party, even if the exact amount of the damage claim remains unclear.

The "original" cause of the damage

Until recently, the Austrian Supreme Court applied the so-called "one-entity theory" *(Einheitstheorie)* to determine the beginning and end of the limitation period. Accordingly, the original cause of damage triggered a uniform limitation period for any foreseeable consequential damages. With regard to investors' damages due to a breach of duty by a financial advisor, the original damage has frequently been deemed to be the purchase of a risky investment instrument (eg swaps, options and other derivatives instruments). In this case, the damage of the investor was the fact that he bought a high-risk instead of a low-risk investment.

Do different causes of damages trigger different limitation periods?

The German Supreme Court chose a different path and developed the so-called "separation thesis" *(Trennungsthese)*. According to this theory, different causes of damages trigger separate limitation periods. This means that in one proceeding a damage claim based on one breach of duty might be time-barred, whereas the limitation period for the same damage (in the same amount) based on another breach of duty might not have expired yet.

New case law

Recently, the Austrian Supreme Court chose to transfer the legal concept of the (German) "separation thesis" into Austrian law (3 Ob 112/15i). It ruled that the failure to provide advice on the loss risk of the invested money and the failure to provide clarification that pay-outs to the investor are not irrevocable profits but the repayment of contributions (and thus might have to be refunded by the investor), trigger two separate limitation periods. This judgment left many urgent questions unanswered and was hotly debated by legal scholars and practitioners. Fortunately, this controversy caused the Austrian Supreme Court to make some important clarifications in its most recent ruling on this issue (5 Ob 133/15t). Pursuant to this ruling, it is a prerequisite for the existence of different limitation periods that the damage claim is based on autonomous breaches of duty by the financial advisor and that such a failure was of significant importance to the investor.

Summary and outlook

Although the Supreme Court linked the existence of different limitation periods to certain conditions, its recent judgments are a remarkable shift in Austrian jurisprudence.

There has also been an intense debate among legal scholars about the recent judgments and the admissibility of the separation thesis under Austrian law. It remains to be seen how Austrian courts will handle limitation periods in investor-related proceedings in the future when there is more than one breach of duty. In a worst-case scenario, claims that would already be time-barred pursuant to the earlier jurisprudence could now be filed successfully.

> Different causes of damages may trigger separate limitation periods for investors' damage claims.

Hungary Amends its Civil Code to Help Deal with NPLs

Gergely Szalóki

According to the government, the primary aim of the amendment, which entered into force on 1 July 2016, was to correct the Civil Code's legislative and conceptual shortcomings.

Overview

The situation in Hungary

The purchase of loan receivables is a licensed activity in Hungary, meaning that prospective buyers are expected to have a valid Hungarian banking licence (or a licence issued by a European Economic Area member state passported into Hungary). The licensing requirement, as the main impediment to the sale of NPLs (non-performing loans), was reinforced by the discouraging volatility of Hungarian legislation, the lack of effective enforcement measures and the lack of an effective market.

Transfer of loan agreement under the Civil Code

The enactment of the new Hungarian Civil Code (in force as of 15 March 2014) deepened the problem with its rules on the transfer of loan agreements. These rules have been heavily criticised. The Civil Code rendered the security interests of transferred loan agreements terminated regardless of who is affected by the transfer (ie creditor or debtor) or of whether the security provider has given its consent to the transfer or not. If the security provider agrees, however, the terminated security interest can be revived on the same rank.

Incentives

Non-performing loans (**"NPLs"**) were on the rise in both the retail and commercial sectors in Hungary, and are causing considerable problems for the Hungarian financial sector. Understanding the problem, the Hungarian National Bank incentivised the banks to clean up their portfolios and decided in October 2015 to introduce additional capital requirements for credit institutions by implementing a systemic risk buffer.

The systemic risk buffer will apply as of 1 January 2017 and will be set between 0 % and 2 % of the entire risk-weighted exposure. Only CET1 instruments will be eligible as additional capital. The Hungarian National Bank will determine the applicable rate of the systemic risk buffer individually for each bank struggling with a problematic portfolio that exceeds the threshold of HUF 5 billion (approx EUR 16 million).

Banks can only avoid falling under the scope of the additional capital requirement if they reduce the rate of non-performing project loans by the end of 2016. Therefore, the additional capital requirement may motivate the banks to deal more drastically with their non-performing project loans (ie restructuring may not be sufficient) and to simply sell them. However, this requires changes to the legal environment.

The changes

First step: Amendment of the Banking Act

In order to address the obvious problem, the Hungarian Parliament amended the Hungarian Banking Act (in force as of 7 July 2015), which provides for the regulation of loan portfolio transfers. Under the new regulation, such transfers may be authorised directly by the Hungarian National Bank, bypassing the need for the agreement of either the borrower or the security provider (however, it does not provide for an easement on the banking licence requirement). It is only possible to apply for approval to transfer loan portfolios if the threshold of either HUF 10 billion (approx EUR 33 million) – regardless of the number of contracts to be transferred – or 20 contracts, regardless of their aggregate value, is reached.

Unfortunately, the amendment did not provide a complete solution to the problems created by the general rule of the Hungarian Civil Code (ie the termination of all security interests), because it makes the transfer of loan portfolios possible only among financial institutions (the requirement regarding the banking licence remains), and sets forth the authorisation requirement of the transfer itself with the Hungarian National Bank.

Second step: Amendment of the Civil Code

The amendment of the Banking Act did not provide a sufficient solution. Banks remained reluctant to transfer loan portfolios or even a single loan agreement under the Civil Code, as they feared losing the security interest. Therefore, on 13 June 2016, the Hungarian Parliament adopted an amendment to the Civil Code, the main body of which entered into force on 1 October 2016. The primary aim of the amendment, which entered into force in a hastier manner on 1 July 2016 – according to the government communication – was to correct the Civil Code's legislative and conceptual shortcomings and to simplify the operation of Hungarian financial institutions, as well as to ensure compliance with the Capital Requirements Regulation (CRR).

The new rule foresees that the security interest does not terminate under any circumstances, but remains in place. The consent of the security provider will only be required if the debtor transfers its contractual position, ie it would be possible to implement a change in the creditor's position without the involvement of the security provider. This may enhance the secondary loan market and help the financial sector to reduce their overall NPL rate in Hungary.

> The additional capital requirement may motivate the banks to deal more drastically with their non-performing project loans (ie restructuring may not be sufficient) and to simply sell them. However, this requires changes to the legal environment.

New Developments in Corporate Criminal Liability

Rudolf Bicek I Claudia Bock

The Czech Act No. 418/2011 Coll. on the Criminal Liability of Corporations and Proceedings against Them (the **"Act"**) has been criticised for containing only the minimum requirements arising from the Czech Republic's international commitments so far. The new amendment to the Act, effective from 1 December 2016 (the **"Amendment"**), will extend the range of criminal acts for which corporate entities may be criminally prosecuted, and also the possibilities to exclude their liability.

Introduction

Corporate entities can be held criminally liable in the Czech Republic since 1 January 2012. Generally, a corporate entity may only be held criminally liable in the Czech Republic, if a criminal offence:

- was committed on its behalf, in its interest or within the scope of its activities; and at the same time
- was committed by (i) its statutory body or other persons acting on its behalf (eg under a power of attorney); (ii) persons performing management or supervisory activities within the corporate entity (eg manager, head of department); (iii) persons exercising decisive influence over the management of the corporate entity (eg parent company); or (iv) the employees while carrying out their tasks.

Furthermore, a corporate entity can be held criminally liable if:

- it has a registered office in the Czech Republic;
- conducts its business in the Czech Republic through an enterprise, branch or otherwise; or
- has assets in the Czech Republic.

Therefore, not only Czech corporate entities, but also foreign corporate entities can be held criminally liable under the Act for criminal offences committed in the Czech Republic. In addition, Czech corporate entities (ie entities with a registered office in the Czech Republic) can also be punished under the Act for criminal offences committed abroad.

Extended range of crimes

Until now, the Act listed eighty-four possible criminal offences which could be committed by corporate entities. The Amendment introduced a new system by which criminal offences that can be committed by legal entities are no longer specifically enumerated in the Act. Rather, the Act only sets out criminal offences which cannot be committed (usually by their very nature) by corporate entities and refers to the range of criminal offences which can be committed by natural persons under the Czech Criminal Code (Act No. 40/2009 Coll., as amended). To this end, corporate entities may now be held liable for about 200 crimes.

As a result, under the Amendment certain crimes against property (eg embezzlement) and economic crimes (eg unauthorised business or consumer detriment) will be added to the list of crimes that can be committed by a corporate entity. Similarly, certain crimes against life and health (eg negligent homicide or bodily harm) and defamation (libel) will be also added to the list.

Compliance programmes: New possibility to exclude corporate entities' liability

Another introduction is the extension of exculpation, ie the possibility of corporate entities to free themselves from liability for a criminal offence. Under the current Act, corporate entities can exculpate themselves from criminal liability only for crimes committed by their employees in the course of their work performance, if the corporate entity can demonstrate in criminal proceedings that its employees committed a criminal offence despite the fact that the corporate entity or its part implemented (i) obligatory legislation or (ii) measures that can be justly required from the corporate entity.

Under the Amendment, corporate entities have the new possibility to exculpate themselves from criminal liability even if the criminal offence was committed by their statutory body or a person in a managerial or supervisory position, or another individual outside the corporate entity who exercises decisive influence over it. However, in order to be exonerated from criminal liability, the corporate entity must prove that it has made every effort that may be reasonably expected to prevent the commitment of the criminal offence.

As case law does not address the question of what “every effort that may be reasonably expected” is, the interpretation of the term is now subject to discussion and will be further developed and elaborated on by professional writings and corporate commentaries.

Based on current expert views on the assessment of whether a company made every effort that may be reasonably expected, it will be necessary to examine, on a case by case basis (i) if a company has internal regulations in place which define the rights and obligations of individual employees, as well as persons in leading management positions; and (ii) whether a monitoring system is implemented which would control the compliance of respective employees and persons in leading management positions in line with the internal regulations.

The broad professional public view is that as a basic starting point in order to be exonerated as a corporate entity, basic rights and obligations should be stipulated in employment contracts or agreements on performance of a function or other contracts or agreements, or in the conditions of employment or the general internal regulations of the corporate entity. Other preventive duties in order to prevent possible criminal offences should be elaborated in statutes, working and organisational regulations, and other measures of the corporate entity. Mid-size and large companies should adopt other internal regulations that are mandatory for employees to comply with and that ensure the prevention of possible criminal offences, such as codes of ethics, standardised rules of employee conduct, and they should hold anticorruption and other programmes and trainings aimed at preventing risks and thereby creating awareness and a corporate culture, on a regular basis. Some companies create compliance programmes, comprehensively declaring that the corporate entity wants to act in accordance with all laws and regulations, as well as the internal ethics codes, both within the company as well as externally.

Further, in order for a corporate entity to have a chance to exculpate itself, it is also necessary to monitor and ascertain whether all employees as well as executives and members of the boards of the corporate entity are duly informed about all internal documents from which they derive relevant obligations, rules and instructions. For this reason, regular mandatory training sessions – compliance trainings – should be organised.

Other issues

Besides the two above mentioned core changes, the Amendment also extends the range of criminal offences that can be committed abroad by a corporate entity without registered office in the Czech Republic (eg crimes against the Czech Republic, foreign states and international organizations, as well as crimes against humanity, against peace and war crimes), and also extends the catalogue of criminal offences where effective mitigation of liability is excluded and the catalogue of criminal offences whereby the ending of criminal liability and barring of the service of a sentence (punishment) by the statute of limitations are excluded.

Conclusion

Corporate entities should be aware of the wide range of crimes that they may be liable for under the Amendment. They should also be aware of the possibility to avoid criminal liability for delictual actions of their employees, statutory bodies and other entities in leadership or influential positions. It is important not only to ensure the implementation of prevention and compliance programmes, but also to provide control mechanisms relating to compliance combined with internal rules.

It is always necessary to ascertain whether all employees, statutory bodies and other entities in leadership or influential positions are familiar with all internal documents and are informed of their special duties and the rules and instructions. In terms of prevention, employees and further persons involved in the management of a company listed above should undergo compliance trainings.

> “It is important not only to ensure the implementation of prevention and compliance programmes, but also to provide control mechanisms relating to compliance combined with internal rules.

When the Public Prosecutor Comes Knocking: Is Communication with your Attorney Privileged?

Klara Kiehl

Prosecution authorities will finally be prohibited from seizing privileged attorney-client communication located outside an attorney’s office.

Attorney-client privilege – a fundamental right

Article 6 Sec 3 of the ECHR (European Convention on Human Rights) stipulates the fundamental right of every defendant charged with a criminal offence to defend himself in person or through legal assistance. An indispensable prerequisite to efficiently execute this right is to communicate openly and without restrictions with the attorney about a case. In constant rulings, the ECHR acknowledges this privileged relationship between an attorney and his client.

In Austrian criminal law, this fundamental right is specified in Article 157 Sec 1 Para 2 and Article 157 Sec 2 of the Austrian Code of Criminal Procedure (**“ACCP”**). All attorneys have the right to refuse testimony as witnesses about all information which was disclosed to them in their function as counsel of the defendant. Thus, the refusal right covers information that was disclosed to the attorney in his function as counsel of the defendant (i) by his client (ii) by a third party (iii) or in any other way. In order to avoid an undermining of this fundamental refusal right, Articles 144 and 157 Sec 2 of the ACCP prohibit circumvention of this refusal right, eg by confiscating the attorney’s documentation, data storage media and notes about the mandate or by questioning the attorney’s employees. Evidence obtained in violation of Articles 144 and 157 Sec 2of the ACCP is void by law.

The (now outdated) interpretation of Article 157 Sec 2 of the ACC of the Austrian Supreme Court

The Austrian Supreme Court argued that Articles 144 and 157 of the ACCP apply to attorneys (and other persons subject to professional confidentiality) only. In other words, the defendant himself or third parties were not protected by Articles 144 and 157 Sec 2 of the ACCP. Consequently, correspondence which was kept outside the attorney’s office or residence, for example in the defendant’s office or e-mail account, could be searched, seized and confiscated by the prosecution authorities. As absurd as this may sound in this day and age, this resulted in severe limitations of attorney-client communication, ie clients had to be advised to refrain from e-mailing their attorneys regarding criminal law advice or from keeping any opinions or memoranda in their office.

Even though this practice did not remain unchallenged, as notable scholars as well as the Austrian Bar Association repeatedly called for better protection of privileged attorney-client information, the Supreme Court refused to change its line of argument. Now it will finally have to, as Austria has implemented Directive 2013/48/EU on the right of access to a lawyer in criminal proceedings.

The (now outdated) interpretation of the Austrian Supreme Court

The new Article 157 of the ACCP enters into force on 1 November 2016. It stipulates that any documents or information disclosed to the attorney by the defendant or from the attorney to the defendant for the purpose of obtaining or giving legal advice or developing a defence strategy may not be seized, regardless of whether the information is in the possession of the attorney or the defendant himself. The initial draft intended to offer even broader protection, including all work-related information of an attorney, regardless of its location.

However, the Supreme Court opposed this amendment in its statement on the draft bill. Thus, it is to be feared that the Supreme Court will insist on a very literal interpretation of the new provision and refuse to extend the protection to (i) information the attorney received from a third party, ie a legal expert and later handed over to the defendant, (ii) client privileged information that is not in the hands of the defendant but a third party, and (iii) information which was stolen or hacked from the attorney’s office.

How to prevent a seizure of privileged attorney-client documents in practice

In case of a house search, the defendant (either a natural person or in case of charges against a corporate entity, the entity itself) may object to the seizure of privileged commu-

nication and request that all such communication be sealed and separately stored with the court. Next, the court will order the defendant to specify and explain which documents are privileged. This statement and the sealed documents are then reviewed by the court that will decide which documents are privileged and must be returned to the defendant and which documents may be reviewed by the public prosecution authority. This decision of the court can be appealed by the public prosecution authority as well as the defendant.

> The public prosecutor may no longer access the defendant's correspondence with his or her attorney, even if it is located outside of the attorney's office.

How to Sweeten the Termination of an Agency Contract?

Gábor Kordoványi

EU Directive on self-employed commercial agents: an unnecessary interference with business relations or a justifiable financial protection of agents?

Commercial agents: a downtrodden race?

"Commercial agents are a downtrodden race, and need and should be afforded protection against their principals," said Lord Justice Staughton, wryly explaining his view on the background of Directive 86/653/EEC on self-employed commercial agents (the **"Directive"**).

In fact, commercial agents often build up strong and lasting business relationships for their principals. Business relationships established by the agent may far outlive the relations between an agent and the principal. That is to say that the principal makes a profit from the agent's work long after the agent is gone. We should therefore revisit Lord Justice Straughton's remark and examine whether commercial agents deserve financial protection against termination.

The Directive is implemented into Hungarian law by the Civil Code, which contains various provisions to financially protect agents against the termination of their agency contracts. In other words, the Civil Code offers to sweeten the termination of an agent's contract.

The first sweetening: pipeline commission

Probably the least controversial measure to protect agents' interests is the so-called pipeline commission. The expression means that the agent is entitled to receive the normal commission for a transaction that the agent prepared, but which only materialised after the termination of the agent's contract.

To receive the pipeline commission, the transaction must materialise within a reasonable period of time after the termination of the agency contract. Generally, three months from the termination is considered a reasonable period. Nonetheless, what is considered a reasonable period of time may vary depending on the industry or the complexity of a given project. For example, in the Tigana v Decoro case, the English courts held that in view of the realities of the leather furniture business, even nine months from termination was a reasonable period for awarding pipeline commission to an agent.

Indemnity or compensation

Under the Directive, an indemnity or compensation is payable to the agent if the agency contract is terminated. Interestingly, the Directive regulates two parallel methods to protect agents: the German "indemnity" model and the French "compensation" model.

Under the German indemnity model, an agent may receive one year's remuneration calculated as the average of the preceding five years or, if the contract goes back less than five years, based on the average of the period in question. The agent is entitled to the indemnity if he has brought the principal new customers or has significantly increased the volume of business with existing customers.

The Directive does not specify the calculation of the compensation; instead it stipulates that the agent is entitled to compensation for the damage he suffers as a result of the termination of his relations with the principal. Practically, agents may receive compensation equalling the commissions of the last two years or the average of the last three years' commissions multiplied by two.

Member States could choose if they want to implement the German indemnity model or the French compensation model. Hungarian legislators decided to implement the German indemnity model. Uniquely in the EU, both systems were implemented in Great Britain, where, unless the parties agree differently, compensation applies by default.

The second sweetening: indemnity

The indemnity rules of the Hungarian Civil Code basically protect the agent against any termination of the agency contract. The only cases when an agent may not be entitled to an indemnity is when the principal terminates the contract due to the agent's default and when the agent transfers his business with the principal's agreement to a third person. Consequently, the agent is entitled to indemnity if the agency contract is mutually terminated.

What's more, the indemnity is due to the agent even if he himself has terminated the agency contract because of

his age or illness. In Abbot v Condici Limited, the English courts found that the age of 65 is "embedded as a retirement milestone" and it is therefore reasonable for the agent to terminate the contract at that age. Nonetheless, the prevailing retirement age of the given country should be considered when assessing if the agent is entitled to the indemnity.

A second question also arises in connection with termination on the grounds of age, as both individuals and companies may be commercial agents. So can an agent who performs his work as a company terminate the agency contract on the grounds of age?

To answer that question, we should return to a basic principal of Hungarian law: legal persons have the same rights as natural persons, unless a right, due to its nature, may only pertain to natural persons. As the concept of age does not apply to legal persons, it can be inferred that companies may not quit due to age. Accordingly, only natural persons should be entitled to an indemnity in case of termination on the grounds of age.

> Directive 86/653/EEC on self-employed commercial agents is implemented into Hungarian law by the Civil Code, which contains various provisions to financially protect agents against the termination of their agency contracts. In other words, the Civil Code offers to sweeten the termination of an agent's contract.

Manager Liability – New Business Judgment Rule in Austria

Florian Kusznier

Personal liability is one of the main deterrents to finding competent managers. High liability exposure can discourage individuals from accepting an appointment as a manager, director or supervisory board member, and may lead to risk aversion that can ultimately be detrimental to the shareholders' interests. Balancing the need for good corporate governance with the need to give management room for development is thus crucial. The newly introduced "Business Judgment Rule" aims to achieve this by providing a safe harbour from personal liability for management and supervisory boards if they follow certain key principles.

Framework and key principles

With effect from 1 January 2016, the Austrian Stock Corporation Act *(Aktiengesetz)* and the Austrian Act on Limited Liability Companies *(GmbH-Gesetz)* were amended to introduce a so-called "Business Judgment Rule" into law. The new rule applies to managing directors, management board members and supervisory board members.

The key elements are that the rule protects only business decisions; and in addition the following criteria must be met: i) board members must act free from conflicts of interest; ii) decisions must be based on all (material) information reasonably available; and iii) board members must have (in good faith) believed that the decision was in the best interest of the company.

The limitation to business decisions means that the BJR will only protect board members and managers in areas where they legitimately have discretion to decide between alternative options. This is not the case if the law or the articles of the company require specific conduct. For instance, whether to seek approval of the supervisory board or the shareholders for an important matter or whether to file for the opening of insolvency proceedings is not a question left to the discretion of management.

Putting words into deeds: Beware the burden of proof

The burden of proof that the criteria for benefitting from the BJR were met is on the manager or board member. The only time when a plaintiff would first have to provide an "initial suspicion" would be when it comes to determining whether board members acted free from conflicts of interest. It would otherwise be virtually impossible for the manager to exclude all potential conflicts of interest. In practice, this means that (standardised) documentation, transparency and professionalism (of processes) will become increasingly important in the preparation of business decisions.

Austrian case law, as a principle, provides that management and supervisory boards enjoy broad discretion and risk personal liability only when materially overreaching their room for manoeuvre, ie when taking "manifestly incorrect" or "disproportionate and indefensible" (business) decisions.

The benefit of hindsight

However, one of the main risk factors is the problem of "hindsight bias". In other words, once a deal has turned bad, several years after the fact it will be tempting to accuse the manager in charge at the time of not having acted diligently or of having overlooked something, or of simply second-guessing their actions.

Managers and board members should also be aware that liability claims are often raised only after the termination of their mandates. What this typically means for the individual manager is that they no longer have access to evidence and documentation. They may also have been prevented from taking copies of records with them in terms of the terms of their employment agreements.

Lessons to be learned

There are several practical steps that can help protect a manager or board member:

- sound preparation is key: be unbiased, keep an open mind, ask critical questions and insist on a cost/benefit analysis based on realistic parameters;
- certain things are just a step too far: if the potential exposure arising from an idea is so high that it could put the company out of business if it fails, no matter the likelihood of that risk materialising, it will be an uphill battle to argue that this was "in the best interest of the company", and in hindsight this may become almost impossible;
- standardised documentation: if certain steps have always been taken in the preparation of a decision during your tenure, a court will find it credible if you argue that there just must be a certain valuation, expert opinion or risk analysis – even if you don't have it because you left the company;
- as far as supervisory boards are concerned, especially in complex or far-reaching matters, it will not be sufficient to rely on summaries or overviews prepared by management; instead, the supervisory board must conduct its own assessment of the matter. This may entail obtaining independent (expert) advice.

Analysis of the US Sarbanes-Oxley Act of 2002 showed that a rigid liability regime discourages individuals from taking management positions and leads to risk aversion. Recommendations resulting from this analysis went so far as suggesting that managers should not be liable for slight negligence and proposing a liability cap for cases of gross negligence. We are not there yet, but the introduction of the BJR and its "safe harbour" from personal liability is an important step in the right direction.

> "No risk, no reward" is part of being an entrepreneur. Too much risk is not good for companies, but neither are managers who sit on their hands because they are too afraid to take decisions.

Stock Trading Costs in Serbia: What is Your Money's Value?

Srećko Vujaković | Gorana Kršikapa

Foreign investors typically do not have clear insight into the cost structure of stock deals in Serbia, in particular the costs of currency conversion.

Conversion losses and cash flow

Under the general rules of Serbian law, and subject only to several clearly defined exceptions, payments, collections and transfers between residents, and between residents and non-residents within Serbia are to be made in Serbian dinars (RSD). A separate rule concerning stock trades says that stocks are traded via the Serbian Central Securities Registry, Depot and Clearing House, and that stock purchase prices are paid within Serbia (essentially under supervision by the said Registry).

Due to the above rules, and given that stock trades are not exempted from the above rule on currency of payment, stock purchasers need to pay the purchase price for the targeted stocks in RSD. To do so, non-resident purchasers will typically need to transfer a certain amount of foreign currency to Serbia, which would, in the course of the transaction, be converted into the local currency and transferred to the respective seller. If the seller of the stock is also a non-resident, it will typically, upon receipt of the purchase price in RSD, want to re-convert the funds into a foreign currency, and then transfer them out of Serbia.

These two conversions (one on the buy side and the other on the sell side) entail a hidden cost paid by the transacting parties, given that the exchange rates used in them are typically different. In some cases, depending on the banks performing the conversion and the currencies involved, the exchange rates can vary by up to 10 %.

Through this mechanism, a substantial amount of foreign currency can be "lost" through two conversion processes due to differences in the buying and selling exchange rates applicable to the foreign currencies involved and charged by the respective bank.

Stock deal cost structure

Apart from foreign currency conversion costs, stock trades entail other charges that can be classified as: (i) predetermined costs (charges determined in tariffs of competent authorities and taxes), and (ii) variable costs (costs that vary depending on a choice among different banks and brokers charging different fees). It should be noted that not all of these costs are chargeable in each and every stock transaction.

At present, the predetermined costs, ie charges determined in tariffs of competent authorities and taxes, are:

(i) fee for opening a proprietary financial instrument account charged by the Central Securities Registry, Depot and Clearing House: RSD 500;
(ii) charge for sale/purchase transactions entered into on the stock exchange or multilateral trading facility charged by the Central Securities Registry, Depot and Clearing House: 0.10 % of transaction value, but not more than RSD 1,500;
(iii) transaction fee (regulated and open markets) charged by the Belgrade Stock Exchange – 0.1 % or 0.12 % (for block transactions) of transaction value;
(iv) capital gains tax – 15 % (natural persons) and 20 % (non-resident legal persons) (subject to double taxation treaties);
(v) fee for obtaining certificate of tax clearance from tax authority – RSD 600 (needed to transfer funds out of Serbia).

Typical variable costs, ie costs that vary depending on a choice among different banks and brokers, are:

(i) broker or bank commission for carrying out stockbroker activities concerning the sale/purchase transaction, normally determined as a certain percentage of the transaction value;
(ii) brokers and authorised banks may also charge other fees (eg, for opening the proprietary financial instrument account, order placing/withdrawal, etc);
(iii) other fees chargeable by the authorised bank with which the seller/buyer has special-purpose non-residential trading accounts.

Controlling stock trade costs

Prior to trading with Serbian stocks, non-resident investors should become informed about all applicable related costs they could face prior to entering into agreements with both a broker and a bank. Careful market insight is key in selecting the most cost-effective solution.

Ideally, both the seller and purchaser of stocks should use the same bank or broker for the trade, thereby gaining more leverage in negotiating fees, but also favourable exchange rates for the conversion of foreign into local currency and vice versa.

The objective should be to negotiate such foreign currency buying and selling exchange rates that are as close as possible to the mid-market exchange rate published daily by the National Bank of Serbia, thereby reducing the related currency conversion losses.

> It is highly advisable that foreign investors become informed about all applicable costs related to stock deals that they could face prior to entering into agreements with both a stockbroker and a bank.

Overcoming Information Asymmetry in M&A

Manuel Ritt-Huemer

In M&A, information about target companies is usually allocated asymmetrically. Buyers mitigate the risks arising from incomplete information through various means.

Economics goes legal – information asymmetry in M&A

Companies grow not only organically, but to a large extent through mergers & acquisitions (**"M&A"**). Even though empirical data shows a certain cyclicality of M&A activity ("M&A waves") – the last peak being at the outbreak of the financial crisis in 2007 – M&A is a phenomenon in the modern business world. Many legal and other advisors are kept occupied analysing M&A opportunities, evaluating targets and implementing transactions.

One driving element in M&A deals is the price paid for the target (company). Whereas neoclassical finance theory implies efficient capital markets and completely informed players, in practice, we typically see information asymmetry detrimental to the buyer. At the outset of a transaction, the buyer (bidder) has only limited insight into the qualities of the target determining its value; thus, the buyer cannot reliably establish the price it should pay. The seller may, on the one hand, have no concrete information regarding the target.

Explanations for limited seller information, besides practical information barriers (eg insufficient reporting tools/ mechanisms), include, among other things, the confidentiality obligations of the target's management, and the concept of equal treatment of shareholders. On the other hand, the seller has few incentives to disclose any information to the buyer.

As with any meeting regarding supply and demand, the players in M&A transactions also form a market; in terms of economic theory, this is called the market for corporate control. When *Akerlof* introduced his concept of a market for "lemons" (adverse selection problem) in 1970, he came up with the infamous example of used cars.[1] Likewise, the theory could be translated into the market for corporate control, and would predict that the problem of adverse selection would result in a collapse of the M&A market. Fortunately, this is not observed in reality.

So, how are information asymmetries in the M&A market overcome in practice? What is the legal context for this?

Due diligence

The first intuitive solution is for the buyer to seek missing information. This process is widely known as a due diligence process. Legally, the concept stems from the fact that the management of the buyer may be liable to the company (or creditors) if it harms the company through

making uninformed decisions. Therefore, virtually any M&A deal is preceded by a more or less thorough due diligence exercise. The buyer would thereby not only review publicly available information, such as published annual accounts, registers, capital market information, etc, but would request specific information to be disclosed in a "data room". The limitations of this approach are obvious: First, the buyer would always have to rely on the completeness and correctness of the pieces of information disclosed by the seller. Secondly, implicit knowledge (eg cultural values and organisational processes) can hardly be ascertained from a due diligence exercise.

Market solutions

Another approach originates from the economic concepts of signalling and self-selection. Capital markets are highly regulated. Publicly listed companies are on the one hand bound by strict and comprehensive disclosure obligations (eg regular reporting, ad-hoc reporting) or even disclose information voluntarily (eg at road shows); on the other hand, a company that chooses to launch an IPO (ie going public) is less likely to be a "lemon". Hence, if a buyer selects a publicly listed company as a target, it can be assured that there are much smaller information gaps than with a private company.

Structural solutions

Risk mitigation cannot only be achieved through the reduction of information asymmetry, but also by limiting one's exposure; this is what economists refer to as ownership solutions. A buyer can opt not to buy a 100 % stake in a company, but to enter into a joint venture with the seller or the target company. This can be implemented either contractually (through a cooperation agreement) or by the acquisition of a minority or majority equity stake. That way, both parties share the risk of incomplete information.

Options are a useful tool to be combined with a joint venture structure. After gaining further insights over time, the new partner may exercise a put option (if the opportunity did not turn out well) or a call option (in case of a success story) and thus either divest its stake or fully utilise its investment.

Contractual solutions

Lawyers find contractual solutions particularly interesting. Just like structural ones, contractual solutions do not aim at decreasing information gaps pre-signing, but at allocating the risk of asymmetric information (partially) to the seller.

By way of an earn-out, the buyer pays and the seller receives an additional purchase price if certain qualities (usually measured by certain key performance indicators) of the target materialise within a certain period after the closing of the transaction. A seller offering an earn-out scheme also signals the target's qualities.

Warranties, representations and guarantees work the other way round. If, ex post facto, a certain quality of the target turns out to be untrue or missing, the seller is obliged either to "repair" the defect (restitution in kind) or to compensate the buyer financially (damages). Both remedies cure the overpayment.

Conclusion

These ways of mitigating the risks arising from information asymmetry are not exhaustive. Experience shows that markets (including the M&A market) tend to develop mechanisms to tackle friction arising from such asymmetry. Legislation provides a framework for incentivising or forcing market players to reduce information gaps. Moreover, there are efficient ways to control such risks through legal solutions.

> Information asymmetry is a common phenomenon in any market. M&A markets deal with this issue in different ways that can broadly be categorised into due diligence, and market, structural and contractual solutions.

[1] *Akerlof, George A.:* The Market for "Lemons": Quality Uncertainty and the Market Mechanism. In: The Quarterly Journal of Economics, Vol. 84 (1970), p 488-500. In short, *Akerlof* shows that the quality of goods traded in a market diminishes in the presence of information asymmetry. He uses the automobile market "for its concreteness and ease in understanding rather than for its importance or realism" (p 489).

Loan Sale and Purchase Agreement vs Standard SPA

Ilko Stoyanov

The LSPA structure replicates the structure of a standard SPA. Some concepts, however, are applied differently.

A loan sale and purchase agreement (**"LSPA"**) relates to the transfer (assignment) of a large number of individual receivables. The individual receivables may originate from virtually any kind of economic activity of the seller that involves entering into numerous agreements with customers, such as loan, lease, supply or service agreements. As more customers default on their payments, the seller no longer has the organisational capacity to deal with the defaults, and transfers the receivables (referred to as "non-performing") at a discount to a buyer specialised in dealing with defaulted customers.

The LSPA structure replicates the structure of a standard SPA. Some concepts, however, are applied differently.

As a standard, the LSPA implements a locked box mechanism. Unlike the sale of a business, the sale of receivables involves a limited number of financial variables, which are known and manageable from the beginning: principal, accrued interest and accrued collection expenses. Thus, there is usually no need for post-closing adjustments (closing accounts). Instead, the amount of the receivables is guaranteed as of an earlier accounting date (eg 31 December) and any movements in the accounts since that date are for the benefit and risk of the buyer.

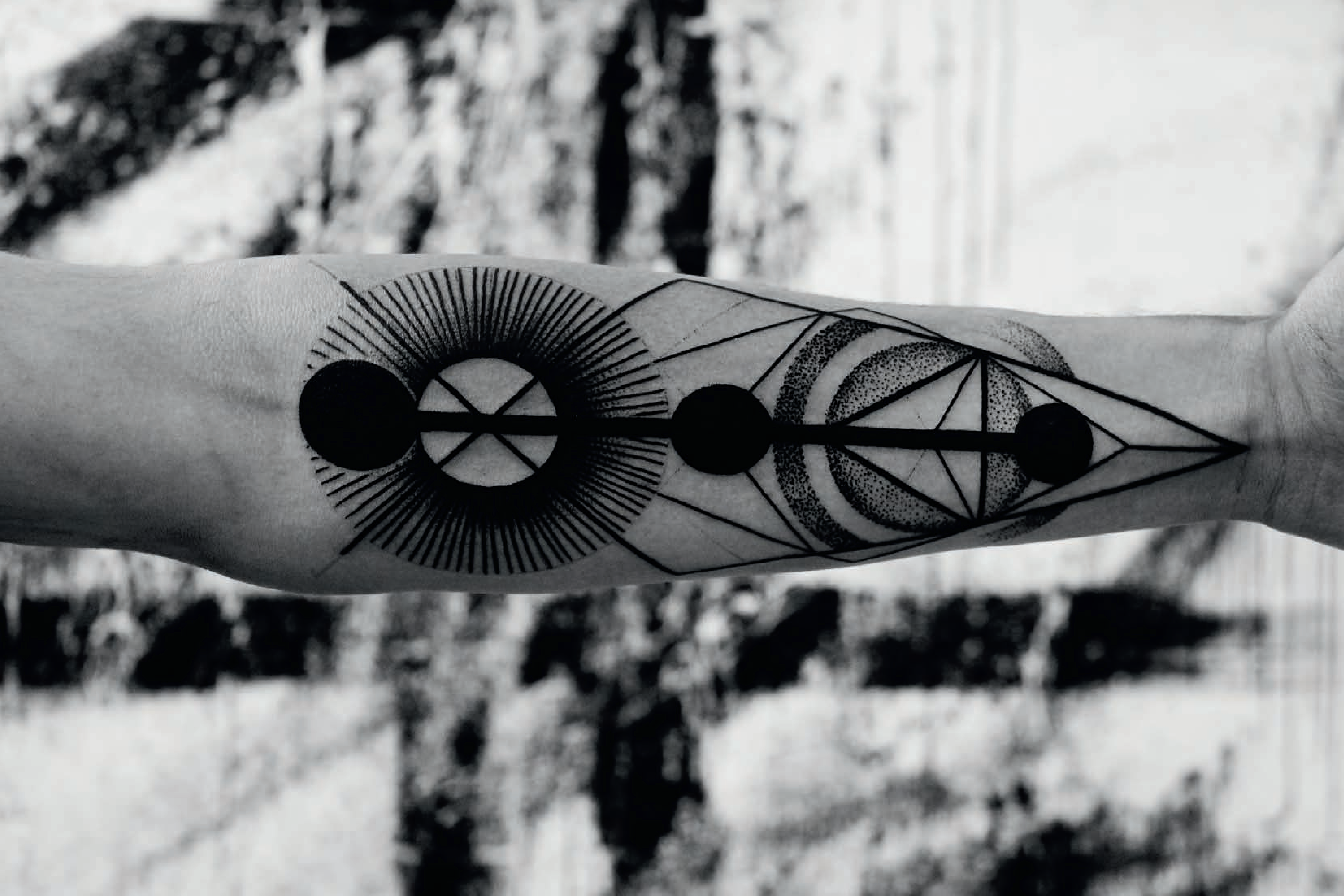
An important topic in any LSPA negotiation is whether/what public information should be deemed disclosed. As disclosure releases the seller from liability for the disclosed facts, the seller wants to disclose more. A seller would claim that any public information, although not specifically disclosed to the buyer, should have been known to the buyer. On the contrary, a buyer would oppose the disclosure of anything that it has not specifically reviewed. This dynamic is part of any SPA negotiation. In the context of an SPA and sale of a business, however, a seller is more aware of the risks associated with its business and would disclose these risks specifically, rather than rely on public information. In the context of sale of receivables, the seller is often unaware of the associated risks, because there may be hundreds or thousands of receivables and any one of them may be tainted by enforcement or litigation problems, none of which is specifically kept on record with the seller and cannot be specifically disclosed.

While a compromise on the public information disclosure would depend on the particulars of the transaction, two things may facilitate the process. First, if a seller would expect a buyer to search any public information in addition to the specifically disclosed information (data room), the seller should make this clear from the beginning of the process (ideally, buyer's searches should be limited to reliable online registers only). Second, the parties should not presume that anything in the public domain is also known to the public and the buyer. This is true for registers that legally introduce a presumption of awareness, such as the Bulgarian Commercial Register. If there is no such legal presumption, the public information is only publicly accessible, but not presumably known by the public, and the extent of the buyer's awareness of such information can be freely regulated in the LSPA.

In an LSPA, the parties should expect a more limited catalogue of seller's warranties compared to an SPA. In practice, the list of what is expressly not warranted is usually longer than the list of what is warranted. Under Bulgarian law, a seller's warranty on the existence of the receivables in the amount specified in the LSPA applies by operation of law and cannot be contracted out. Virtually all other warranties can be freely regulated in the LSPA.

There are two approaches to capping a seller's liability in an LSPA. In addition to the customary limitation on liability as per any SPA – de minimis, basket, total cap, time limitations, etc – any claim may be capped either at the proportionate amount of the purchase price (ie, if the claim is 3 % of the total amount of transferred receivables its liability cap is 3 % of the total purchase price) or at a price specifically allocated to the receivable underlying such a claim. The latter approach is called line item pricing and is considered more beneficial for the seller, because it allows allocation of low caps to otherwise large receivables if they bear the risk of legal defects.

Lastly, a unique concept in an LSPA is dealing with ongoing litigation involving the transferred receivables. Under Bulgarian law, a buyer of a receivable does not automatically replace the seller in ongoing litigation involving that receivable. Unless there is consent by the debtor, which



presumably would not be given, the litigation continues between the seller (although no longer an owner of the receivable) and the debtor. In this scenario, the parties may either decide to exclude the litigated receivables from the scope of the transaction or regulate a mechanism in which the ongoing litigation continues formally with the seller, who would act on instruction, risk, cost and benefit of the buyer.

> In an LSPA, the parties should expect a more limited catalogue of seller's warranties compared to an SPA. In practice, the list of what is expressly *not* warranted is usually longer than the list of what *is* warranted.

Convertible Loans for Austrian Start-Ups

Thomas Kulnigg

A convertible loan is a popular investment means to finance a start-up. Austrian law, however, does not foresee convertible loans for the most popular corporate form of Austrian start-ups: limited liability companies. Convertible loans thus have to be synthetically structured.

What are convertible loans and why are they a popular investment means To finance start-ups?

Convertible loans are typically loans that provide the lender (investor) the right to convert the loan into equity of the borrower. Sometimes the right is replaced by a fixed conversion procedure upon occurrence of a certain event or upon expiry of time. Convertible loans are popular amongst start-up investments and financing because they defer one of the major obstacles of start-up transactions: the valuation of the start-up.

Due to their nature, the parties do not need to agree on a valuation of the start-up for a convertible loan. The parties simply need to agree on (i) the principal loan amount and interest; and (ii) when the conversion shall take place. In the start-up world, conversion is typically connected to the subsequent equity financing round, ie when the start-up receives its next valuation. Upon such event, the loan (including accrued interest!) is converted into equity on the basis of the valuation of the financing round. Convertible loans thus allow faster execution than ordinary financing transactions.

Key incentives for investors

Lenders under convertible loans are typically incentivised not only by being able to use the accrued interest at conversion (thereby increasing the potential share in the start-up after time), but also by agreeing on a discount on the future valuation (typically around 10 %). The discount allows the investor to receive a higher equity participation for the same amount of money. Other incentives are generated by agreeing on a cap on the valuation, which guarantees the investor a certain minimum equity participation. Such incentives shall compensate the higher risk of the investor as debt providers (convertible loans are usually not secured), and also for the fact that the investor typically does not receive any voting rights or other rights that minority shareholders typically have. However, certain basic minority rights, including veto rights for extraordinary transactions, are commonly negotiated.

Sample legal obstacles of convertible loans

The following two sample legal obstacles show the necessity to properly set-up a convertible loan:

Convertible loans are unknown for Austrian limited liability companies

Limited liability companies (LLCs) are the most popular legal form for start-ups in Austria. The Act on Limited Liability Companies, however[1], does not provide for convertible loans as instruments for investing into and financing limited liability companies. The conversion mechanics have thus to be structured "synthetically". Such a "synthetic" structure can be achieved via an agreement between the investor on the one side and the start-up company and its shareholders on the other side. The agreement must include the obligation of all shareholders to effect, upon occurrence of the conversion event, a capital increase and to allow the investor to exclusively subscribe for the newly issued shares. It is not yet confirmed by court rulings that such agreements are fully enforceable. Furthermore, it is not entirely clear if the convertible loan agreement must be concluded in the form of an Austrian notarial deed or not. The convertible loan agreement should also provide for future changes to the start-up (eg changes of the legal form) or for changes in shareholdings (eg future shareholders must accede to the agreement).

Potential violation of the Austrian Banking Act

Granting loans (including convertible loans) on a commercial basis may require a banking licence under the Austrian Banking Act. Even one loan may qualify as commercial lending, thus requiring a banking licence. Conducting banking activities without a corresponding licence not only exposes the parties to a risk of administrative fines (up to EUR 5 million or 200 % of the benefits obtained from the unlawful activities, if such a benefit can be determined), the investor would also lose all claims for interest and costs connected with such unlawful activities, by operation of law. Convertible loans thus need to be thoroughly structured from a regulatory perspective.

> Convertible loans for Austrian limited liability companies are legally feasible, but need to be thoroughly structured, in particular from a regulatory perspective to avoid legal pitfalls.

[1] Contrary to the Act on Joint Stock Companies, which provides for convertible bonds.

Pricing Trends: Negative Purchase Prices in M&A Transactions

Alexandra Munteanu

Sellers seeking to exit distressed investments may be forced to bring money to the table to secure the prospects of a deal. Investors, on the other hand, looking at acquisitions in a restructuring M&A ambit, may argue opportunity costs with further restructuring efforts to back nominal, or even negative values of purchase prices. In a distressed market, with inherent risks and benefits, proper planning is key in agreeing on a deal structure and ensuring contractual protection for both parties.

Background

Companies with high levels of debt (negative net asset values) are generally priced at nominal values of the purchase price (symbolic amount) or even a negative value. In the latter case, a price following its adjustment with debt is no longer paid by the purchaser.

Is this permissible under Romanian law? So long as the parties can substantiate the economic rationale of such a

structure, the validity of such a share sale should not raise concerns.

The validity of sale-purchase agreements is premised on the following price conditions:

- the price must consist of money (otherwise the transaction would be qualified as an exchange);
- the price must be determined or determinable – a condition which is met by the consideration clause in the transaction documents;
- the price must be real (ie, with the intention of payment) – in a nominal/negative purchase price scenario, a purchase price exists, but its adjustment with debt is so high that only a symbolic amount will be paid, or it will no longer be paid by the purchaser;
- the price must be serious, ie, sufficiently high to indicate a fair balance between the seller's duty to deliver the subject matter of the transaction and the purchaser's duty to pay.

Romanian courts have consistently dismissed challenges alleging lack of seriousness of share sales prices, in case of companies registering significant financial losses where prices were set by reference not only to the company's assets, but also by reference to its debts, as evidenced in the company's accounts. Hence, for as long as there is a sound economic reason – ie, parties may substantiate the economic rationale of a low or negative purchase price – courts should not invalidate such transactions.

In a distressed environment, purchasers may argue the economic soundness of a symbolic purchase price on the cost of acquisition and the further cost of restructuring that may be required to keep the company "alive" (eg, the cost of dismissing certain employees and of obtaining regulatory licences). This is all the more true in regulated industries, where sellers must mandatorily divest the non-performant entity, liquidation not being an option, and where the cost of post-closing restructuring remains high.

Practical challenges

In a distressed scenario, sellers are required to bring money to the table in the form of capital injections, usually between signing and closing, to normalise the level of the company's net asset value. The reinstatement of the net asset/equity ratio is also dictated by an imperative norm, according to which if net assets fall below half of the value of the subscribed share capital, the respective entity is bound to undertake corporate measures to remedy the situation.

Structure-wise, if dealing with limited liability companies, parties may wish to consider the corporate limitations that condition the validity of share transfers upon undergoing a 30-day opposition period. Parties should aim to capture under the publicity formalities the sale of both existing and "new" shares issued as part of the share capital increase to mitigate the risk of any potential subsequent challenges.

Lastly, there is always the matter of the arm's length principle, which dictates that all transactions between related parties (including the sale of shares) must be priced at market rates. In some situations, this rule may prevent parties from agreeing on a symbolic price for the transfer of shares, unless that price can be backed up by the valuation of the underlying business, and implicitly of the shares. It may very well be that a target entity with a "zero" net asset still has some value on the market.

> Doing deals in distressed environments carries its own risks and benefits and hence it is key to structure the deal wisely and keep an eye on the potential pitfalls. Among these, a sound economic foundation is crucial in substantiating a structure involving a nominal/negative purchase price.

Slovakia Reintroduces a Dividend Tax

Stanislav Kovár

Step by step, the Slovak tax system has become less business friendly. The planned reintroduction of a dividend tax and other changes to the tax code, shall place an additional burden on entrepreneurs.

Business-friendly tax system eroded by financial crisis

Slovakia introduced a flat-rate income tax in 2004. At that time, a revolutionary tax reform, along with other factors led to an inflow of foreign investment and record economic growth. One of the essential pillars of the Slovak tax system was the principle that profit is taxed only once, at the level of the company that earned the profit. The subsequent distribution of profit to the company's partners or shareholders in the form of a share in profit or dividend (**"dividend"**) was not subject to an income tax, as this payment was made from already taxed profit.

The financial crisis in 2008 led to a loss of tax revenue, in response to which the Slovak government began adjusting the country's tax system. First came an increase to the corporate income tax rate, then reductions to the amount of tax-deductible items. In 2011, the government introduced something known as the health insurance contribution from dividend, a kind of hybrid between a tax and mandatory health insurance. A health insurance contribution of 14 % must be deducted from dividends that legal entities pay to a Slovak natural person, and must be remitted to the Slovak insurance company that provides compulsory health insurance to the dividend recipient. However, the health insurance contribution is not calculated from the whole dividend, but only from an amount capped at approximately EUR 50,000.

New package of changes to tax code further tightens the screw

Recently, the Slovak government put forward a package of proposed changes to the tax code that galvanised the entire business community. The package aims not only at increasing the tax burden, but also at strengthening the position of the tax authorities in several sensitive areas, such as transfer pricing, transactions with tax havens and VAT returns.

Under the proposed changes, the burden of proof in a tax inspection will be partially shifted to the taxpayer, the time that the state has to refund excess VAT returns will be extended, and penalties for transfer pricing will be doubled. An increase of the tobacco excise tax is also planned. The special contribution imposed on regulated industries (energy, insurance, pharmaceutical, etc), which was introduced as an interim measure and was supposed to be abolished this year, will continue to apply and will be doubled.

Dividend tax on the horizon

The most surprising part of this package, however, is the planned dividend tax. This tax will be imposed on income from dividends paid by:

(i) a Slovak commercial company or cooperative and similar foreign legal entity (**"foreign legal entity"**) to a Slovak natural person;
(ii) a foreign legal entity from a non-signatory state to a Slovak natural person; and
(iii) a Slovak commercial company or cooperative to a foreign legal entity from a non-signatory state,

while the term "non-signatory state" includes both typical tax havens as well as various third-world countries.

The dividend tax is supposed to substitute the current health insurance contribution from dividends as of 1 January 2017. Currently, a tax rate of 7 % is proposed (the originally planned 15 % rate was decreased after strong protests from the business community) in the cases mentioned in (i) above and a tax rate of 35 % is proposed in the cases mentioned in (ii) and (iii) above.

An important difference is the fact that the dividend tax should be paid from the full amount of the dividend received, ie the current cap on the health insurance contribution will not apply to the dividend tax. The dividend tax will be deducted not only from dividends, but also from payments to a silent partner, from a settlement share payable upon the withdrawal of a partner from a company, and from a share in the company's liquidation balance.

Impacts on Slovakia's attractiveness for business

It has become clear that the health insurance contribution from dividends was just a transitory measure leading to the introduction of a fully functional dividend tax. The only good news for businesses is that the implementation of a dividend tax should be compensated by a decrease in the

corporate income tax rate from 22 % to 21 %. It is questionable, however, whether this will be enough to attract foreign investment in competition with the neighbouring states, which all have a significantly lower corporate income tax rate. Indeed, the proposed changes to the tax system risk decreasing Slovakia's attractiveness for business to the point where the once business-friendly tax environment becomes a thing of the past.

> Recently, the Slovak government put forward a package of proposed changes to the tax code that galvanised the entire business community.

Dividends in Kind under Polish Commercial Law

Krzysztof Leśniak

Polish companies can distribute profits in ways other than cash payments. What are the main practical aspects of a dividend in kind?

What is a dividend in kind?

According to the Polish Commercial Companies Code (**"CCC"**), a company's profit declared in its annual financial statements can be paid out to its shareholders. Detailed rules for calculating the distributable profits are set out in the CCC. Though the division of profits is generally paid in cash, some companies choose to pay in non-cash forms, called dividends in kind. Payment of such dividends usually takes the form of a distribution of the company's assets, eg the shares held in subsidiary companies, claims, real estate or the company's products.

Why companies decide to pay a dividend in kind?
In practice, there are some cases when a dividend in kind may be considered better than its cash equivalent. With capital being in short supply, a company may choose to dispose of overstocked goods and to retain cash for other investments. It is also a way of simplifying the payment procedure, as the company does not need to capitalise its assets first. Avoiding the sale of the company's stakes at a lower than expected price may also be a reason to distribute shares held in other companies. Transfer of the subsidiary companies' shares or intragroup claims as a dividend in kind can be useful in restructuring the capital groups. Lastly, payment of a dividend in kind can be used to optimise tax processes.

Practical examples
A dividend in kind is not often used, but over the years the number of examples of key corporations distributing dividends in kind has increased. The sophisticated and complex procedures which included, among others, transferring parts of a gas pipeline of the biggest Polish oil and gas company to the State Treasury in the form of a dividend in kind, lead the State Treasury to acquire 100 % of the shares in gas Transmission System Operator in 2005.

Another transformation in the energy sector worthy of mention was completed in 2008 when electricity Transmission System Operator distributed the shares of its subsidiary company to the State Treasury. Payments of dividends in kind are also increasingly used by smaller companies from the private sector.

Polish legislation regarding dividends in kind

Despite being broadly approved of in practice, dividends in kind are not legally regulated. The CCC does not set out any provisions regarding distribution of a non-cash dividend.

Some legal practitioners are of the opinion that in order to protect minority shareholders from receiving useless assets, a company's articles of association should explicitly allow for payment of a non-cash dividend. This topic is still the subject of discussion. However, it seems that when there is only one shareholder, or all shareholders have granted consent to payment of a dividend in kind, authorisation in the company's articles of association is not required.

Payment of a dividend in kind
In a limited liability company, a shareholder's claim to a dividend arises once a resolution on the distribution of the company's profit between its shareholders is adopted in an ordinary shareholders' meeting. Only shareholders holding shares on the date thereof are entitled to a dividend. In addition, the resolution should also set the date of payment.

A company that decides to pay a dividend in kind should comply with the specific conditions regarding the legal means through which to assign assets or rights, eg a notarial deed is required to transfer real estate. Currently, companies willing to benefit from a dividend in kind are left to rely on the competence of lawyers in order to use this attractive and useful instrument. A separate issue that should be taken into consideration is the tax treatment of a dividend in kind.

Practical issues
As is often the case in reality, legislation regarding dividends is not necessarily aligned with practice. Legal practitioners propose explicit regulation of dividends in kind under Polish commercial law, and clarification of the issues arising from such regulation are required to rectify this reality-practice imbalance eg: authorisation and forms of approval, conditions of payment, methods of asset valuations and potential liability for misrepresentation, tax aspects or the warranties for physical and legal defects of the transferred assets.

> Currently, companies willing to benefit from a dividend in kind are left to rely on the competence of lawyers in order to use this attractive and useful instrument.

Investment Landscape in Turkey Looking Brighter

Arzu-Sema Cakmak

Turkey has announced new regulations to improve the investment environment.

Introduction

The Law Amending Certain Laws for the Purposes of Improvement of the Investment Environment *(Yatırım Ortamının İyileştirilmesi Amacıyla Bazı Kanunlarda Değişiklik Yapılmasına Dair Kanun* – the **"Improving Law"**) and the Law on Supporting Investments on a Project Basis and Amending Certain Laws and Bylaws *(Yatırımların Proje Bazında Desteklenmesi ile Bazı Kanun ve Kanun Hükmünde Kararnamelerde Değişiklik Yapılmasına Dair Kanun* – the **"Project-Based Law"**) have come into force, with the objective of improving the investment climate in Turkey.

The Improving Law

The Improving Law numbered 6728, which was announced in the Official Gazette number 29796 on 9 August 2016 and thus became effective, brings changes, *inter alia,* to the Execution and Bankruptcy Law *(Icra ve Iflas Kanunu),* Cheque Law *(Çek Kanunu),* Commercial Code *(Ticaret Kanunu)* and in several tax laws *(Vergi Kanunlari)*.

The focus of the first part of this article, however, is on the Commercial Code and tax laws.

Amendments to the Commercial Code
The most important changes in the Commercial Code are as follows:
i. notarisation of signature circular is no longer required, if executed before the Trade Registry office director or vice-director;
ii. notarisation of the articles of association is no longer required, if executed before the Trade Registry office director or vice-director;
iii. Incorporation costs of a joint stock or limited liability company have been reduced by the abolition of certain notarial fees, even if the articles of association are notarised; and
iv. The timeframe for the liquidation process is reduced from one year to six months.

Amendments to several tax laws
The Improving Law amends a number of tax laws, including the Income Tax Law *(Gelir Vergisi Kanunu),* Real Estate Tax Law *(Emlak Vergisi Kanunu),* Value Added Tax Law *(Katma Değer Vergisi Kanunu),* Corporate Income Tax Law *(Kurumlar Vergisi Kanunu)* and Stamp Tax Law *(Damga Vergisi Kanunu),* which is expected to incentivise investment in Turkey.

1.1 – Corporate Income Tax Law
Under the amended Corporate Income Tax Law, "regional headquarters" or "management centres" operating under a permit granted by the Ministry of Economy are exempt from the Corporate Income Tax. In this context, the Improving Law also offers payroll tax exemptions for the employees working in these regional headquarters or management centres.

1.2 – Stamp Tax Law
The most significant change is the abolition of stamp duty on share purchase agreements on shares of joint stock companies *(anonim şirket)* and limited liability companies *(limited şirket).* Before the entry into force of the Improvement Law, each executed original copy was subject to stamp duty either for a fixed fee or at a rate of 0.948 %. In sizeable M&A transactions, stamp duties could easily reach the capped amount of approximately EUR 550,000 (which is the applicable cap for 2016 and re-evaluated on an annual basis) per original of such share transfer documents. Under the Improvement Law, however, stamp duties are no longer applicable to such documents.

In addition, documents relating to transfer of loans provided by banks and the receivables arising from them are also exempt from stamp tax.

The Project-Based Law

The Project-Based Law numbered 6745, which was announced in the Official Gazette number 29824 on 7 September 2016 and thus became effective, consists of 82 articles. Without doubt, the most significant article is Art. 80, which aims to enhance the investment environment, speed up and ease investment by eliminating bureaucratic barriers by authorising the Council of Ministers on the implementation of certain investments. Accordingly, investment projects could benefit from the following supports:
- corporate income tax discount up to 100 %;
- investment contribution up to 200 %;
- corporate income tax exemption for profits for up to 10 years;
- income tax withholding;
- exemption from custom duties;
- grant of a free easement right for 49 years in case of investment in immovables belonging to the Turkish Treasury; or free transfer of ownership in and to such immovable, in the case of completion of the investment and anticipated employment for at least five years;
- coverage of the employer's social security premiums of up to 10 years;
- coverage of energy usage expenses up to 50 % for up to 10 years;
- financial support in interest or rates arising from loans used to finance the initial investment;
- salary support for qualified employees for up to 20 times the gross monthly minimum wage for up to five years; and
- state's partnership of up to 49 % of the total shares providing a public offer or direct sale to an investor within 10 years.

> The new regulations are likely to attract both domestic and foreign investors, which is why a boost of the Turkish economy is anticipated.

Enforceability of Emergency Arbitration Decisions in Moldova

Anna Cuşnir

Amid the growing use of emergency arbitration involving Moldova, it is interesting to see whether it is capable of yielding the desired results.

The relatively new concept of emergency arbitration (**"EA"**) is gaining momentum, with more and more institutions across the globe, such as the Stockholm Chamber of Commerce (**"SCC"**), the International Chamber of Commerce (**"ICC"**) and the London Court of International Arbitration, among others, taking steps to revisit their arbitration rules to embrace the EA mechanism.

Being party to a handful of treaties embedding the SCC Arbitration Rules, the Republic of Moldova has found itself in the EA exposure zone and has already gotten a taste of EA in a number of investor-state disputes (*Tsikinvest v. Moldova,* SCC Arbitration EA 2014/053; *Evrobalt v. Moldova,* SCC Arbitration EA 2016/082; *Kompozit v. Moldova,* SCC Arbitration EA 2016/095).

There is also potential to use EA in the international commercial arbitration setting under the rules of the arbitral institutions featuring EA provisions. In addition, a new arbitral institution is emerging under the roof of the American Chamber of Commerce in Moldova, and it will be interesting to see whether EA will be included in its dispute resolution toolkit.

The EA concept

EA is an expeditious procedure offering conflicting parties who have entered into an arbitration agreement interim relief before the arbitral tribunal is constituted and, under certain arbitration rules, even before the arbitration is commenced. Interim relief is granted by an emergency arbitrator appointed on an urgent basis in order to specifically deal with the application for interim relief. The features of EA vary somewhat from arbitral institution to institution, but share certain core aspects.

The first is the expeditious timeline. As an example, under the SCC Arbitration Rules (2010), an emergency arbitrator is appointed within 24 hours of receipt of the application and an emergency decision is rendered within five days of referral to the emergency arbitrator.

The second aspect is the nature of the relief sought. Emergency relief is provisional in nature and is sought to protect the claim in the underlying dispute. The interim measure can be aimed at maintaining or restoring the status quo, at preserving assets and/or evidence pending final adjudication. Unlike the provisional measures ordered by a state court, the effect of the interim measures granted by an emergency arbitrator is limited to the parties to the arbitration agreement and generally may not bind third parties. For example, an emergency arbitrator's decision may not bind a third party bank, thus limiting the effectiveness of a freezing order on a bank account.

The third aspect relates to the circumstances justifying the relief. Besides the *prima facie* reasonable possibility to succeed on the merits, the applicant must generally prove that it faces imminent and irreparable or substantial harm if no urgent relief is granted. Whether the threshold is met or not shall be decided on a case-by-case basis. Notably, under the same fact pattern, emergency arbitrators may come to opposite conclusions.

For instance, applications for emergency relief in *Evrobalt v. Moldova* and *Kompozit v. Moldova* originated from the same actions of Moldovan authorities aimed at the divestiture of shares held by a number of investors in a Moldovan bank. While the Kompozit emergency arbitrator established that the tests of urgency, imminence and irreparability were satisfied and ordered the Moldovan state to refrain from taking any further steps relating to the cancellation of the bank's shares, in *Evrobalt LLC v. Moldova* the emergency arbitrator concluded that the divestiture of shares would not result in irrevocable loss that could be made good by monetary compensation awarded in the main arbitration proceedings, and therefore denied the application.

Potential routes to enforcement in Moldova

Decisions by an emergency arbitrator generally take immediate effect and are binding on the parties concerned. As statistics of various institutions shows, percentage of voluntary compliance with EA decisions is relatively high. This is because respondents usually want to create a good impression with the future arbitral tribunal. But these statistics are of little use to those claimants whose opponents choose not to comply. Available enforcement options are

then on the table and they in turn depend on the origin of the EA decision (Moldovan or foreign).

The concept of EA cannot be found in Moldovan law. Pursuant to the Moldovan Arbitration Act 23/2008, in the course of arbitration, an arbitral institution may order interim relief which can be enforced through a public court, if necessary. Since relevant jurisprudence on EA is lacking, it can only be assumed that the enforceability of domestic EA decisions will largely depend on whether they are deemed to be issued by an arbitral institution.

If an EA decision is imported from overseas, its enforceability is determined under the treaties to which Moldova is a party or according to the principle of reciprocity.

Moldova is one of 156 state parties to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 10 June 1958 (the **"NY Convention"**). The issue of whether foreign EA decisions are enforceable under the NY Convention is widely debated. On the one hand, the proponents of enforcement, including courts in certain jurisdictions, assert that such decisions terminate the dispute over provisional measures, thus passing the finality test and being enforceable. On the other hand, the predominant view, which is also in line with the Moldovan Supreme Court's explanatory decision of 25 April 2016 with regard to arbitration decisions on interim measures, is that an emergency arbitrator's decision lacks the finality required under the NY Convention, since the issue can be reopened and revised in the main arbitration. Accordingly, the chances of EA decisions being enforced under the NY Convention are slim.

By virtue of international treaties, however, Moldova must enforce not only foreign arbitral awards, but also other types of arbitral decisions rendered abroad. While incorporating certain arbitration rules into its treaties, Moldova undertook to put the resulting arbitral decisions into practice. Thus, in line with the approach used in neighbouring Ukraine,[1] treaty-based EA decisions (eg rendered under the SCC rules) should also be enforceable in Moldova; it is, however, for the Moldovan courts to pronounce on the issue. So far, out of the above three SCC EA decisions, in *Tsikinvest* and in *Kompozit,* emergency arbitrators decided in favour of investors. However, there is no information on attempts to enforce EA decisions through the Moldovan courts. It appears from publicly available information that Tsikinvest so far failed to pursue its claim in the main arbitration, while notwithstanding the EA decision in *Kompozit,* the investor's shares in the Moldovan bank were annulled, new equivalent shares were issued and, as of the beginning of October 2016, were put up for sale.

As for foreign EA decisions made outside the umbrella of international treaties, which the Claimant cannot enforce on the basis of the NY Convention, the creditor may try to request the Moldovan court to issue an equivalent interim relief order using the EA decision as an authoritative document. Nevertheless, it will be up to the court to assess the persuasiveness of the conclusions drawn by the emergency arbitrator.

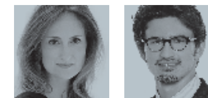
Some suggestions

Being another attractive tool at the claimant's disposal, EA has its own bottleneck – the enforceability of the resulting decisions. In order to make EA more sustainable, the Moldovan legislator should recognise it and pave the way for the enforcement of both domestic and imported EA decisions. In the meantime, the Moldovan Supreme Court should explain to the lower courts that the interim measures ordered by arbitrators and emergency arbitrators domestically are on equal footing and thus equally enforceable, and that foreign treaty-based EA decisions also have a pathway to enforcement in Moldova. Finally, in order to spur voluntary compliance with EA decisions, the contracting parties should consider incorporating punitive damages provisions in their arbitration clauses; such provisions are triggered if a party fails to comply. By the same token, arbitral institutions should grant emergency arbitrators the power to set a penalty for non-compliance, while in both cases the arbitral tribunals should subsequently incorporate the accrued penalties in their final awards.

> Being another attractive tool at the claimant's disposal, EA has its own bottleneck – the enforceability of the resulting decisions.

[1] Resolution of the Kyiv City Court of Appeal dated 17 May 2016, Case no. 757/5777/15-ц, http://sccinstitute.com/media/145837/appeal-court-decision_17052016_eng.pdf.

Commercial Mediation: Dispute Resolution 2.0



Anne-Karin Grill | Sebastian Lukic

Users are increasingly looking for innovative, time and cost-efficient dispute resolution. Commercial mediation can do the trick!

The essential characteristics of commercial mediation are straightforward: broad scope of application, flexibility, compatibility with other dispute resolution methods, time and cost-efficiency, and confidentiality. These features make mediation a tool that is increasingly employed when it comes to effectively resolving (international) commercial disputes.

Flexibility is Key

Flexibility is the backbone of every successful mediation process. In this sense, there is never a rigid procedural framework that needs to be adhered to. Rather, the ground rules of mediation – whether they are established in the form of institutional rules or determined together with a mediator – are such that they leave considerable space for the parties to shape the process. This approach reflects the fact that in any consensual dispute resolution process, the decision as to whether and how a dispute will be resolved remains exclusively up to the parties involved.

Compatibility is Trump

Another key characteristic of mediation is its compatibility with other dispute resolution methods. Mediation may easily be combined with different, more traditional, forms of dispute resolution. In particular, the combination of mediation and arbitration is growing in relevance. In the case of "Arb-Med-Arb" proceedings, the arbitration procedure is usually stayed in the interest of a process of mediation. If the parties fail to reach a consensual solution, arbitration continues. If there is a settlement, the arbitration proceedings may be continued for the purpose of transforming the parties' agreement into an award on agreed terms, or to simply record the settlement. Parties frequently choose the former approach to take advantage of the enforcement privileges granted by the United Nations Convention on the Recognition and Enforcement of Arbitral Awards.

Effectiveness vs Efficiency

While the benefits of mediation are evident, it still might not be a suitable method for every dispute. In fact, it would be misleading to call mediation a full substitute for arbitration. Recent statistics issued by the International Chamber of Commerce (**"ICC"**) reveal that 70–80% of mediation proceedings lead to a successful settlement. Thus, commercial mediation is an effective and business-friendly dispute resolution method that enables sustainable solutions that do not sacrifice business relationships.

Furthermore, commercial mediation is an extraordinarily time and cost-efficient approach to resolving disputes. Depending on the particularities at hand, international mediation may take no more than one or two days, and a maximum of six months. If the amount in dispute is EUR 1 million, the costs for mediation conducted under the Mediation Rules of the Vienna International Arbitral Centre (**"VIAC"**) amount to EUR 12,000 and cover the registration fee, administration and the first advance on the mediator's fees. In comparison, with the same disputed amount, conducting arbitral proceedings before a sole arbitrator under the VIAC Arbitration Rules would amount to EUR 45,000 on average – not including costs of legal representation.

Institutional Mediation Rules

The leading arbitration institutions administering international arbitration proceedings, such as, probably most prominently, the ICC, offer commercial mediation services. In Austria, the VIAC has promoted conciliation – another consensual method of dispute resolution with the involvement of a neutral third party – since its beginnings 40 years ago. In line with recent developments in the field of Alternative Dispute Resolution (**"ADR"**), the VIAC recently introduced a new set of ADR Rules. The Vienna Mediation Rules have been in force since 1 January 2016. They provide a modern, user-friendly instrument that codifies best practices of international mediation by establishing a procedural framework for successful commercial mediation.

Outlook

In recent years, ADR in general and commercial mediation in particular have grown in importance, which is not only reflected in the rising number of registered cases, but also in the fact that international contracts now more frequently contain business-friendly multi-tier dispute resolution clauses.

The adoption of a convention on the enforcement of mediated settlement agreements would be another huge milestone on the road to reshaping today's dispute resolution culture. In this regard, in July 2015, the United Nations Commission on International Trade (**"UNCITRAL"**) mandated its Working Group II to prepare an instrument for the international enforcement of settlement agreements resulting from commercial mediation. In September 2016, the most recent session of the Working Group resumed in Vienna to continue its deliberations on draft provisions to be included in the enforcement instrument.

Faced with the increasing popularity of mediation, arbitration practitioners face an important challenge: to stay on top as regards the workings and benefits of the various existing ADR methods and, if the option to mediate were pursued by the client, to understand how to best represent their client in the mediation.

In the end, the key will lie in counsel correctly identifying whether a commercial dispute should be referred to arbitration or mediation – and to apply the correct set of skills in the chosen procedure.

> Commercial mediation enables sustainable solutions that do not sacrifice business relationships.

Foreign Arbitral Interim Measures in Serbia and Montenegro: Do They Really Work?

Tanja Šumar

How does one enforce an arbitral interim measure if the opposing party refuses to comply?

As with litigation, interim measures are ordered in arbitration to prevent hindrances to the proceedings, the parties' legitimate interests, or the final arbitral award. The very nature and goal of interim measures is that swift compliance is vital. This – and the fact that arbitrators, unlike state courts, are not backed by public instruments of coercion to enforce their decisions – brings up a challenging question: How does one introduce an arbitral interim measure into a national legal system, give it the force of a court decision, and ensure its swift and efficient enforcement?

Interim measures – a system of its own

While arbitral awards are routinely recognised and enforced worldwide, the specific characteristics of arbitral interim measures dictate they be treated differently from awards.

Like awards, arbitral interim measures are limited to the parties and the subject-matter of the dispute. Crucially, however, arbitral interim measures are limited in time, susceptible to amendments, dependent on the ultimate resolution of the dispute, and must not "affect the discretion of the arbitral tribunal in making any subsequent determination" on the merits of the case.

These characteristics, specifically the lack of finality, are the main obstacles to arbitral interim measures being recognised and enforced by the national courts. Therefore, these inherent features of interim measures are also the main reason that arbitral interim measures may turn out to be unfeasible and sometimes even useless tools in arbitration.

Thus, various jurisdictions either (i) have specific rules adapted to recognition and enforcement of arbitral interim measures, (ii) enforce arbitral interim measures without a framework designed for this purpose, or (iii) are simply unlikely to recognise and enforce arbitral interim measures. Montenegro and Serbia can each fit one of these categories.

Montenegro – statutory framework in place, but courts have yet to apply it

In Montenegro, the Arbitration Act *(Zakon o arbitraži)* (**"MAA"**) shows a strong pro-enforcement bias. Modelled on the UNCITRAL Model Law on International Commercial Arbitration of 2006, the MAA includes provisions expressly allowing for recognition and enforcement of arbitral interim measures by national courts.

The MAA thus provides limited grounds which may lead to refusal of recognition and enforcement of arbitral interim measures. Essentially, these grounds were transplanted from those intended for the recognition and enforcement of arbitral awards, with adaptations required to acknowledge the specific nature of interim measures.

In the first place, grounds relating to arbitral awards were incorporated (by reference to the relevant article of the same law) in entirety, except for the "lack of finality", given that interim measures are never final. Specific grounds, adapted to interim measures, were then added.

Thus, recognition may be refused if (i) the party requesting such a measure in arbitration did not provide security as ordered by the arbitrator(s); (ii) the interim measure was terminated or suspended by the arbitrator(s), court at the seat of arbitration (if authorised to do so), or by the state whose law was the basis of the interim measure; or (iii) the arbitrator(s) ordered an interim measure which is unknown in Montenegrin law. In the last case, however, the court may still recognise the interim measure in question by amending it in line with Montenegrin law (ie adapting it to its own law), without changing its substance.

The mechanism is yet to be tested in practice, given that the MAA, enacted in 2015, is still quite new. Nonetheless, with the statutory framework in place in Montenegro, arbitral interim measures should be recognised and enforced.

Serbia – with no specific statutory framework, can practice show flexibility?

Unlike Montenegro, Serbia is not among those jurisdictions which provided for a specific statutory framework to deal with this matter. Although enacted in 2006, the Serbian Arbitration Act *(Zakon o arbitraži)* was modelled after the UNCITRAL Model Law on International Commercial Arbitration of 1985 and, therefore, does not implement specific provisions on recognition and enforcement of arbitral interim measures.

In principle, this would mean that arbitral interim measures are not capable of being recognised and enforced in Serbia. However, it was reported that according to the Supreme Court of Serbia, the fact that a decision is an interim measure is not per se a reason to deny it recognition and enforcement.

Despite this pronouncement of the Supreme Court, in Serbia the recognition and enforcement of arbitral interim measures has not been prominent in practice so far. Therefore, it has yet to be seen whether, on what grounds and to what extent courts would show flexibility in recognising and enforcing arbitral interim measures. The lack of an express statutory framework, the general unfamiliarity of the courts with arbitration, and the overall inconsistency of court practice, would suggest that this effort could prove difficult at best.

> In Montenegro, with the statutory framework in place, arbitral interim measures should be recognised and enforced. In Serbia, it has yet to be seen whether, on what grounds and to what extent courts would show flexibility in recognising and enforcing arbitral interim measures.

Romania's Bilateral Arbitration Option Clause: A Binding or Non-binding Arbitration Mechanism?

Andreea Ghiță

In most cases, parties insert an arbitration clause expressly agreeing to submit their differences to arbitration. However, sometimes they may wish to leave a door open to freely choose how their disputes will be settled at a future time.

The arbitration option clause

In an arbitration option clause, parties agree to either submit their disputes to the domestic courts or to settle their differences before an arbitral tribunal. The choice is made after the dispute has arisen, when both the nature of the dispute, and the other party are identified.

While resorting to an arbitration option clause instead of an arbitration agreement is not without snags, the parties may find some benefits in taking this road.

The parties may be of the view that arbitration corresponds to a loss of their right to go to court in favour of a private court that they have no experience with and a reluctance to test. Consequently, the parties' intention is to try to preserve the advantages of both court and arbitration proceedings.

Legal framework in Romania

Under Romanian law, domestic and international arbitration are regulated separately. Book IV concerns domestic arbitration and Book VII – Title IV of the New Civil Procedural Law international arbitration, respectively. However, there is no express provision on the Romanian view of the bilateral arbitration option clause, and it is not often encountered in Romanian legal practice either, being dealt with by the Supreme Court in only a handful of cases spanning 13 years[1].

The main issue that arbitration and domestic courts are struggling with resides in the binding or non-binding character of arbitration that the option clause provides parties under Romanian law.

The questions that arbitration and national courts were required to answer were the following: Is a bilateral option clause a binding arbitration agreement? Is an additional agreement required in order to proceed to arbitration pursuant to Romanian law?

Under Article 553 of the Romanian Code of Civil Procedure, the conclusion of the arbitration agreement excludes the jurisdiction of the national courts for the dispute that it concerns. Moreover, Article 550 roughly provides that via arbitration agreements, the parties commit to refer disputes that their contract may give rise to, to arbitration.

Romanian arbitration and domestic court case law

As legal practice shows, the answer offered by Romanian case law depends on who you are asking. Arbitration practice shows a predilection to *in favorem validitatis* interpretations of the option clause, while national courts are undecided over what the option clause allows the parties to undertake.

The arbitration tribunals are consistent in determining that the option clause is a valid arbitration agreement. Opinions stemming from some arbitration decisions show that the intention of parties to resort to arbitration, even as an option, is enough to find that an arbitration clause exists and that it binds the parties to arbitration.[2] In their view, why else would the parties mention arbitration if they did not want to be bound by it?

In other instances, the arbitral tribunal found that to subject the commencement of arbitration to a distinct agreement between the signatories would mean depriving the bilateral option clause of its effects. As soon as the claimant files a request for arbitration, the arbitration clause should be considered effective[3].

National courts have a different view

On the one hand, domestic courts[4] ruled that since the option clause does not irrefutably exclude the jurisdiction of the national courts, it does not represent an effective arbitration agreement, refusing enforcement of the award issued in its respect. As such, being considered a purely optional clause, the clause was not considered a binding arbitration agreement per se.

However, on 11 February 2016[5], the Supreme Court held that the bilateral option clause is not null and void. Here, it considered that resorting to arbitration was optional for the parties: *"Exercising one option or the other is dependent […] on the subsequent agreement of the parties, in favour of arbitration or the national court"*[6].

Remarks

As the arbitration clause is recognised as representing a severable contract from the contract where the arbitration clause is contained, it must also be subject to the same rules of interpretation and validity as those applicable for any contract. Thus, the arbitration agreement must be supported by adequate consideration and be expressed in writing[7], as an *ad validitatem* requirement.

Thus, in the view of the national courts, the bilateral option clause was ineffective because it was not supported by mutual consideration, even if the contract as a whole was supported by adequate consideration. As there was no mutual commitment to arbitrate, there was no intention to arbitrate the disputes. However, the Supreme Court did not dismiss the bilateral option clause from the outset. The parties' will to establish mutual consultation before submitting the dispute to arbitration was considered as binding between the parties.

The Supreme Court's approach aims at giving effective meaning to the terms provided by the parties under the bilateral option clause. As such, the Supreme Court's recent decision is of interest for Romanian arbitration as regards bilateral option clauses, since it opens the door to the validity of these defective clauses nationally.

Conclusion

Although the concept of a bilateral option clause is quite new in Romania, a trend can be seen in the validity of this type of defective clause. While Romanian arbitration practice is a pro-arbitration jurisdiction, a proper understanding of national practice and specific domestic legal trends could come in handy when arbitrating or litigating under the national laws.

> Romanian law does not explicitly regulate the arbitration option clause, national courts are laying down the foundations towards their recognition as a binding mechanism.

[1] Meaning from 2003 until 2016, including the decisions rendered where State-owned companies were involved, as well as where the issue of its validity was not in question.
[2] See, for instance, Award no. 283 dated 25 November 2009, V.A. Vlasov, Commercial Arbitration. 2007-2009 arbitration case law. Legal Practice, Hamangiu publishing house, 2010, pages 8-9.
[3] See, for instance, Award no. 233 dated 16 November 2007, V.A. Vlasov, Commercial Arbitration. 2007-2009 arbitration case law. Legal Practice, Hamangiu publishing house, 2010, pages 10-11; For further reference, Award no. 49 dated 9 March 2010, Award no. 124 dated 22 July 2009 and Award no. 145 dated 27 December 1996 rendered by the Court of International Commercial Arbitration attached to the Chamber of Commerce and Industry of Romania and cited in Pandectele Romane Journal no.2 dated 28 February 2011.
[4] Bacau Court of Appeal, Decision no. 3259 dated 16 October 2014.
[5] Supreme Court Decision no. 318 dated 11 February 2016.
[6] Supreme Court Decision no. 318 dated 11 February 2016.
[7] Same requirement as provided by art. 7(2) of UNCITRAL Model Law.

Whistleblowing Hotline – Implementation Only with Employee Consent?

Stefan Kühteubl | Natalie Hahn

Is a whistleblowing system always subject to co-determination rights of the works council or does it depend on its specific features?

Legal basis

Under Section 96 (1) (3) of the Austrian Labour and Constitution Act (the "ArbVG"), the "implementation of monitoring measures and technical systems for employee monitoring" requires participation of the works council if those measures (systems) affect "human dignity". If there is no works council, these monitoring measures can be adopted pursuant to Section 10 of the Employment Law Harmonisation Act (the "AVRAG") with the consent of each and every employee.

Monitoring measures include any practices useful to monitor employees and all technical facilities suitable on an objective-abstract basis to monitor employees. Whether monitoring actually takes place or whether the employer subjectively intends to monitor its employees is irrelevant in this context. Furthermore, only permanently established monitoring measures must be approved. Ad hoc inspections, for example in connection with theft, do not require employee participation. Notably, not all permanently established monitoring measures require employee participation, only those affecting human dignity.

DSB's legal opinion

A condition precedent for registration by the Austrian Data Protection Commission (the "DSB") is the conclusion of a corresponding works council agreement or of individual agreements with the employees since its Decision of 14 December 2012 (Case number GZ K600.320-005/0003-DVR/2012).

According to the DSB, a reference to a code of conduct that encourages and prompts employees to report potential infringements is sufficient to assume that a monitoring measure is in place that affects human dignity, because an encouragement to report purported wrongdoings means that employees would permanently monitor each other. However, it will be shown below that the DSB's opinion is incorrect, since the question of whether the implementation of a whistleblowing system must be qualified as a permanently established monitoring measure under Section 96 (1) no. 3 of the ArbVG depends on the particular way in which the system is set up.

No permanently established monitoring measure

If the whistleblowing system that is put in place

- offers a confidential helpline and a website operated by an independent third party;
- allows the employee to choose whether to disclose his or her identity or to remain anonymous;
- permits employees to report only legally sanctioned incidents (in accounting, internal accounting controls and auditing);
- does not constitute an obligation to report and employees are not obliged to use the available whistleblowing system,

such a system cannot be qualified as a permanently established monitoring measure under Section 96 (1) no. 3 of the ArbVG.

Such a system is simply unsuitable for monitoring employees on a permanent or lasting basis, as a report can only be made in the event of a concrete suspicion restricted to the mentioned areas – comparable to suspicion of theft – and an investigation in the form of an inspection will only be conducted later.

Notification and reporting duty implied by loyalty

Employees already have a comprehensive obligation to be loyal to their employer and are expected to protect the employer's interests based on the contract of employment. This loyalty obligation implies notification and reporting duties. Employees are obliged to report any strong suspicions that other employees might be involved in criminal offences or serious misconduct.

Such a system would do nothing more than clarify the loyalty that is already expected from employees anyway and would simply be one of several ways of reporting irregularities. Even after such a system is implemented, employees could still choose other ways to report irregularities.

Human dignity not affected

Even if such a system were a permanently established monitoring measure, it would not affect human dignity, because

the scope of reportable incidents would be limited and would include only legally sanctioned incidents. This must be taken into account when balancing the various interests.

The employer's operational interest in being informed of unlawful incidents must be balanced against the employees' interest in not being caught in the act of committing a crime that might even be targeted against the employer. Besides the operational interest, the public interest in exposing and preventing irregularities would have to be balanced. It must be taken into account that the margin of tolerance which allows an intrusion into individual rights is not a foregone conclusion, and that the severity of operational interests and those of the public, which a monitoring mechanism will establish, must be considered. This is why the employer's interests would prevail.

> The fact that a whistleblowing system contains the term "system" does not allow it to be qualified as a monitoring measure beyond the scope of the employee's duty to be loyal. Against this backdrop and contrary to the opinion of the DSB, the availability of co-determination depends on the particular way in which the system is set up.

Employee Non-Compete Clause vs. New Civil Code

Denisa Zezulka | Marie Hasíková

An employee non-compete clause is the effective legal instrument for an employer to protect its business secrets or otherwise prevent information leaks.

Non-compete clause under the Labour Code

Employee non-compete clauses are regulated by Sections 310 and 311 of the Labour Code (the **"Labour Code"**)[1]. It is no surprise that non-compete clauses have recently gained in popularity, as they are an effective legal instrument to protect business secrets and prevent information leaks.

Under the Labour Code, a non-compete clause is basically a written agreement between the employer and the employee under which the employee is obliged to refrain from engaging in activities in the same line of business as the employer's, or to refrain from activities that compete against the employer for a period of at least one year from the termination of the employment agreement. In return, the employer undertakes to provide the employee proportionate compensation at least in the amount of one half of the employee's average monthly salary. Non-compete clauses cannot be concluded with anyone, however – only with employees – which is reasonable considering the nature of the information, knowledge, working knowledge and technological processes that they have gained or will gain in the course of their employment, the use of which in a competing activity, could seriously hamper the employer's business. Therefore it will affect particularly employees in decision-making positions. Given that the non-compete clause is not among the mandatory requirements of the employment agreement, concluding one is optional and employees cannot be forced to sign it.

The legal regulation of non-compete clauses contained in the Labour Code has been relatively stable for several

years. With the adoption of new civil law, in particular the adoption of the new Civil Code (the **"Civil Code"**)[2], a new general legal framework for non-compete clauses, regardless of the nature of the contractual relationship, has been established. The question therefore arises whether such an arrangement is generally applicable to employment relations and thus an employee non-compete clause.

Does the Civil Code need to be applied?

The relationship between the Civil Code (as a general private law) and the Labour Code, even after the recodification of private law, is characterised by the principle of subsidiarity. Section 2401 of the Civil Code expressly refers to special legislation, when it declares that the employment relationship and the rights and obligations of employees and employers in an employment relationship are governed by another law – the Labour Code. In other words, this means that the Civil Code will apply to employment relations only if a particular issue is not explicitly regulated. The principle of subsidiarity is also incorporated in Section 4 of the Labour Code, which states that employment relations are governed by the Labour Code, but that the Civil Code will be applied if it cannot be used.

The general rules of non-compete clauses within the Civil Code are systematically included among the provisions relating to abuse and restriction of competition. These provisions will therefore apply, unless any special private law does not apply to the respective legal issue. According to the Civil Code, every non-compete clause must contain the following elements: (i) the territory covered by the prohibition of competitive activity; (ii) the scope of activities covered by the prohibition of competitive activity; and (iii) the range of third parties to which the prohibition of competitive activity applies[3]. In the absence of any of these requirements, the non-compete clause would be disregarded.

The relevant case law expressly declaring (or rebutting) that the provisions of Section 2975 of the Civil Code must be applied to an employee's non-compete clause does not yet exist. Nevertheless, as the Labour Code does not address these issues, the only conclusion that can be reached is that compliance with these essential elements is a required condition for the valid conclusion of a non-compete clause, even in relations between employers and employees.

An employee's non-compete clause must therefore specify, among other things, the essential elements set out in Section 2975 of the Civil Code. Otherwise, it would be considered a putative clause, i.e. it would not give rise to any legal effects.

Conclusion

The special legal regulation on employee non-compete clauses contained in the Labour Code also has to be viewed through the lens of a general regulation of non-compete clauses resulting from the Civil Code.

Therefore, when negotiating an employee non-compete clause, not only mandatory provisions of the Labour Code (and related case law) must be taken into account, but also the relevant provisions of the Civil Code. Otherwise the non-compete clause would not be validly concluded and the protection of the employer cannot be guaranteed.

> When negotiating an employee non-compete clause, not only mandatory provisions of the Labour Code (and related case law) must be taken into account, but also the relevant provisions of the Civil Code. Otherwise the non-compete clause would not be validly concluded and the protection of the employer cannot be guaranteed.

[1] Act No. 262/2006 Coll., Labour Code, as amended.
[2] Act No. 89/2012 Coll., Civil Code, as amended.
[3] Compare with Section 2975 of the Civil Code.

Anti-discrimination Rules During Workforce Reorganisation

Daniel Gera

Employers enjoy great freedom in (re-)organising their workforce. Do the current dismissal and anti-discrimination rules provide sufficient protection for employees?

Employers in Hungary generally enjoy a great degree of freedom in establishing the manner in which they conduct their business. This freedom includes, among others, the ability to define the framework of their operations and set up their organisational structure. An additional aspect of this freedom is the right to change that structure and reorganise the workforce, if they deem it necessary. This article focuses on certain limitations of that freedom and examines their application in practice.

Background: economic grounds for dismissal

Employment law generally aims to mitigate the effects of the disparity between parties' economic power, hence it sets certain limitations to what employers can do. One of these limitations is the restriction regarding grounds for dismissal. The rules governing dismissal differ in each jurisdiction, but – in one form or another – most of them accept economic grounds as a valid reason for dismissal. Hungarian employment law also recognises such grounds (in Hungarian terminology: "reasons related to the employer's operations") as valid grounds for dismissal.

When an employer terminates one or more employment relationships on the basis of an economic ground, it still enjoys a great deal of flexibility. As an example, in the case of a dismissal for economic grounds Hungarian employers do not have to offer other available jobs to the employees as opposed to other legal systems, where this is customary or even a legal obligation.

Employers' freedom regarding dismissals

The employers' freedom has several facets. Firstly, employers may freely decide on a reorganisation when they deem it necessary. When a dismissal is based on economic grounds (eg workforce reorganisation), in the event of a dispute, a court can only examine the validity of the grounds (whether it indeed took place), but cannot examine its reasonability or economic substance.

But what does this look like in practice? If an employee challenges the dismissal in court, the employer has to prove that the grounds for dismissal were valid, ie (i) the reorganisation has indeed taken place, (ii) the employee's position has been terminated, and (iii) the tasks have been allocated to other persons, etc. This is normally the point at which the court's authority to examine the background ends, because if these circumstances are successfully proven by the employer, the court has no authority to further examine whether the reorganisation was necessary.

Secondly, if several employees are affected by a reorganisation, an employer may freely select the employees who will be made redundant.

If, for example, the decision is to reduce the headcount of a sales department, consisting of 20 employees, by 25 %, the employer is free to select which five employees will be made redundant. Unless specific circumstances (such as discrimination) occur and are raised by the employee during a court procedure, the court may not examine why one person, and not another from the same position, was made redundant.

Selection of employees

But how do employers select? Practice shows that employers tend to select lower performing employees, but in general they are not required to set out any sort of (objective) guidelines, performance standards or any other criteria based on which the selected employees and not others are made redundant. Normally employers do not have to justify why they selected X instead of Y at court.

This does not mean that employers could not take into account certain other considerations (social background of employees) or set out social plans detailing selection criteria; it only remains that they are not legally required to do so.

General legal principles and anti-discrimination rules are a significant limitation to that freedom. When making their selection, employers may not act discriminatively. If an employee challenges the dismissal as being discriminatory (which happens quite often), the court could conclude that although the reason for the dismissal is valid and lawful, the dismissal itself is still unlawful.

Disputes surrounding discrimination

What does such a dispute look like? If an employee challenges the dismissal on the basis of discrimination, the employee has to declare and make it probable that he or she had an attribute protected by law (eg sex, age, family status, sexual orientation, etc) and that he or she suffered due to that attribute in comparison with other employees.

If an employee makes such a claim, the employer must prove that it has not acted discriminatively, and as a part of that process has to reveal the selection criteria (if any).

Employers acting in good faith have no reason to worry though. The court practice shows that courts seem to strongly accept employer's freedom for selection and discrimination claims are only successful in obvious cases. In one recent case heard by several courts, the Supreme Court declared that the employer had not acted discriminatively when the two oldest employees with the longest length of service were made redundant.

The Supreme Court considered that the employer had the right to choose who to terminate and there were no grounds supporting age discrimination. The court further stated that the length of service at a particular employer is not an attribute that is protected by equal treatment laws.

> As opposed to other legal systems, where in the case of a dismissal for economic grounds the employer must offer other available jobs to the employees, Hungarian employment law is not as strict and provides less protection to employees.

Managers are Creative Too – The New Copyright Act

Peter Devínsky | Michal Lučivjanský

The new regulation of copyright work created by employees provides a flexible system more suitable for new tech industries and start-ups in Slovakia.

The New Copyright Act in Slovakia

In today's economy, the value of intellectual property created by employees is increasing, mainly due to the rising importance of new tech, start-ups and creative industries, such as TV and media. In these fields, it is natural for employers and owners to use such intellectual property to further develop their business and therefore to try to protect it as much as possible.

The former regulation of copyright works created by employees in place in Slovakia had its limits and did not reflect rapid economic development and emerging industries. As of 2016, the new Act No. 185/2015 Coll., on Copyright, as amended (the **"New Act"**) provides for more flexible protection of employee works and options when exercising rights arising from such works.

Extended scope of protection

The biggest change under the New Act is to the scope of employee works. Under the former legislation, the regulation applicable to employee works only covered works created by an employee in the course of performing his or her duties within an employment or civil service relationship.

Under the New Act, the specific regulation also applies to:

- employees who are only temporarily assigned to a so-called “user employer”;
- members of the managing, controlling or supervisory bodies and statutory representatives (such as managing directors) of legal entities in connection with the performance of their duties associated with this office.

The extension of the scope of employee works to works created by managers is a novelty in Slovak law. Since managers usually perform work on the basis of contracts of employment, they were already covered by the former legislation. However, quite a few managers work under other types of contracts, eg cooperation agreements, or (mainly in the case of statutory representatives) even without a specific contract. Thus, compared to the former regulation that covered only works created by employees, the New Act will potentially cover more intellectual property.

Nevertheless, some problems in the application of the new regulation can already be foreseen. As the New Act does not precisely define which bodies should be deemed managing, controlling or supervisory bodies, there is room for potential future disputes. For instance, a manager (not working under a contract of employment) could claim that his position in a specific body (eg the R&D committee of a company) cannot be considered as a position in a managing, controlling or supervisory body.

A similar situation might arise with respect to a managing director performing his or her function without a written agreement, which is common in Slovakia. As Slovak commercial law stipulates the duties of managing directors only in general terms, it could be easily disputed whether certain work created by a managing director was in fact created in connection with his or her duties.

More flexible assignment of employee works and specific licence

The former regulation led to practical problems in the assignment of economic rights arising from employee works from the employer to a third party, mainly as a result of the employer’s obligation to obtain the employee’s consent to such assignment.

Under the New Act, an employer-oriented solution has been introduced. Now the employer may assign intellectual property rights from employee works to a third party without the author’s consent, unless agreed otherwise. Therefore, no consent of the author (employee or manager) is required unless specifically agreed.

On the other hand, an employee who has authored a work now has the right to request from his or her employer a licence to use it under standard conditions if the employer exercises economic rights from the work poorly or does not exercise them at all. The employer, however, is entitled to refuse to grant such a licence if doing so would be contrary to its legitimate interests or if another serious reason exists.

Potential impact

The main practical impact of the new regulation of employee works is its extension to managers. This is important mainly in companies where managers can potentially create a copyright work, such as start-ups, where the managing directors themselves usually create the company’s product.

In order to avoid future disputes, the potential aspects of employee works should be covered in every agreement concluded with a manager.

> The New Act introduces a very employer-oriented solution. Now the employer may assign intellectual property rights from employee works to a third party without the author’s consent.

"Abuse of stronger bargaining power" in Bulgaria

Galina Petkova

First decision of the Bulgarian Commission for Protection of Competition for abuse of stronger bargaining power.

The case

At the end of May 2016 the Bulgarian Commission for Protection of Competition (the ***"Commission"*** *or the* ***"CPC"****) fined Siemens EOOD (****"Siemens"****) for abuse of stronger bargaining power, in the amount of BGN 35,000 (approx EUR 17,900) plus attorney fees of BGN 2,500 (approx EUR 1,280). This is the first case in which the Commission has dealt with abuse of stronger bargaining power, introduced to the Bulgarian Competition Protection Act (****"CPA"****) at the end of July 2016. Given the abstract wording of the provision about "abuse of stronger bargaining position" and the lack of any methodology or instructions about its application, the CPC's decision can be considered as initial guidance on how the Commission will interpret the provision in the future.*

The proceedings for abuse of stronger bargaining power against Siemens were opened on 7 March 2016 by a request from its competitor and commercial partner, Bright Engineering OOD (**"Bright Engineering"**) to the CPC.

Bright Engineering claimed that as a result of the unjustified refusal of Siemens to supply it with a Siemens SST-300 steam turbine, Bright Engineering was not able to supply its own contractor – EVN Bulgaria Heating EAD (**"EVN"**) with the same. Bright Engineering claimed further that it suffered damages (as did its customer, EVN) as a result of the unjustified refusal. According to Bright Engineering the refusal constituted an "abuse of stronger bargaining power" by Siemens.

Siemens' arguments

Siemens, in turn, claimed that the elements for abuse of stronger bargaining power were not present. In particular, Siemens claimed that: (i) under the internal structure of Siemens it did not supply the steam turbines in Bulgaria, but they were supplied by another Siemens company to which Bright Engineering had been redirected; (ii) Bright Engineering may have been supplied with the steam turbines by other producers; (iii) Bright Engineering did not act with the due diligence of a "good merchant" because it did not ask Siemens whether it would be able to supply the steam turbines before entering into a contract with EVN; (iv) EVN does not fall within the definition of "customer", as the definition is given under the Consumer Protection Act (the CPA does not provide for a definition of a "customer"). Hence, the entire provision about abuse of stronger bargaining position was not applicable.

The CPC's decision

The Commission did not accept Siemens' arguments and found that abuse of stronger bargaining power was in fact present in this case.

The CPC underlined that given potential competition, the number of alternative suppliers/purchasers, entry barriers, etc, the assessment of a "stronger bargaining power" has to be made on a case-by-case basis. In line with that, a stronger bargaining power is present where partners of a certain company are dependent on it, given the characteristics of the relevant market's structure, the specific relation between the concerned undertakings, the character of their activities, and the difference in their scale of operations.

In addition, the CPC states that the stronger bargaining power can be found at each stage of the commercial relations between the parties, including during their negotiations.

The Commission ruled that in the case at hand, Siemens, as representative of Siemens AG had a "stronger bargaining power" since Bright Engineering was economically dependent on it in order to supply its own customer, EVN. The CPC further considered that according to the principles of good faith, and considering the existing relations between Siemens and Bright Engineering, Siemens had to (i) justify the grounds for its refusal and (ii) cooperate with Bright Engineering for the delivery of the Siemens steam turbine.

Further, given the lack of a definition for "customer" in the CPA, the Commission found that the sector-specific definition under the Energy Act should apply (and not the definition under the Consumers Protection Act, as claimed by the defendant).

The CPC further defined that by causing direct damages to EVN, Siemens may also have caused damages to the end consumers (consumers of EVN).

The sanction

Given that Siemens had a 0 % market share in the relevant market for 2015, the Commission sanctioned it with a fine of BGN 35,000 (approx EUR 17,900) plus attorney fees of BGN 2,500 (approx EUR 1,280).

What next?

The decision of the CPC is currently being appealed by Siemens before the Supreme Administrative Court (**"SAC"**).

If the CPC's decision is upheld, this would automatically turn the case into a precedent on how abuse of a "stronger bargaining power" will be interpreted in the future. Certainly, the wide interpretation made by the CPC would put not only Siemens, but also many other companies on the spot with strong positions in the market, when they negotiate or do business with their partners and competitors.

> "The CPC underlined that given potential competition, the number of alternative suppliers/purchasers, entry barriers, etc, the assessment of a "stronger bargaining power" has to be made on a case-by-case basis. In line with that, the stronger bargaining power is present where partners of a certain company are dependent on it [...]"

Investigative Tools – Case Study of a Sectoral Inquiry

András Nagy

An EU-wide series of inquiries compelled online travel agencies to materially alter their business practice. It has shown that authorities have ample tools and great potential to investigate and affect a market.

Sectoral inquiry

Sectoral inquiries are large-scale investigative tools used by competition authorities (including the European Commission) to better understand the functioning of competition in a certain market. The authorities usually commence sectoral inquiries on the basis of information about certain discrepancies, shortcomings or lack of healthy competition in a given market. The sectoral inquiry may develop into a full-scale investigation against certain practices, agreements and behaviour of market participants. This potential (risk) stems from the fact that uncovering evidence of potential infringements is one of the purposes of the investigation. Thus the sectoral inquiry allows competition authorities to commence an investigation on a larger scale and to initiate specific cartel or other proceedings only if there is a clear indication or evidence of an infringement in the market. In light of the latest developments – where authority officials also highlight that economic analysis fails to provide the competition authorities with a clear indication of whether competition may or may not be distorted in a market – such investigations gain in importance.

Inquiry into the online accommodation booking market

The Hungarian inquiry was launched on 29 July 2013. The Hungarian Competition Authority (**"HCA"**) researched and analysed market conditions and investigated market participants extensively. Besides contacting the market participants with requests for information, the HCA employed market research agencies, and conducted comprehensive analysis of statistical and market survey data. The HCA ultimately concluded that the price parity clauses used by online travel agencies (**"OTA"**) were to blame for the rigid market prices. These so-called "most favoured nation" clauses obliged the hotels not to offer lower prices on any possible distribution channel than on the website of the respective OTA. These provisions led to standardised prices, which effectively undermined competition. The accommodation provider was constrained in its activity, as it could not offer lower prices on its website or any other channel (including through other OTAs). This restrictive framework ultimately resulted in standardised prices. Thus, although OTAs fostered price competition between accommodation providers with straightforward price comparison possibilities, competition between the OTAs was practically absent, furthermore the prices of accommodation providers were identical on all channels.

Compelled changes in business

As a result of the inquiries, price parity clauses have been banned in Germany and France. Most competition authorities, however, seem to accept OTAs' responses to the scrutiny – narrow price parity clauses. In the framework of narrow price parity clauses, accommodation providers may not offer less favourable conditions on the OTA's website compared to their own. This gives accommodation providers the freedom to offer lower prices on other channels, eg in a reply to an e-mail, on the phone or, most importantly, on the websites of different OTAs. The HCA terminated the sectoral inquiry with the expectation that the introduction of narrow price parity (and the subsequent elimination of wide price parity) will strengthen competition on the market. Nevertheless, it made clear its willingness to intervene if narrow price parity fails to bring an effective and lasting positive change in the dynamics of competition.

Lessons to learn

The HCA – in line with the general opinion of the competition authorities – seems to accept the legitimacy of narrow price parity, also considering the OTA's interest in providing incentives for booking through their, and not the accommodation provider's, website (prevent "free riding"). Nevertheless, the HCA continues to keep a close eye on market developments, so although the alert level for OTAs has dropped, an intervention cannot be ruled out.

Competition authorities (including the European Commission) are willing to proactively gather information on the markets and have a variety of tools to do so. Sectoral inquiries are among the most effective proceedings to gather information on a large scale and indirectly affect the behaviour of market players. Consequently, the authorities have the potential to cause involuntary and immense changes on the market. As any information conveyed to the authorities may result in an investigation or increased scrutiny, a high level of caution and professional advice remain indispensable in such cases.

> A sectoral inquiry allows competition authorities to commence an investigation on a larger scale and to initiate specific cartel or other proceedings only if there is a clear indication or evidence of a market infringement.

Subordinated Bondholders vs. State Aid: 0:1

Eva Škufca | Urša Kranjc

In December 2013, the Bank of Slovenia adopted exceptional measures resulting in the annulment of financial instruments held by shareholders and subordinated bondholders for the purpose of burden-sharing in rescuing five Slovenian banks.[1] In its decision of 19 July 2016, the European Court of Justice confirmed that such burden-sharing is not contrary to EU law; however, the Slovenian public remains divided.

Contested measures trigger outrage

From 2010 onwards, the five (largest) Slovenian banks succumbed to the global financial crisis, which led them to suffer capital shortfalls, ie they did not have sufficient assets to satisfy their creditors and to cover the value of deposits. Consequently, the Bank of Slovenia decided to adopt emergency measures, which became a point of contention. The contested measures adopted on the basis of the Slovenian Banking Act *(Zakon o bančništvu)* included writing off equity capital as well as hybrid capital and subordinated debt, in exchange for a significant capital injection by the Republic of Slovenia, which became the only shareholder.

The measures triggered loud disapproval from the subordinated bondholders, who claimed a violation of their (constitutional) rights, especially their right to property. They turned to the Slovenian Constitutional Court *(Ustavno sodišče)* and called for a constitutional review of the contentious provisions of the Slovenian Banking Act. The Constitutional Court considered that it cannot examine the respective provisions before the nature and validity of the European Commission's (**"EC"**) Banking Communication,[2] on the basis of which the contentious provisions were adopted, is clarified. Therefore, it turned to the European Court of Justice (**"ECJ"**) for help, requesting a preliminary ruling on, *inter alia,* whether the provisions of the Banking Communication should be considered *(de iure* or *de facto)* binding and whether points 40 to 46 of the Banking Communication – which make the possibility of granting state aid conditional on the requirement to write off capital, hybrid capital and subordinated debt instruments – are compatible with the right to property and the principle of protection of legitimate expectations.

The European Commission's Banking Communication

The EC introduced the updated EU state aid rules for banks during the crisis in 2013 with a view to defining common EU conditions under which Member States can support banks with recapitalisations, guarantees or bad asset transfers. The Commission vice-president in charge of competition policy, Joaquín Almunia, stressed that *"bank owners and junior creditors will need to contribute before any more taxpayers' money is spent on bank bail-outs"* and that *"banks will need to present a sound restructuring plan, which will lead to swifter and more efficient restructuring"*. The Banking Communication therefore provides that in case a bank no longer meets the minimum regulatory capital requirements, state aid cannot be granted before equity, hybrid capital and subordinated debt have fully contributed to offset any losses.

Should the Banking Communication be considered binding on Member States?

Sometimes the EC adopts guidelines or communications in order to establish the criteria on the basis of which it assesses the compatibility of the notified aid measures. By doing so, however, it imposes a limit on the exercise of that discretion, which it cannot exceed. In the judgment at hand, the ECJ also recalled that the EC holds exclusive competence over the assessment of the compatibility of aid measures with the internal market and enjoys broad discretion when deciding which measures are compatible with the internal market.

It follows from the foregoing that if a Member State notifies the EC of a state aid measure compliant with the Banking Communication, the EC is obliged to authorise such aid. As the ECJ also emphasised, however, the Banking Communication does not relieve the EC of its obligation to examine specific exceptional circumstances. In short, (i) the Banking Communication is not binding on Member States, and (ii) the Member States retain the right to notify the EC of a proposed aid measure that does not meet the criteria laid down by the Banking Communication. In exceptional circumstances, the EC may authorise such proposed aid.

Does the principle of burden-sharing go against the principle of protection of legitimate expectations and the right to property?

The principle of protection of legitimate expectations and right to property are both generally recognised as superior principles and fundamental rights of EU law. The ECJ, however, did not concur with the applicants that either of the two were breached as a consequence of the burden-sharing obligation.

In accordance with general rules applicable to shareholders of public limited liability companies, shareholders are liable for the debts of the bank up to the amount of its share capital, whereby the bank's creditors, in accordance with the Banking Communication, should only contribute (i) after losses are first absorbed by equity, and (ii) if there are no other possibilities' available to overcome the capital shortfall.

Banks' shareholders and subordinated bondholders must be aware of and fully bear the risk of their investments. The ECJ recalled that the scale of losses suffered would, in any event, be the same, regardless of whether they are caused by potential insolvency proceedings, as no state aid has been granted, or by a procedure for the granting of state aid which is subject to the prerequisite of burden-sharing. In economic terms, neither shareholders nor subordinated bondholders would be worse off and hence it cannot be reasonably maintained that the burden-sharing measures, such as those laid down by the Banking Communication, constitute interference in the right to property or the principle of protection of legitimate expectations of shareholders and subordinated creditors.

In whose favour is the adopted decision?

Interestingly, the reaction to the ECJ's judgment was positive. It seems that all parties involved in Slovenia believe that the ECJ's decision works to their benefit.

On the one hand, the Slovenian Investors' & Shareholders' Association is certain that this decision means that the contested burden-sharing measures should not have been adopted. On the other hand, the Slovenian Ministry of Finance also welcomed the ECJ's decision, which confirmed that the measures in question fully comply with EU law.

The Slovenian Constitutional Court will have the final word whether the measures implemented with the Slovenian Banking Act, which required burden-sharing of the respective shareholders and subordinated bondholders, are acceptable despite the fact that the EC's Banking Communication as such is not binding upon Member States.

Nevertheless, the ECJ's reasoning should not come as a surprise, and while the Member States are in principle free to propose state aid measures that are not in compliance with the principles established by the EC's decisional practice and guidelines, in practice this means that the outcome of such proceedings is much more uncertain and also time-consuming, which especially in times of crisis Member States most likely (will) try to avoid.

> In economic terms, neither shareholders nor subordinated bondholders would be worse off and hence it cannot be reasonably maintained that the burden-sharing measures, such as those laid down by the Banking Communication, constitute interference in the right to property or the principle of protection of legitimate expectations of shareholders and subordinated creditors.

[1] Nova Ljubljanska banka, d.d., Nova Kreditna banka Maribor, d.d., Abanka Vipa, d.d., Probanka, d.d., and Factor banka, d.d.
[2] Communication from the Commission on the application, dated 1 August 2013, of state aid rules to support measures in favour of banks in the context of the financial crisis (the **"Banking Communication"**) (OJ 2013, C 216, p.1).

Principal's Liability for Service Providers' Conduct

Franz Urlesberger | Lukas Solek

In daily business, companies often turn to the services of dependent or independent service providers. In fulfilling their duties, these service providers may encounter or even participate in conduct that infringes competition law. Principals must therefore ask whether and subject to what conditions the service provider's conduct may be imputed to them and exposes them to liability for fines and damages. Two recent judgments may shed light on this critical issue.

Imputation of service providers' conduct

It has long been an established decisional practice at the EU level that companies acting as principals are not only liable for their own conduct, but might also be liable for the conduct of their service providers. The core question concerns the conditions subject to which the (potentially) infringing conduct of the service provider might be imputed to the principal. Looking at the case law of the EU courts, one can differentiate between "dependent" and "independent" service providers with respect to the requirements of imputation.

Dependent service providers

The imputation of dependent service providers' conduct to the principal has been subject to settled case law in the past. Dependent service providers, such as employees, false self-employed persons, sales agents, subsidiaries and other controlled entities are viewed as auxiliary bodies, forming an integral part of the principal's undertaking. It is therefore not surprising that the conduct of these service providers is attributable to the principal without the need for the principal to have instructed the dependent service provider to participate in an infringement or to have been aware of the dependent service providers' involvement. A glimmer of hope that might limit the extent of the principal's liability is the scope of the service providers' authorisation to act on behalf of the principal.

This point was recently clarified by the General Court of the EU with respect to the imputation of a sales agent's conduct to his principal (Case T-418/10, *voestalpine AG and voestalpine Wire Rod Austria GmbH v European Commission,* Judgment of the General Court of 15 July 2015). The General Court held that a sales agent's conduct going beyond the scope of the entrusted activity (authorisation) generally cannot be imputed to the principal (assuming the lack of knowledge and intent on the part of the principal). Might the EU courts also be ready to accept a limitation of the principal's liability for the conduct of its employees (or other dependent service providers), if the latter clearly act beyond their authorisation? Regardless, the authorisation does not limit the principal's liability if the sales agent's conduct is qualified as part of an overall conduct by several participants (eg the sales agent responsible for one country takes part in a European-wide infringement). Contrary to the previous case law, it is irrelevant to the principal's liability whether the sales agent provides services exclusively, let alone whether the agent generates a major share of his income with a particular principal (unless multiple representations disqualify the sales agent as a dependent service provider).

Independent service providers

The imputation of independent service providers' conduct to the principal was only recently addressed by the Court of Justice of the EU (Case C-542/14, *SIA 'VM Remonts' and Others v Konkurences padome,* Judgment of the Court of Justice of 21 July 2016). Independent service providers are normally legal or physical persons who provide their services independently on a given market. Points of contact between the activities of independent service providers and competition law sensitive matters are numerous. The exposure is substantial in scenarios where independent service providers handle sensitive information of or for several principals. The most prominent example is the preparation of tender documents by an independent service provider for several bidders. Should the independent service provider use the information and data received by all principals as a reference point to secure that one predestined bidder wins, the question arises under what conditions this infringing conduct may be attributable to the principals.

The Court of Justice foresees a two-tier test for the imputation of the independent service provider's conduct to the principal. First, for the purposes of the imputation, the principal (i) must be aware of the anti-competitive objective pursued by the independent service provider and other participants and (ii) must have the intent to contribute to them by its own conduct. If these conditions are not met, the imputation might still materialise, provided the principal (i) could have reasonably foreseen that the service provider will engage in anti-competitive conduct and (ii) was prepared to accept the risk which that entailed. In neither case is it required that the principal authorise the service provider's conduct. The limiting effects of the authorisation have not been discussed by the Court of Justice in this respect. As for proof of knowledge on the part of the principal, it might be presumed (subject to a rebuttal) that the principal was aware of its service provider's anti-competitive conduct already based on an incriminating message/statement that the service provider/other participant communicated towards the principal. In such an event, the principle should verifiably distance itself from the conduct or report the conduct to the Competition Authorities to rule out its liability.

Prevention and limitation of the principal's liability

The first way that principals can avoid liability is by means of compliance training and contractual safeguards, such as commitments on the part of the service provider to comply with applicable competition laws, a precise definition of the scope of the authorisation, reporting obligations with respect to anti-competitive behaviour, obligations not to disclose confidential information internally (eg "Chinese walls") or to third parties, and contractual penalties. While these measures might not prevent the service provider from participating in an infringement, and hence might not prevent the imposition of a fine on the principal, they might minimise the risk or at least the extent of the liability.

In any event, the recent case law warrants closer scrutiny of the contractual relationships with and the actual conduct of dependent and independent service providers entrusted with activities that are competition law sensitive.

> Companies using service providers in competition law sensitive matters expose themselves to potential liability as a result of the service providers' anti-competitive conduct. Given the far-reaching and financially exorbitant consequences of such infringements, principals are well advised to introduce safeguards preventing or at least limiting their exposure.

Companies as “Co-authors” of the Serbian Competition Authority’s Decisions

Zoran Šoljaga | Srđana Petronijević

Recent decisions of the Serbian Commission for Protection of Competition (**“CPC”**) show that the CPC increasingly applies a commitment procedure to close antitrust investigations. The CPC has also recently cleared a complex merger concerning some 80% of the sugar market subject only to behavioural measures. Undertakings have their say in the proceedings before the CPC.

Active participation in competition proceedings

Undertakings should not merely reply to information requests and wait for a decision, by virtue of which the Competition Authority could impose a hefty fine, behavioural or structural remedies, or even prohibit a merger. Instead, they can significantly affect the Authority’s decisions, avoiding the harshest sanctions by offering the Competition Authority measures to eliminate its competition concerns. Therefore, the outcome of the proceedings is largely in the hands of the undertakings concerned.

Active participation of undertakings in “creating” the decisions of the CPC is enshrined in the Protection of Competition Act (Official Gazette of RS No. 51/09, 95/13) (**“Competition Act”**), specifically in its provisions prescribing i) the commitment procedure and ii) conditional approval of concentration. Although these two concepts are applied in different types of proceedings before the CPC, their essence is the same: parties propose measures to the CPC which, if accepted, become binding on them and bring the investigation to an end.

Commitment procedure

The commitment procedure is considered a win-win solution, which spares all the parties from having to undergo an antitrust investigation. The CPC likes it since it i) speeds up the proceedings; ii) saves CPC resources; and iii) ensures effective competition in the market. On the other hand, it also matches the interests of the undertakings as it helps them to:

(i) avoid high fines and infringement decisions;
(ii) escape lengthy and costly antitrust proceedings; and
(iii) reduce the risk of consumers/customers lodging successful damage actions, as there is no finding of infringement.

In addition to these advantages, the undertakings may actually propose their own, voluntarily offered, commitments. The CPC carries out a market test to check with the relevant stakeholders whether the proposed commitments properly address the identified competition concerns. Then, the CPC adopts a conclusion suspending the procedure, by which measures become legally binding. In case of non-compliance, the CPC may impose fines and reopen the proceedings.

Article 58 of the Competition Act sets out the rules for suspending proceedings enabling parties to submit their offers. However, the parties must submit the commitments before they receive the CPC’s Statement of Objections, which comes at the final stage of the investigation.

The CPC increasingly applies the commitment procedure to end proceedings. In 2016, two investigations concerning alleged abuses of a dominant position were closed by commitment decisions. Both cases related to the activities of public undertakings, one in the railway sector, which concerned denial of access to railway infrastructure (*Železnice Srbije,* 19 January 2016), and the other in the unified utilities billing system, which concerned discrimination of trading partners (*JKP Infostan Tehnologije,* 17 August 2016). Unlike in the EU, preliminary assessment or state of play meetings are not inherent to antitrust proceedings in Serbia, and it therefore remains unclear in which cases, or at what time during an investigation, the CPC is willing to start negotiating and accepting the commitments.

Merger remedies

The CPC may block a merger if an in-depth analysis shows that the transaction will lead to a restriction of competition. This can affect the business plan of the undertaking, undermining many months of hard work, negotiations and project preparations. To prevent such an outcome, Article 66 of the Competition Act introduces the possibility for the parties to propose measures they are willing to accept, so that the transaction will meet the requirements for approval. The parties may propose the measures at any stage of the proceedings; they usually do it after the CPC has issued a conclusion initiating *ex officio* proceedings.

On several occasions, the CPC has conditionally cleared concentrations, imposing both behavioural and structural measures. A recent CPC sugar market decision (the *Sunoko* decision) shows that the CPC is ready to impose behavioural measures even in cases where the joint market share of the merging parties is around 80 %. The decision indicates that there is no need for undertakings to immediately propose structural measures (such as divestiture), but that they should instead engage in negotiations with the CPC, proposing behavioural measures first.

Since the measures directly affect the company’s market behaviour and performance on the one hand, and the transaction itself on the other, companies should take special caution when formulating and ranking the measures they are willing to offer to the CPC, starting with the most lenient and gradually progressing to the more stringent as the negotiations with the CPC continue, until agreement has been reached.

How to prepare commitments and remedies

The design of commitments/remedies is one of the most complex aspects of the proceedings before the CPC, which can directly affect the undertaking and the transaction. Undertakings should approach it with maximum caution, as there are no clear guidelines or procedures for defining and proposing measures (commitments or remedies) in Serbia.

The desire to suspend proceedings immediately and avoid fines or a prohibition decision could lead an undertaking to i) offer the CPC more than is needed, ii) make promises that would be difficult to fulfil, or iii) even offer commitments in cases in which the CPC could not prove severe violations of the Competition Act. To avoid this, undertakings should:

(i) conduct a detailed assessment of the case and of the relevant market;
(ii) define a strategy to interact with the CPC;
(iii) identify the CPC’s possible competition concerns; and
(iv) carefully rank all possible measures acceptable for the undertaking concerned.

Only after such preparation should undertakings approach the CPC with a list of possible commitments/remedies. Competition law expertise and knowledge of the CPC’s practices and procedures are crucial in defining acceptable measures that will address competition concerns and leave undertakings unharmed.

> Undertakings should not merely reply to information requests and wait for a decision, by virtue of which the Serbian Competition Authority could impose a hefty fine, behavioural or structural remedies, or even prohibit a merger. Instead, they can significantly affect the Authority’s decisions, avoiding the harshest sanctions, by offering the Serbian Competition Authority solutions to eliminate its competition concerns. Therefore, the outcome of the proceedings is largely in the hands of the companies.

Exchange of Sensitive Information – Romanian Perspective

Cătălin Suliman | Silviu Vasile

Undertakings exchanging sensitive information may be faced with significant fines imposed by national competition authorities scrutinising such practices.

Compliance with competition legislation has become a priority for all businesses in Romania. This is much more important nowadays given the fact that the Romanian Competition Council (**"RCC"**) is very active. In 2015 alone, the RCC finalised **21 investigations** and **launched another 13** in various sectors, ranging from energy to retail. In its newly launched investigations, the RCC is looking at the potential exchange of sensitive information as one of its priorities, viewing the exchanged data in a larger context.

Exchange of sensitive information

The mere exchange of sensitive information may lead to restrictions in terms of competition legislation. As an example, where information with respect to future prices was exchanged, the RCC needs to prove that such exchange took place, without the need to further prove any (anticompetitive) effects on the competition environment.

Although it is clear that such practices will continue to be sanctioned in the future, the simple exchange of sensitive information, even without aiming to set prices or other hard-core infringements, might lead to competition legislation infringements. This is due to the fact that the exchange of sensitive information may have **anti-competitive effects** without leading to a hard-core infringement. In particular, such effects would be related to the facilitation of coordination between the market participants or by foreclosing the market for other players.

This was also the opinion of the European Commission (and General Court) which, in one of its cases (see *UK Agricultural Tractor Registration Exchange, OJ 1992 L68/19*), considered that, although transparency in the market may lead to an intensification of competition, *in a concentrated market, regular and frequent sharing by the main suppliers of strategic information has the adverse effect of revealing to the market positions and strategies of the individual undertakings to their competitors.* This trend also seems to be followed by national competition authorities (see *Hotel le Bristol v Minister of the Economy, Finance and Industry*).

On a local level, the RCC seems to take a more aggressive approach when dealing with potential exchanges of information, thoroughly analysing the context of the exchange, the type of information exchanged and its nature (historic, aggregated etc).

Therefore, in order to minimise any risks of fines for the exchange of sensitive information, one should make sure that the information disseminated outside the company does not concern: future prices, quantities or output, the undertaking's future market conduct, and strategic information (eg future promotions, relationships with suppliers etc).

The risk of such information being considered sensitive increases if such information is not public, and if it is disseminated in a non-aggregated fashion. Nonetheless the potential harmful effect of exchanging this kind of information varies depending on the industry in question.

Trade associations

An important aspect regarding the exchange of sensitive information concerns the occasions on which it takes place. The RCC focused on **trade associations** and, apparently, this trend continues. In meetings of trade associations, undertakings should analyse whether the information requested by the association is made public (beforehand), to what extent (as is, in an aggregated form, etc), who receives and compiles the data, and whether there is a real need for the exchange (eg, the assessment of data is instrumental for the association / market activity).

In addition, a clear methodology is mandatory for the disclosure of information and its communication to other parties. This methodology should include rules of disclosure, procedures to safeguard the confidentiality of the raw data, rules for publishing and other key elements that would mitigate any risk in case of control by the RCC.

Given the above, due care is recommended when participating in such meetings where incidental exchanges of information may occur. In some recent cases, the RCC considered the contacts in the association that led to disclosure of future conduct in the market and led to collusion. Thus, considering that these meetings might be attended by company representatives, who are not necessarily aware of the applicable competition legislation, each undertaking needs rules for participation in meetings of associations.

In order to reduce the risk of a potential exchange of sensitive information by commercial representatives during meetings within trade associations, a prior agenda should be set, and any deviation which may have a potential anticompetitive impact, should result in the representative expressly dissociating from the deviation, and he/she should leave the meeting.

Another instance that may lead to an exchange of sensitive information and is not necessarily taken into consideration relates to the ***hub-and-spoke.*** In terms of this practice, two (or more) competitors might exchange sensitive information through a common customer or supplier who gathers such information from both parties and then retransmits it, thus acting as an indirect means for exchange. Although there are few practical examples in this respect at EU level, some national competition authorities have taken this into consideration. Even though the RCC has not yet finalised any *hub-and-spoke* cases, it closely analyses constant exchanges of information using a joint channel.

In conclusion, since the RCC has embarked on investigating several cases where the exchange of sensitive information is core, it is advisable for undertakings operating in Romania to take additional security measures in order to avoid exposure to such practices. This could be covered by implementing specific safeguard measures and providing specific training to individuals with representative functions.

> The simple exchange of sensitive information, even without aiming to set prices or other hard-core infringements, might lead to competition legislation infringements.

Tattoos and Copyright

Guido Kucsko

Looking at tattoos from an IP-lawyer's perspective leads to some interesting questions.

Is a tattoo a work of art?

Tattoos were very simple in the past, showing only well-known graphical symbols such as anchors, hearts or skulls. So the question whether they could be considered to be "art" was not really considered. Now we see very creative and individual works inked on people's bodies. No doubt, the vast majority of such works could be regarded as pieces of visual art. This year's roadmap shows some examples of such extraordinary works.

Is a tattoo a copyrightable work?
Why not? Copyright law only asks whether a work is sufficiently individual and to which category (literature, film, applied art, fine art) it applies. The drawing that a tattoo artist makes on paper or on his computer in order to show a draft of the tattoo to his client is simply a traditional drawing. And copyright does not differentiate between the material on which a graphic or painting is made (wood, paper, glass).

Who owns the copyright in a tattoo?
As with any other works of art, the author is the copyright owner. But he may transfer the rights to someone else by way of a contract. Depending on the national legal copyright framework, this could be a full transfer of rights or (only) an exclusive or non-exclusive, comprehensive or limited licence. Therefore, a tattoo artist inking the tattoo may have transferred or granted all or some of his rights in the creation to the owner of the tattoo studio he is working in.

What rights does the customer have in the tattoo inked on his skin?
If a customer contributes to the creative work, he may become a co-author. Otherwise his position is no different to that of any other art buyer, and he has no genuine copyright in "his" or "her" tattoo. If he wants to use the work in a way that infringes the copyright of the artist (or the right holder), he needs a licence. That is a consequence customers might not be aware of. But could it have a consequence in practical life?

Take the example of a very successful and widely known athlete with a tattoo – let's say on his neck up to his ears. A TV station wants to have an interview showing this tattoo, a publisher wants to distribute collectible stickers and cards with a portrait of this celebrity on them, a computer game is made with that character identifiable by his famous tattoo. All of these actions might be in conflict with the artist's copyright.

Is there a way out for the customer?
He can try to argue that his contract with the tattoo artist or the tattoo studio includes an implied licence (ie an unwritten license that covers the intended use). But this is a question of interpretation of the legal relationship between those parties in the specific case, and the scope of such a licence is usually unclear (eg would it also cover commercial exploitation of the tattoo? Is that licence transferable? etc).

What happens if the tattoo is plagiarised?
If the tattoo artist copies the protected work of someone else, he is the plagiariser infringing the author's rights, and is thus subject to the claims of the author. But this might also have consequences for the customer, because the (implied) licence given by the tattoo artist would not be valid, as nobody can transfer more rights than he has. An extreme consequence would be that the right holder could try to enforce his right of destruction of the counterfeit copy. But in my opinion, it is questionable whether such a claim would be successful, because serious surgery would be required to remove the illegal copy from the body of the customer, which is in clear conflict with the predominant interests of the customer and with human rights.

Is there any recommendation for tattoo artists and their customers?
A lawyer's recommendation is simple: Conclude a detailed contract, including a proper licence agreement wide enough to cover all potential uses for a lifelong period, and make sure that the artist as the licensor has all rights in the tattoo he created.

> As a rule tattoos are copyright protected works of art with all the severe legal consequences attached to them.

CJEU on Cost Reimbursement → More Money for Right Holders?

Adolf Zemann

In a recent judgement, the CJEU shed light on conditions a national cost reimbursement regime has to fulfill under the Enforcement Directive (2004/48/EC).

The issue

IP infringement proceedings often require a thorough preparation of the facts of a case, and often involve complex legal issues on which there is little or no CJEU or national court guidance. As a consequence, preparing and conducting IP-infringement proceedings can be expensive. Whether and to which extent costs of legal (and technical) advisors have to be reimbursed by the losing party to the winning party can be an important factor in deciding whether infringements of IP-rights are taken to court.

The case

In the course of patent proceedings, a Belgian court ordered the losing party to reimburse costs of the first instance proceedings of EUR 11,000, the maximum amount provided for in regard to lawyers' fees under Belgian law for these kinds of proceedings. The successful party, however, requested, *inter alia,* reimbursement of lawyers' and patent agent fees (the latter are only reimbursed under Belgian law in cases of fault in filing or continuance of the proceedings) amounting to ca EUR 230,000.

As Art 14 of the Enforcement Directive harmonises the conditions for cost reimbursement in IP-cases, questions were referred to the CJEU asking, in essence, whether the Belgian provisions are in line with the Enforcement Directive.

The decision of the CJEU (28 July 2016, C-57/15)

Fees of lawyers and technical advisors covered by Art 14

The CJEU first confirmed that the concept of "legal costs" to be reimbursed under Art 14 includes the lawyer's fees, which generally constitute a substantial part of the costs incurred. Moreover, the broad wording of Art 14 also includes – in principle – the costs for the services of a technical advisor. Accordingly, national laws providing that costs for a technical advisor are only reimbursed in the event of fault on the part of the unsuccessful party are in conflict with Art 14. Such costs therefore have to be reimbursed, if they are directly and closely linked to a judicial action seeking to enforce intellectual property rights.

Guidelines for national cost reimbursement regimes

The CJEU held that a system providing for a flat-rate of reimbursement of a lawyer's fees could, in principle, be in conformity with the Enforcement Directive. However, it has to ensure the reasonableness of the costs to be reimbursed, taking into account factors such as the subject matter of the proceedings, the sum involved, or the work to be carried out to represent the client concerned.

The requirement that cost reimbursement has to be **"reasonable"** does not justify legislation imposing a flat-rate significantly below the average rate actually charged for the services of a lawyer in that Member State.

Moreover, cost reimbursement must also be **"proportionate"**. While the requirement of proportionality does not imply that the unsuccessful party has to reimburse the entirety of the costs incurred by the other party, it does mean that the successful party should at least have the right to reimbursement of a significant and appropriate part of the reasonable costs actually incurred by that party.

Accordingly, national legislation providing for an absolute limit in respect of costs attached to the assistance of a lawyer must ensure that such limit reflects the reality of the rates charged for the services of a lawyer in the field of intellectual property. Art 14 excludes from its scope situations in which **"equity"** does not allow the legal costs to be borne by the unsuccessful party.

However, such exclusion only serves as a basis for national provisions allowing courts to disregard the general scheme on cost reimbursement by way of exception in specific cases in which the application of the general scheme would lead to a result considered unfair. It does not justify rules providing for a general unconditional absolute limit of costs to be reimbursed.

The impact

National cost reimbursement schemes vary significantly within the EU. However, many of them contain some kind of limitation of costs to be reimbursed to the successful party. The CJEU clarified that such limitations may not be in line with the Enforcement Directive's requirements, unless they ensure that the successful party receives "reasonable" and "proportionate" costs from the unsuccessful party.

National courts will therefore have to construe their national cost reimbursement scheme in line with the decision of the CJEU and may even have to disregard national rules in conflict with this decision.

> National cost reimbursement rules for IP-cases have to ensure that the successful party can recover reasonable and proportionate costs from the unsuccessful party.

Trademarks – The New Concept of Intervening Rights

Christian Schumacher | Dominik Hofmarcher

With the EU trademark law reform, the possibilities to defend a later trademark against an earlier trademark have been significantly expanded due to the establishment of so-called intervening rights.

Principle of priority

According to the principle of priority, in the case of a trademark conflict the earlier right will succeed. Normally, the proprietor of a trademark cannot defend himself by pointing to the fact that he is the owner of a later trademark (CJEU C-561/11, Fédération Cynologique Internationale; CJEU C-491/14, Rosa dels Vents Assessoria).

While there have already been exceptions to this principle (eg toleration of the use of a later trademark for five successive years), the EU legislator has now established a general concept of intervening rights.

Legal framework

The new provisions on intervening rights are construed as defence in infringement proceedings (Art 18 of the Trademark Directive; Art 13a of the European Union Trademark Regulation) and as "grandfathering" or "exclusion" in revocation/invalidity proceedings (Art 8, 9, 46 para 2 of the Trademark Directive; Art 53 ff of the European Union Trademark Regulation).

The provisions in the European Union Trademark Regulation are already in force. The Member States must transpose the new Trademark Directive into national law by 14 January 2019.

New legal situation

According to the new legal provisions, the situation at the filing or priority date of the later trademark also has to be taken into account. The earlier right will succeed only if the proprietor of the earlier trademark would (also) have been successful in enforcing its rights at the filing or priority date of the later trademark.

Here are the most important principles:

- The earlier trademark is not an obstacle to the registration and use of a later trademark, if the earlier trademark could have been declared invalid due to non-use at the filing or priority date of the later trademark.
- The earlier trademark, which lacks inherent distinctiveness, is descriptive or a generic term, will not succeed if it had not yet acquired a distinctive character at the filing or priority date of the later trademark.

- The earlier trademark will not succeed because of the likelihood of confusion, if it had not yet become sufficiently distinctive to support a finding of likelihood of confusion at the filing or priority date of the later trademark.
- The earlier trademark with reputation will not succeed based on unfair exploitation of, or detriment to its distinctive character or reputation, if it had not yet acquired reputation at the filing or priority date of the later trademark.

On the other hand, the proprietor of a later trademark will not be able to prevent registration and use of an earlier trademark based on the later trademark (Art 18 para 3 of the Trademark Directive; Art 13a para 3 of the European Union Trademark Regulation). Thus, intervening rights result in a coexistence of conflicting trademarks.

Consequences

Consequences for trademark owners
As invoking an intervening right is now a valid defence against actions taken by the earlier trademark owner, this shall be a motivation to monitor applications of new trademarks and to initiate proceedings, in particular opposition proceedings, against conflicting trademarks at an early stage.

Since genuine use, acquired distinctiveness or reputation may need to be evidenced for historical points in time, it is more important than ever to fully document the use of the trademark and to establish a respective archive.

Consequences for the application of (later) trademarks
Intervening rights merely provide "grandfathering" for later trademarks in the single case and allow use of such a trademark. However, future trademark applications cannot be justified based on intervening rights.

Bearing this in mind, it therefore is not a suitable strategy to forego earlier-rights-searches and attacks against earlier conflicting trademarks (which are subject to cancellation) and instead rely on intervening rights.

Consequences for owners of non-registered trademarks and other signs
Other later signs that are not registered as trademarks are not capable of constituting intervening rights according to the current provisions. This might be a motivation to register (all elements of) a sign as a trademark as soon as possible.

> The newly established intervening rights will have important consequences for trademark owners, trademark applicants and owners of other signs, as the relevant point of time in infringement and revocation/cancellation proceedings will now be the filing or priority date of the later trademark rather than the date of action.

Hashtagging a #trademark or Trademarking a #hashtag?

Denisa Assefova

What happens if you use a famous brand in a hashtag on social media platforms? Can you register a popular #hashtag as a trademark? The answer is: **#itdepends**

Originating from Twitter, hashtags have gradually become a ubiquitous phenomenon amongst both consumers and companies when communicating on social media platforms such as Facebook, Twitter, Snapchat, Instagram, etc. Businesses have discovered that hashtags are a powerful marketing tool that allows consumers to interact with the companies that make their favourite brands or products and directly engage in online marketing campaigns. The companies then encourage users to talk about their brands and create catchy slogans while turning them into popular #hashtags.

With the growing influence of hashtags, large companies such as Pepsi have started to trademark their popular hashtag slogans (eg Pepsi's EU trademark **"#sayitwithpepsi"** registration no. 014653968, or MHCS's **"#moetmoment"** international registration no. 1271942) to protect themselves against competitors trying to freeride on their popularity by using the same hashtags and thus attracting consumers' attention.

Hashtag trademarking in the US and Europe

Hashtags are even more popular in the United States. The US Patent and Trademark Office ("USPTO") has already received more than a thousand applications for hashtag trademarks. The boom has even inspired the USPTO to update its Trademark Manual by adding specific guidelines. Section 1202.18 of the Manual is explicitly dedicated to hashtag trademarks.

Despite the growing number of hashtag trademarks, uncertainty remains regarding the registrability of hashtags as trademarks. Some say that as hashtags are merely metadata – a hyperlink leading to other online content – their use should not be restricted or monopolised.

There is a clear similarity here to the keywords used in search engines to generate links to designated website content, such as Google's AdWords. The use of famous or well-known trademarks as search keywords by competitors was examined by the Court of Justice of the European Union on multiple occasions[1] before at least some of the related legal questions were answered.

The current trend of registering hashtags (often marketing slogans) as trademarks continues and national trademark offices in Europe (unlike the USPTO) do not seem to treat hashtag trademarks differently from other trademarks, the main criteria being the capability of the mark at issue (exclusive of the # sign) to function as a source indicator. The # sign is being implicitly disclaimed as not being able (alone) to fulfil this function.

Trademark infringement cases

Nevertheless, legal uncertainty lingers over the question of whether the use of a registered (famous) trademark in or as a hashtag (eg#Nike or #coke) when creating online content can be seen as illegal, ie as trademark infringement (or possibly unfair competition). Indeed, the first trademark infringement cases based on the (unlawful) use of branded names in hashtags are starting to emerge, perhaps not surprisingly, in the United States. In Fraternity Collection, LLC v. Fargnoli, the district court concluded that "hashtagging a competitor's name via social media could deceive customers for purposes of a false advertising claim"[2]. In other cases[3], however, the US courts have adopted a different approach, concluding that hashtags are incapable of functioning as an indication of source and that even a distinctive or renowned trademark used in a hashtag does not, in the eyes of the consumer, establish a trademark use. This approach is interesting in view of the fact that the USPTO explicitly acknowledges hashtag trademarks and allows their registration, subject to certain conditions.

Risks

It will be interesting to see what the Court of Justice of the European Union will have to say about hashtagging well-known brands, especially in cases where there is a clear intention to free-ride or profit economically from the hashtag. A strong argument in support of brand owners is the fact that the viral use of an originally distinctive mark through hashtags not originating from the brand owner can lead to the mark becoming generic and thus losing the basic trademark function – identification of source of origin. These are the potentially disastrous effects of the unrestrained use of hashtags referring to a distinctive brand.

Even if in a particular case the use of a hashtag that includes a famous trademark may not be seen as a use of trademark in the course of trade, it could still be perceived as unlawful under unfair competition laws.

Conclusion

The legal implications arising in connection with the use of hashtags outlined above are a typical example of technology being one or more steps ahead of the law. Some questions are waiting for the courts to answer them, but three things are clear:

(i) Companies should seek trademark protection for popular slogans related to their business and becoming viral through hashtags.
(ii) Companies should monitor competition and trending hashtags for possible hashtag hijacking (using brand names in hashtags for unfair purposes).
(iii) Companies should monitor the use of their brands in hashtags for the purpose of avoiding dilution and loss of distinctiveness.

… in other words: **#dontoverhashtag (!)**

> Hashtagging a competitor's brand via social media could deceive customers and be detrimental to the brand owner. Moreover, extensive viral use of one's brand in hashtags may lead to dilution and loss of distinctiveness of the brand. These factors encourage companies to register their hashtag trademarks, although uncertainty remains regarding the registrability of hashtags as trademarks.

[1] E.g. joined cases C-236/08-238/08, Google France and Google Inc. vs Louis Vuitton Malletier SA
[2] Decision of the District Court for the Southern District of Mississippi, no. 3:13-CV-664-CWR-FKB, 2015 WL 1486375 (S.D. Miss. Mar. 31, 2015, at *1-2)
[3] E.g. Decision of the District Court of California in Eksouzian v. Albanese, no. CV 13-00728-PSG-MAN, 2015, WL 4720478 (C.D. Cal. Aug, 7, 2015)

Relativity of Absolute Grounds for Trademark Refusal

Sorin-Eduard Pavel

Under Romanian trademark law, absolute grounds for trademark refusal are not as absolute as they should be.

Absolute grounds of trademark refusal: legal framework

Romanian Trademark Law[1] (**"RTL"**) provides two categories of grounds of refusal that can be claimed in refusing a trademark application or invalidating a registered trademark: relative grounds (referring to conflicts between trademark and prior rights of third parties) and absolute grounds of refusal.

Absolute grounds of refusal (provided under art. 5 (1) (a)-(n) RTL) inter alia prohibit the registration of trademarks that (i) are devoid of distinctive character; (ii) may serve in trade to designate kind, quality, purpose, value, geographical origin or other characteristics of goods/services; (iii) have been commonly used in the current language or established practices of trade; (iv) are deceptive in respect of geographical origin, quality or nature of goods and services; (v) contain a geographical indication that misleads the public as to the real origin of the goods; (vi) are contrary to public order or morality; (vii) contain signs protected under art. 6 ter of the Paris Convention for the Protection of Intellectual Property (the **"Paris Convention"**) without the consent of competent authorities that hold such signs; and (viii) contain signs, other than those protected under art. 6 ter of the Paris Convention, without the permission of authorities holding such signs.

Statute of limitations on trademark invalidation proceedings

Both absolute and relative grounds of refusal could be invoked under examination proceedings to refuse a trademark application, and to invalidate a trademark after it is registered.

Invalidation proceedings (based on absolute and relative grounds) should be brought before the Bucharest Court (Tribunalul București) within the statute of limitations period (**"SLP"**) of five years from the date of trademark registration (art. 47 (1) (a) (b) (3) RTL).

Legal issues of the statute of limitations for invalidation proceedings due to absolute grounds of refusal

The SLP blocks trademark invalidation proceedings, rendering a challenged trademark unchallenged. Blocking invalidation proceedings that are based on relative grounds of refusal is justified – the SLP would only be a consequence of the inactivity of the right-holder who did not exercise his right to contest a later conflicting trademark owned by a third party. But blocking invalidation proceedings that are based on absolute grounds of refusal due to the expiry of the SLP is in conflict with other laws.

Let us assume that trademarks subject to absolute grounds of refusal stay unchallenged due to the expiry of the SLP. What would the consequences be? Such trademarks lacking distinctive character, or designating characteristics of goods/services, or customary in the trade/current language, should be freely available for use by anyone. Making such registrations incontestable after five years would create a monopoly by which the trademark owner may require third parties to refrain from the use of respective signs. This situation would definitely be in conflict with the reason behind absolute grounds of refusal.

Registration of a trademark consisting of a geographical indication (**"GI"**) for goods not originating from the designated territory is contrary to the EU Regulations on protection of respective geographical indications (the **"GIs Regulations"**) (EU Regulations 1151/2012, 110/2008, 1308/2013, 479/2008), bearing in mind that under the GIs Regulations, member states are compelled to reject such trademarks.

The Constitution of Romania (**"ROC"**) obliges the Romanian state to comply with international treaties and conventions (art. 11 (1) ROC) and forbids manifestations contrary to morality (art. 30 (7) ROC). In addition, art. 6 *quinquies* B (iii) of the Paris Convention, to which Romania is party, requires contracting parties to refuse trademarks that are contrary to morality and public order. Taking these aspects into account, registration of trademarks that are against morality and/or public order, disregards constitutional rules under art. 11 (1) ROC. Moreover, registration of a trademark contrary to morality may be deemed a manifestation forbidden by art. 30 (7) ROC.

Registration of a trademark consisting of a sign protected under art. 6 ter of the Paris Convention, without the consent of a competent authority, is contrary to the Paris Convention, leading to non-compliance between RTL and constitutional rules under art. 11 (1) ROC.

Conclusion

The statute of limitations for the invalidation of a trademark registered by disregarding absolute grounds of refusal is in conflict with constitutional, EU and international law.

The solution is to make absolute grounds of trademark refusal really absolute without a statute of limitations period.

> Absolute grounds for trademark refusal should remain really absolute regardless of the time factor.

[1] Law 84/1998 on trademarks and geographical indications republished

Machine Learning: Whom to Credit, Whom to Blame?

Günther Leissler | Wolfgang Tichy | Michael Woller

Rapid technological progress, artificial intelligence, machine learning – all those advancements require a new concept of legal thinking.

Data protection in a connected world

Data protection will become more and more important, thanks in no small part to ever more rapid technological progress. Self-driving cars, the internet of things, automated medical diagnosis – all these things invariably require data processing. Algorithm-based data analysis will play a key role in the future. This will raise certain questions about data protection, such as how to ensure proper data anonymisation, pseudonymisation or aggregation in order to comply with applicable data protection laws.

In addition, joint data processing and all the questions related to it will become increasingly important. As our world becomes more and more connected, huge amounts of data will need to be exchanged and (inter)transferred, making it more and more difficult to determine the responsibilities and roles of the data controller, in particular when no proper contracts are in place.

The most recent legal developments we have seen in Europe will boost the relevance of data protection, as will the General Data Protection Regulation, as it becomes effective by 2018. It will introduce new concepts to the existing regulatory framework (such as the Privacy Impact Assessment). On an overall note the General Data Protection Regulation will push companies towards a higher degree of responsibility. Crucially, the General Data Protection Regulation will apply directly and on a Union level in the Member States. This means that Austrian companies will be measured against a Union-wide benchmark so that Austrian companies will have to handle a benchmark as it is created by globally acting corporate groups and their (well-established) data privacy standards. This becomes no less challenging when considering the significant increase in fines that will come with the General Data Protection Regulation, foreseen at up to EUR 20 m in the most severe data protection infringement cases.

Rights to work products of “self-learning” systems

Only natural and legal persons can be owners of rights and duties, but not machines. Hence one always has to look at the person behind the system when attributing rights in creative endeavours or inventions. If certain work (including software code) created by an autonomously learning system would generally qualify for copyright or patent protection, under Austrian law it would have to initially be attributed to a natural person (ie a human being). Authors in the sense of the Austrian Copyright Act or inventors in the sense of the Austrian Patent Act must always be natural persons. Of course, such authors or inventors can grant third parties, which includes legal persons, rights to the to the protected work results.

But what is the author’s or inventor’s position when a self-learning system autonomously produces work? One could take the position that a work created by a self-learning system is only a consequence of the creative or inventive efforts of the person who created the logic behind the self-learning system, and that therefore this person is also to be credited for the end result. On the other hand, it can be argued that rights must be attributed to the person who provided the impetus for creating the concrete work result – eg by entering certain data. Perhaps both persons are co-authors or joint-inventors. Or maybe nobody can assume rights to such work results, if their contribution to the end result was so small that a “creative” or “inventive” effort can hardly be seen, as the system developed the work result almost fully autonomously.

Whom to blame for damages?

The question of liability is complex when it comes to autonomous systems or systems with artificial intelligence. They have been discussed for quite some time now in the context of self-driving cars, and not only in terms of accidents. A central principle of the right to compensation, namely the fault of the party causing damage, is already questionable in the case of a driver whose self-driving car has caused an accident. In this case, the issue might be whether the driver could have intervened to prevent the accident. The fault of the manufacturer (for example in the person of the software programmer) will generally be technically difficult and expensive to verify.

However, since the injured party usually does not have an agreement with the manufacturer, direct contractual liability

will not be applicable. This leaves liability according to product liability acts (questionable whether also for software), liability based on contract with protective effects in favour of third parties, or tort liability. What is clear, however, is that only persons can by liable, not machines.

For damages caused by self-driving cars, in contrast to other systems with artificial intelligence, the so-called "car owner's liability" *(Halterhaftung)* might be a valid basis for a claim. This special liability is based on the mere fact that operating a car poses a risk to the general public and is not based on the principle of culpability.

How this will ultimately affect the manufacturers, especially concerning claims for recourse by the car owner's insurance company, cannot yet be seriously assessed.

> "Technological developments do not only lead to connected data flows; they also require new concepts of connected legal thinking. An interesting and demanding challenge for any legal professional.

New Restrictions in the Real Estate Market

Agata Demuth | Konrad Bisiorek

On 30 April 2016, new restrictions in the trade in real properties in Poland took effect.

Purpose of new regulations

The new regulations have been implemented to limit the purchase of agricultural properties by entities other than individual farmers. However, properties recognised as being agricultural are often located within towns, or constitute a legal whole with real properties on which industrial or commercial buildings are erected. In effect, new restrictions, which were to apply to real properties intended for agricultural production, apply also to other real properties, which impede and sometimes even prevent their purchase. Trade in shares of companies owning such properties, has also been impeded. As a result, transactions by private entities may result in the State Treasury taking over agricultural properties or companies owning them.

New limitations

Ban on purchasing agricultural properties

In general, agricultural properties with an area of at least 0.3 hectares can be purchased by individual farmers only. They can be purchased by other entities, including legal persons, only if permitted by the Agricultural Property Agency (**"Agency"**).

As a result, an investor intending to acquire a commercial property constituting a legal whole with an agricultural property, must obtain the Agency's permit. Contribution of such property to a subsidiary by a parent company also requires such permit.

The Agency's prior permit must be obtained even for acquisition of an agricultural property by way of enforcement, or as a result of a court judgement. As a result, a creditor secured by a mortgage over an agricultural property, may not be able to recover its funds by way of enforcement, or take over the encumbered property.

What is important is that a permit may be sought only by the agricultural property's transferor or an individual intending to start an agricultural activity and acquire the property. But such application may not be filed by for instance a bank in favour of which the mortgage was established.

Restrictions concerning shareholders' rights

If a company owns an agricultural property with an area of at least 0.3 hectares, the Agency has the pre-emptive right with respect to such company's shares, if they are sold. This right is available even if the company is not involved in agricultural activities at all. As a result, the Agency may acquire shares in a company that for example manufactures cars or manages a hospital, if such company owns an agricultural property.

If shares are sold, first of all, a conditional sale agreement must be executed and the Agency must be notified about that. The Agency may exercise its pre-emptive right and purchase shares within one month of being notified. During that time the Agency may access books and documents of the company being sold.

If however a partnership's partner is changed, the Agency must be notified thereof and may acquire the agricultural property owned by the partnership.

Obligations of the agricultural property purchaser

A new owner may not transfer the agricultural property or give it to a third party for use (eg lease) for 10 years. In specific situations the court may permit such actions. Furthermore, the purchaser is obliged to run a farm on that property for 10 years.

Sanctions

Purchase of the agricultural property with an area of at least 0.3 hectares is invalid without the Agency's permit. So is acquisition of shares and change of a partnership's partner without respecting the Agency's rights. This sanction is particularly severe for transactions concerning shares of companies which are not involved in agricultural activities at all, and are often not even aware that they own properties recognised as being agricultural.

Practical effects of new regulations

Asset deals

At present, a commercial investor may not acquire a real property (comprising an agricultural property with an area of at least 0.3 hectares) without the Agency's permit. Only adoption of a master plan in which such property is intended for non-agricultural purposes, results in the Agency's permit not being required. However, in Poland there are relatively few such plans, and the adoption procedure is costly and time consuming. The new regulations have had the effect of nearly halting trading in agricultural properties altogether.

Share deals
It is much easier to acquire a company owning an agricultural property as no Agency's permit is required in this instance. However, investors must remember that in the case of a company, the Agency has the right to acquire shares transferred, and might become a shareholder in the company, and in the case of a partnership, it has the right to acquire the real property owned thereby.

Thus, before each transaction, it must be verified whether the company/partnership owns a real property that can be recognised as being agricultural, and whether the Agency's rights must be included in the transaction planning; the related risks must also be considered.

Internal restructuring
Threats related to new restrictions are especially important for internal restructuring. Apart from the risk of the restructuring being invalid, there is a considerable risk that the Agency will acquire some or all rights of shareholders of the restructured company. As a result, internal restructuring, and even a simple share capital increase may mean the need to work with an external shareholder, or may even result in the loss of the company.

> New regulations make it very difficult for investors to acquire agricultural properties in Poland.

EU-backed Infrastructure Projects Finally in the Pipeline?

Jana Cvirn Adamčić | Ksenija Šourek

A recent report by the European Commission says that Croatia has the worst index of absorption of EU funds amongst all EU states. Can and will this score change?

Room for improvement

Since 1 July 2013, when Croatia joined the European Union, the country has had the opportunity to finance certain projects through EU funds or to use EU-backed financing. According to available data (April 2016), Croatia has so far used about 65 % of funds available for 2007–2013, although this number may be slightly higher if ongoing projects are completed in 2016. According to the European Commission, this is a bad score, and needs to be improved. Certain developments, primarily in Croatia's public sector, signal that improvement may be coming. The available EU funds (eg approx EUR 6.9bln from the EU Cohesion Fund for 2014–2020) are surely there and should be used.

Signs of improvement

The biggest current infrastructure project in Croatia – the building of the Pelješki bridge connecting southern Croatia with Dubrovnik as well as all access roads, with an estimated cost of EUR 525m – is co-financed from EU funds (approx EUR 330m).

There are also a number of ongoing road and railway infrastructure and environmental projects financed from the EU Cohesion Fund.

An investment boost was provided by the European Commission Investment Plan for Europe (the *Juncker Plan* or the *EU Infrastructure Investment Plan*) from December 2014, which also had an impact on Croatia as an EU Member State. The Juncker Plan is expected to generate some EUR 20m of credit lines for Croatian entrepreneurs.

In Croatia, the Juncker Plan is backed by the Croatian Bank for Reconstruction and Development *(Hrvatska Banka za Obnovu i Razvoj)*. Priority is given to ecological projects, tourism projects, use of EU funds, innovations and new technologies, and development of infrastructure.

The European Investment Bank (**"EIB"**) is often referred to as the biggest financing provider in Croatia. In 2014 and 2015, EIB provided approximately EUR 1.6bln to finance projects in Croatia. The bank is currently financing almost all the big infrastructure projects in Croatia, such as the construction of the LNG terminal (a liquefied natural gas terminal with access pipelines), the expansion of Dubrovnik Airport, the new terminal at Zagreb Airport, the Svilaj Bridge, and the enlargement of the railway between Dugo Selo and Križevci.

Forecast

Croatian politicians are stressing the need for better use of EU funds. The government is saying that they are doing their best to speed up the completion of ongoing EU-backed public projects and the preparation of potential public projects to be financed from EU funds. The private sector can use the available funds and financing. All this sounds good, but in practice it is not that easy.

Big infrastructure projects such as roads and railways tend to become complicated when you start dealing with Croatia's "usual suspects" list of problems, such as unresolved ownership issues (the remains of state-owned ownership are still present, part of the Land Register is outdated, etc) and murky zoning situations (many zoning plans have yet to be harmonised, administrative procedures for passing amendments and new plans usually take too long, etc). Thus, in order for a potentially good project not to become a bad one, ie a non-existing project, effort and coordination are required by all parties, especially at the state, regional and local levels. Since the success of these projects is in everyone's interest, it is reasonable to expect that the necessary coordination, cooperation and support will be provided. This is required for projects in both the public and private sectors. The private sector is lagging overall, however, and needs to start recognising the benefits and learning about the opportunities and funds at its disposal. Although few in number, there have been several successful private sector projects that can show the way forward.

> Analysts believe that the much desired growth of Croatia's economy can be achieved only through combined investment in the public and private sectors. EU funds and EU-backed financing exist specifically for this purpose. Both the public and the private sector need to change their mind-sets and take advantage of the opportunities at their disposal.

Czech Legislator Plans Introduction of Law Regulating Real Estate Brokers

Miroslav Dudek | Christoph Dürr

A new law introducing a legal framework to the currently unregulated profession of real estate brokers is likely to be enacted by the end of 2017.

Introduction

Unlike in most European countries, in the Czech Republic the activities of real estate brokers are not subject to any special legislation. This has led to persistent problems which Czech lawmakers plan on tackling by introducing a new Act on the Provision of Services by Real Estate Brokers (the **"Broker Act"**). Although the Broker Act has not

yet been adopted, the Czech government has put forth a legislative proposal representing a material basis for the future Broker Act (the **"Proposal"**). While the Proposal does not yet contain specific normative rules, it does address the most serious deficiencies in the status quo and provides an outline of the content of the Broker Act. In addition to introducing the Broker Act, the Proposal also contemplates corresponding amendments to the Trade Licensing Act, the most significant of which are summarised below.

Qualification requirements for provision of real estate brokerage services
Although profound knowledge of the laws regarding property ownership and its transfer are essential for the provision of adequate real estate brokerage services, currently anybody fulfiling the precondition of legal age (18 years and older), and who does not have a criminal record, may apply for a trade licence in order to provide real estate brokerage services to others. Under the Proposal, the conditions for granting a trade licence will be divided into two groups, which depend on the scope of brokerage services provided. If the applicant merely wishes to provide (i) assistance during the purchase of real estate for the purpose of its further sale, (ii) assistance during the sale of real estate, or (iii) administration/maintenance of real estate, then a licence shall be granted under the current requirements (being of legal age and having no criminal record). If the applicant wishes to provide further brokerage services, he or she must also demonstrate relevant professional competences, eg by passing a qualifying test or by providing evidence that he or she already has long-term experience in the field.

Compulsory liability insurance
Unlike attorneys, insurance brokers and tax advisors, real estate brokers are not required to conclude mandatory liability insurance. The Proposal requires real estate brokers to conclude an insurance policy with liability coverage of at least CZK 3,000,000 for every insured event. The insurance must be valid for the duration of the real estate brokerage activities.

Due diligence obligations of real estate brokers
The Proposal explicitly sets forth the real estate broker's duties of professional care and protection of client's interests. Real estate brokers shall be obliged to inform clients about any circumstances that might have an impact on their decision-making. In addition, real estate brokers must verify the information provided by clients and other information pertinent to the sold real estate (eg seller's ownership title). These measures are designed to ensure the smooth course of the transaction. In the event of a breach, the real estate broker would face potential liability.

Monetary deposit
The Proposal introduces new parameters for the handling by real estate brokers of clients' money, in particular with respect to the possible seizure of this money in execution or insolvency proceedings. Real estate brokers will therefore be obliged to keep their clients' money (eg, purchase price, reservation fee) in a separate bank account. The money in these accounts will be exempt from any execution and/or insolvency proceedings. If the money exceeds a certain amount (the Proposal gives CZK 270,000 as an example), the money must be paid into an escrow account kept by a third party, such as an attorney, notary or bank. This would essentially make it impossible for the real estate broker to embezzle these funds.

Conclusion
The new legislation is expected to come into effect during the second half of 2017. Its enactment will certainly be welcome, as it will not only guarantee better qualified real estate brokers, but will also protect clients' money in cases where the real estate broker is insolvent or attempts to embezzle funds. Mandatory insurance and due diligence obligations on the part of real estate brokers will also serve to ensure that clients' interests and potential liability claims are covered.

> Profession of real estate brokers soon to be regulated by special law.

Consolidated Procedure for Issuing Permits in Serbia – On Paper and in Practice

Dijana Grujic | Ivana Panić

Every new law has its pros and cons. This article points out the main advantages of and obstacles to introducing a new system for obtaining all documents in relation to construction and the subsequent use of the constructed facility. What has the new law introduced to the construction industry?

Introduction

The amendments to the Planning and Construction Act *(Zakon o planiranju i izgradnji)* (**"PCA"**) introduced numerous innovations aiming to improve the procedure for obtaining all permits and/or documents required for the commencement and completion of construction. In theory, this should have simplified the procedure. Fortunately, in most cases it actually did.

Expectation vs. reality

Novelties
A key feature of these changes was the introduction of registers of consolidated procedures and a central record of consolidated procedures operated by the Ministry of Construction, Traffic and Infrastructure and local authorities, which began their activities on 1 January 2016 (jointly **"Registers"**).

The Registers have networked all competent authorities and enabled their cooperation, resulting in a faster procedure. They promote the idea of efficient functioning of administration in the area of construction, especially in: (i) up-to-date examination of the status and progress of the application process for the relevant permits, and (ii) up-to-date insight into the documents submitted and issued in the relevant procedures.

The PCA prescribed that the investor may obtain through a one-stop shop all documents needed for the construction of a single facility, namely: (i) location conditions; (ii) construction permit; (iii) submission of notification of works; (iv) usage permit; (v) project conditions, ie connection of the facility to the infrastructure grid/network; (vi) conditions for connection to the infrastructure grid; and (vii) conditions for registration of the ownership right over the constructed facility, etc.

In this manner, the PCA aimed to facilitate the paperwork required for the issuance of permits by putting more pressure on local authorities. In particular, the deadlines for issuing decisions have been significantly shortened, while the obligation to obtain certain documents has been shifted to local authorities. In other words, instead of asking investors to provide a document which has already been submitted or already exists to a certain competent authority, the local authority now will be obliged to obtain and provide the document to the benefit of the investor. Therefore, the once passive role of local authorities in the issuance of construction documents and permits has become an active one.

Moreover, the new procedure allows all applications and supporting documents to be submitted electronically. This is a huge breakthrough, as submission in paper form and on CD was previously required.

Real life hurdles
Keeping in mind that the process is still brand new in Serbia, practice has shown that there are still a few hurdles that need to be overcome.

For instance, although the PCA prescribes strict deadlines for the action of the authorities (eg provision and gathering of documents), they are not always adhered to, so delays still occur in some cases.

Electronic submission of documents also gives rise to certain obstacles whose impact is mostly felt by the designers and engineers responsible for preparing technical documentation. First of all, a qualified electronic signature needs to be obtained in order to initiate the submission procedure (except for documents submitted in .dwg or .dwf format). Secondly, due to the limitations of the computer system of the consolidated procedure, only certain types of computer files can be accepted for submission, which causes headaches for engineers and designers. Finally, certain technical documents require drawings to have an electronic company stamp, which still does not exist in Serbia.

For the time being, the authorities will provisionally accept a scanned version of the company's physical stamp placed on the technical documentation where needed.

> The introduction of a consolidated procedure is a first step towards accommodating the needs of investors. Certain obstacles need to be overcome, but every new law has to be tested in practice before its drawbacks can be recognised and eliminated.

Legal Gap Puts Mortgage Creditors at Risk in Bulgaria

Dimitar Vlaevsky

Fraudulent debtors are trying to use a disputable interpretation of Article 37, para 4 of the Special Pledges Act on the outcome of enforcement over a special pledge against the rights of secured mortgage creditors.

The Bulgarian legislator is notorious for leaving gaps in enacted legislation. Often such legal gaps combined with inexperience, or even worse – corruption of judges, lead to questionable judgments being handed down. Several of these judgments have put mortgage creditors at risk of losing their collateral in the past year.

Special pledge vs. mortgage

In Bulgaria, a mortgage has long been regarded as one of the most reliable forms of collateral. Thus, it is the preferred instrument of most creditors, including the most important – in terms of creditor rankings – the banks. Although a mortgage has its own disadvantages compared with other types of securities, eg a special pledge *(особен залог)* or financial collateral (eg the costs are higher, the procedures for establishment and enforcement usually take longer, etc), Bulgarian creditors still prefer to use it.

The financial crisis in Bulgaria led to many bankruptcy proceedings. Once such a proceeding is opened with respect to a debtor, all other enforcement proceedings are suspended. Thus, a mortgage creditor should wait for the completion of any bankruptcy proceeding in order to receive its share of the sold real property. This can take several years, however, compared with enforcement on a mortgage, which can be completed in months.

Nevertheless, enforcement of a special pledge is not suspended by the start of insolvency proceedings, and a creditor can sell the pledged property without going to court. Yet Bulgarian banks are still hesitant to replace a mortgage with a special pledge. Their biggest concern is that since the creditor is selling the pledged property on its own, the debtor could later claim that the sale went through at a very low price and claim damages.

The "hidden" benefit of the special pledge

Although the banks are still hesitant to opt for special pledges, in the past couple of years other creditors, mostly from off-shore zones with unknown owners, are pleased to use this security instrument. Such creditors have even registered special pledges on real properties which were already encumbered with mortgages when their owners were on the verge of bankruptcy. Soon thereafter, these creditors will enforce on the collateral and sell the real property to a new owner, irrespective of any ongoing bankruptcy proceedings or mortgage enforcement.

To an uninformed reader, it could sound strange that anyone would choose to use already encumbered property as collateral, or would buy it against a price close to its market value. However, this scheme has come into use due to a certain legal gap which fraudulent debtors try to exploit.

The special pledge was introduced in Bulgaria in 1997 and since it was a totally new security instrument, it still provides a challenge for both the legislator and judges working with it. Thus, there is no explicit legal provision regulating the conflict between a registered mortgage and a special pledge on one and the same property. Although normal logic dictates that the first registered should take priority, there is a provision in the Special Pledge Act which gives ground to some judges to consider that an enforcement of a special pledge over real property should lead to deregistration of any prior encumbrances on it, including any mortgage. Thus, the mortgage creditor could end up without any collateral.

This disputable interpretation has already led to several court disputes with different outcomes. Therefore, the Supreme Court is currently preparing an interpretive judgment which should fill this gap.

> There is no explicit legal provision regulating the conflict between a registered mortgage and a special pledge on one and the same property.

Data Protection Impact Assessment and Big Data: An Unsolvable Task?

Hannelore Schmidt

Data growth over the last few years has prompted regulators to reassess how consumer data is protected. While the rapid growth of data has created an opportunity for companies to better understand the competitive business landscape, data subjects are now more than ever exposed to the risk of losing oversight of personal data.

The collection of large quantities of personal data is nowadays taken more or less for granted. While companies and consumers have both benefited greatly from new and smart technologies, regulations around data privacy and protection are becoming stricter due to the General Data Protection Regulation (**"GDPA"**). As a result of this new regulation, additional obligations have been imposed on data controllers and processors and, more importantly, data subjects are now better protected under this new law.

Data Protection Impact Assessment

The GDPR,[1] which will take effect on 25 May 2018, imposes the Data Protection Impact Assessment (**"DPIA"**) in art 35. The DPIA is a process to help the data controller and data processor identify and reduce privacy related challenges and risks of data processing. If such risks are identified, the GDPR expects the controller to take measures to protect this personal data. The assessment should be conducted before the data processing activity commences.

Only exemplary cases in which a DPIA is necessary are enumerated in the GDPR, eg if sensitive data is processed or in cases of systematic and wide-ranging public monitoring (CCTV of public places), or in cases of profiling. The DPIA therefore means that the data controller has to assess the consequences and risks of future data processing, which makes dealing with big data processing more challenging. If the DPIA indicates a high risk that cannot be tackled by implementing appropriate technical security measures, the data controller will be obliged to consult the Data Protection Authority.

The DPIA process

The DPIA process is flexible and cannot be unified for every company or project. Given the level of execution complexity, the process should commence as soon as dedicated resources have been allocated. The DPIA requires several steps, which are configured with varying degrees depending on the company or project.

Step 1 – Data Flows
At this DPIA level it is necessary to describe the data flows of the company. It should explain exactly which personal data is processed, for which purpose, who is the data subject (eg, customer, employee, supplier, etc), to whom the data will be transferred (if it will be transferred) and who will have access to this data as well as other necessary information.

Step 2 – Identifying Risks
In step two, the company should identify potential risks to data subjects and the company. Risks to data subjects can include damage caused by inaccurate data or a security breach, whereas associated company risk is usually considerable financial loss. A key risk is a legal compliance risk, which could include missing registrations or certificates.

Step 3 – Privacy Solutions
The company should evaluate privacy solutions to assess the effectiveness of the solution to mitigate risks. For example, by implementing security measures, access rights or escalation management, the risk of a breach is minimised. Companies should also be aware that some risks cannot be entirely eliminated by privacy solutions. Available resources, costs and benefits should be evaluated and considered as well.

Step 4 – DPIA Report
The whole DPIA process should be reported and recorded by the company or consultants. The report should describe the DPIA process with all the steps taken to identify, evaluate, reduce or eliminate privacy risks. In addition, the decisions and investments made during the process should be recorded.

Step 5 – Integrating the DPIA outcomes into the company's structure
The DPIA findings and actions should be integrated into the company's structure or plan. This is critical, as the implementation of a new technology, for example, may necessitate another execution of the DPIA process. The

integration may also require additional staff or external consultants.

Is the DPIA an unsolvable task for big data?

The DPIA process, particularly in the area of big data, is a big challenge. It is not impossible, however, and can be accomplished with the right resources. An important prerequisite is that the DPIA process is executed in a timely fashion.

Another pillar of support, especially for future DPIAs, is the concept of Privacy by Design, which enables stronger protection of data subjects' privacy.

> The DPIA means that the data controller has to assess the consequences and risks of future data processing, which makes dealing with big data processing more challenging. If the DPIA indicates a high risk that cannot be tackled by implementing appropriate technical security measures, the data controller will be obliged to consult the Data Protection Authority.

[1] Regulation (EU) 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, and repealing Directive 95/46/EC (General Data Protection Regulation).

Better Safe than Sorry

Veronika Wolfbauer

The higher the penalties, the higher the level of compliance? Penalties of EUR 20 million or 4 % of annual turnover for data protection violations are just around the corner.

Effective, proportionate and dissuasive[1]

The European Union's General Data Protection Regulation[2] (**"GDPR"**) is based on a clear mission: imposing the European understanding of privacy on the world – or at least on multinational companies. This approach will be enforced by a significant increase of the penalties that until now were only known in anti-trust law. Supervisory authorities will have the power to issue fines of up to EUR 20 million or 4 % of annual turnover – whichever is higher. The latter will only apply to undertakings, but comprises the total *worldwide* annual turnover in the preceding fiscal year. The recitals of the GDPR remove any doubt and explicitly refer to the definition of an undertaking under EU anti-trust law. Anti-trust lawyers know that this indicates the application of the "single economic entity doctrine". Thus, non-compliant data processing could lead to fines that take into account the worldwide annual turnover of a local company as well as its parent and affiliated companies. The threat for companies becomes even more obvious in connection with the introductory sentence of art 83 of the GDPR, under which each supervisory authority has to ensure that each fine is effective, proportionate and dissuasive in each case.

Penalty addressee

In general, the GDPR provisions imposing these sanctions are addressed to the controller – the one who determines the purpose and means of the personal data processing. Usually, the company qualifies as the "controller" – and the GDPR apparently wanted to address its fines at the companies. However, under current Austrian administrative criminal law, companies are only liable if certain criteria are met. The principal rule is that the fine is imposed on the body that is authorised to represent the company externally,[3] ie the managing director(s). Although the managing directors would have the option to appoint a responsible representative[4], the liability will not entirely pass to this person. Moreover, the responsible representative has to consent to this appointment. In any case, the penalty addressee under the current provisions would be a natural person, meaning it will become difficult and expensive to find a volunteer willing to play this role.

Sanctioned GDPR requirements

What's more, the threat of extremely high sanctions is not reserved only for gross breaches of the GDPR, but indeed for all kinds of GDPR requirements, especially the basics of data protection. For instance, if the controller processes the personal data of a child without the prior consent of the parent, or if the company lacks appropriate technical and organisational measures to ensure data protection in connection with data protection by design and by default, the fine could be up to EUR 10 million (or 2 % of total global annual turnover).

An even higher penalty of up to EUR 20 million or 4 % of total global annual turnover could be imposed for violations of the basic principles of processing (including conditions for consent) or violations of the data subjects' rights or non-compliance with international data transfers, to list only a few examples.

While the GDPR establishes these as maximum fines, art 22 para 2 of the Austrian Administrative Penalty Act provides that sanctions can be accumulated. This would be the case, for example, if several GDPR offences are committed with several independent acts. Say, for instance, that a company develops an app which is downloaded on a mobile device and does not comply with the privacy by design/default provisions. The app is designed for minors, but parental consent is not obtained and the data is transferred to the US without having model clauses or the like in place. Insolvency, here we come!

Light on the horizon?

Luckily, the supervisory authorities will take into account certain parameters when issuing the fines. Due regard will be given to the nature, gravity and duration of the infringement, in view of the nature, scope or purpose of the processing in question, as well as the number of data subjects affected and the level of damage they have suffered.

The intentional or negligent character of the infringement or the categories of personal data affected by the infringement will also be taken into consideration. The latter obviously leads to a higher compliance benchmark for companies that regularly deal with sensitive data.

> The homework assignment is clear: analysing corporate data protection and the current level of compliance, plus setting all necessary preparatory steps. D-Day for data protection compliance is set: 25 May 2018.

[1] GDPR, Article 83.
[2] Regulation (EU) 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, and repealing Directive 95/46/EC (General Data Protection Regulation).
[3] Art 9 Administrative Penalty Act *(Verwaltungsstrafgesetz, VStG)*.
[4] Art 9 Administrative Penalty Act *(Verwaltungsstrafgesetz, VStG)*.

New EU-Wide Safeguards for Open Internet – EU Regulation 2015/2120

Günther Grassl

By November 2015 the European Parliament and the Council had co-adopted Regulation (EU) 2015/2120 (the **"Regulation"**) aiming at ensuring open internet access and putting further restrictions on roaming surcharges.

Introduction

In the last 20 years the internet has had a tremendous impact on society and in particular on the globalisation of commercial activities. Accordingly, the internet access services (**"IAS"**) industry has become a multi-billion euro business. The deployment of powerful broadband technologies has enabled more and more services to be performed using the communication function of the internet.

On the other hand, as a result, other "classic" communication offerings have been put under pressure. An often-quoted example of this is of a provider of voice and data transmission services, including IAS over a mobile network. Given a very attractive price for these data transmission services, subscribers tend to use a voice-over-IP application instead of a voice service to make phone calls. But what if that provider reacts by blocking or throttling access to all, or certain VoIP applications, except for his own VoIP offer?

New EU regulatory framework on open internet – Right to open internet access

The previous EU legislative framework only provided for information obligations applicable to the service quality of IAS providers.[1] The introduction of further measures on "net neutrality" or "open internet" was left to the Member States and their national regulatory authorities (**"NRA"**). While in Austria, politics and NRA refrained from introducing specific regulations, other member states, such as the Netherlands, adopted far-reaching restrictions on possible blocking, throttling or activities such as "zero-rating offerings" by IAS providers.

EU Regulation 2015/2120 (**"Regulation"**), directly applicable since April 30th 2016, has established a common legal framework on open internet access. It has also commissioned BEREC, the body of European Regulators for Electronic Communication, to adopt guidelines for the implementation of this legislation (**"BEREC guidelines"**). In August 2016 the guidelines were published and provide comments on the individual articles of the Regulation and the associated recitals.[2]

Under the Regulation, any "end-user" of an IAS is granted a "right" to access and distribute information and content via that service, and to use and provide all applications and services. Moreover, the IAS providers are specifically banned from restricting or interfering with the data traffic – mainly by blocking or throttling – or treating it unequally or discriminatorily. That obligation applies irrespective of the sender and receiver, the used terminal equipment, or the specific – naturally lawful – content accessed or distributed.

Permitted conditions of an IAS service – lawful traffic management

However, the new legal framework specifies that IAS providers are free to agree with end-users on the "commercial and technical conditions and characteristics" of the provided service, such as price, data volume or upload/download speed. The regulatory authorities are, however, asked to supervise, in particular, that the essence of the obligation to treat all traffic equally is not undermined by an IAS provider by conditions and/or characteristics of this sort. Hence, price differentiations for certain applications will, according to the BEREC guidelines, not necessarily undermine the user's rights for open internet.

Still, the Regulation allows "reasonable" traffic management measures which are proportionate and non-discriminatory, eg the application of another bandwidth or latency for so-called "real-time" (eg certain online games) or mere network stability management traffic which can both be objectively different from other applications. Beyond such "reasonable" measures, only traffic management, in order to comply with legislative provisions, preserves network integrity and security, and the preventing or mitigating of temporary network congestion is permitted.

Offering of "special services"

In addition to IAS, providers are entitled to offer "services optimised for specific content", applications or services in general requiring a specific level of service quality. Such quality might be necessary, particularly for advanced machine-to-machine communications or health applications in the public interest. However, in order to avoid any circumvention of end-users' rights to an open internet, the NRA must closely monitor whether such offerings are objectively necessary, with priority over other content.

While the BEREC guidelines consider broadcasting IPTV services or Voice-over-LTE as examples of special services, they do not do so for a mere VPN offer for businesses.

In any event, the providers offering such services have to ensure that the network capacity is sufficient to provide such services in addition to any IAS provided. The BEREC guidelines thus require that the NRA monitor how "specialised services" affect other IAS offered by the same provider (for instance with regard to increased delays or packet losses).

More targeted information for end-users

Under previous EU and national legislation, IAS providers were obliged to publish adequate and up-to-date information for end-users on the quality of their service. In particular, they had to inform subscribers of any conditions limiting their access to and/or use of services and/or applications. Now, additional information has to be given as to how traffic management measures, but also how any volume or speed limitation could "impact the quality" of the IAS. Moreover, subscribers have to be informed about the minimum, maximum, normally available, and advertised download and upload speeds (in case of mobile networks: the estimated maximum and advertised download and upload speed) and again its impact on the end users' rights.

Administrative enforcement – Adaptation of existing contracts for IAS

Art 5 of the Regulation entitles NRA to order IAS providers to ensure compliance with requirements for open internet access and information obligations.

However, for non-compliance with such an order based on directly applicable EU law or any other provision of the Regulation, no administrative penalty under the Austrian Telecommunications Act 2003 (*Telekommunikationsgesetz 2003,* **"TKG"**) could be imposed yet. The federal government, however, announced draft amendments to TKG with regard to the Regulation still for this year.

The Regulation requires, if necessary, adapting existing contracts to the extended transparency obligations. It goes without saying that the end user rights and/or the prohibition of restricting or interfering with data traffic may affect provisions in existing contracts which do not satisfy these requirements. Thus, it should be noted that according to art 20 para 2 USD and art 25 para 3 TKG, subscribers have the right to withdraw from a contract on an ECS without penalty in the event that the provider modifies the "contractual conditions", unless such modifications are operating entirely and exclusively to the subscribers benefit.

At present, subscribers may, depending on the individual contract, claim price reduction or even a rescission of the contract if certain contractual performance commitments in relation to the IAS are not fulfilled.

> A new legal framework as to open internet now directly applies throughout the entire EU. It to a large extent bans practices such as throttling or blocking access to certain applications or content, and extends the information to be given to users.

[1] See, in particular, art 1 para 3, art 21 para 3 (c) and art 22 para 1 and 3 of EU Directive 2002/22/EC (Universal Services Directive, **"USD"**), before amended by the Regulation.
[2] Accessible under http://berec.europa.eu/eng/document_register/subject_matter/berec/public_consultations/6075-draft-berec-guidelines-on-implementation-by-national-regulators-of-european-net-neutrality-rules.

Exclusion of Tenderers for Criminal Charges

Heidemarie Paulitsch | Johannes Stalzer

Contracting authorities may exclude tenderers as a result of criminal charges brought against them, as grave professional misconduct is a ground for exclusion under Austrian Public Procurement Law.

Grave professional misconduct as exclusion

Under Austrian (and EU) public procurement law, authorities can exclude economic operators that are considered unreliable and therefore unsuitable to be awarded a public contract. Accordingly, contracting authorities will exclude from procurement procedures economic operators convicted of either criminal or other offences relating to their professional conduct. The latter typically excludes bidders that have been convicted of offences related to employment conditions, health and safety in the workplace and environmental standards. Both grounds for exclusion require the existence of a final and binding criminal judgment. Irrespective of the existence of a criminal judgment, public procurement law provides for the possibility of excluding tenderers who [have] been found guilty of grave professional misconduct proven by the authority. While it is clear – at least since the European Court of Justice ruling in Forposta – that grave professional misconduct covers all misconduct which affects professional credibility (eg, offences under labour law regulations or environmental laws), the level and manner of proof needed to demonstrate grave professional misconduct are still under discussion.

Jurisprudence

On 27 November 2015 the Vienna Administrative Court ruled on the level of proof needed to demonstrate grave professional misconduct. In this case, the managing director (being majority shareholder of the bidder) was accused and prosecuted for collusive tendering in his function as both shareholder and managing director of an affiliate of the bidder during a tender procedure conducted by the same contracting authority several years earlier. Against the background of the indictment by the public prosecution and the possible exclusion of the bidder from tenders due to a potential future conviction, the managing director reduced his area of responsibility and, via a shareholders agreement, declared his intention not to interfere with future procurement procedures as proof that the conduct in question would not reoccur.

Despite these measures, the contracting authority excluded the tenderer, arguing that the indictment sufficiently demonstrated grave professional misconduct on the part of the managing director, rendering the claimant unreliable. According to the authority, the self-remedying measures were not sufficiently promising or credible to prevent wrongdoing by the company controlled by the managing director.

The court ruled that the managing director (and subsequently the affiliated company) had been indicted for a crime (collusive tendering) that illustrated grave professional misconduct. On review of the longstanding and extensive criminal investigations, the court found that the indictment provided sufficient evidence for the contracting authority to assume grave professional misconduct on the part of the claimant. As the contracting authority and its affiliates were the aggrieved parties in the respective criminal proceedings, it could not reasonably be expected to continue business operations with the tenderer. Regarding the level and means of proof required in relation to the conduct, the court referred to respective German case law[1], stating that a contracting authority need not necessarily wait for a final criminal judgment. In fact, if criminal investigations provide grounds for sufficient and precise suspicion, there is no need to wait for an indictment or a court order to institute proceedings.

In addition, the court concluded that the self-remedying measures taken by the bidder were insufficient to restore its reliability. Effective self-remedying requires immediate personal and organisational measures, including the immediate and complete dismissal of all persons involved.

Therefore, the claimant would have had to implement a clear organisational and personal dissociation from the entity and person in question, making it impossible for the latter to exercise influence by way of internal ownership rights.

Consequences

This is the first Austrian ruling by an Austrian procurement authority and court addressing the weight of an indictment. As such, it will likely serve as case law for future rulings with regard to the demonstration of grave professional misconduct.

From a criminal law perspective, the key factor is that an indictment that has been submitted by the prosecution of-

fice initiates the main proceedings at the criminal court. The question of guilt can be answered only in the course of the main proceedings. However, according to Austrian criminal law, an indictment is the result of previous criminal investigations which have explored all relevant facts in detail and weighed the interests in favour of and against the perpetrator. Indictments are submitted to the criminal court only if the prosecution is convinced that a conviction is reasonable. As a result, an indictment may be regarded as sufficient evidence to challenge a bidder's integrity.

As regards the principle of presumption of innocence, the court argued that this does not prevent authorities or parties from taking preventive measures, such as ordering pre-trial detention. Hence, this principle does not prevent a tenderer from suffering negative economic effects due to the loss of trust caused by the perpetrator.

According to the ruling, whether the proceedings ultimately lead to a conviction, nullification of the proceedings or an acquittal (as an indictment sufficient to demonstrate the tenderer's unreliability), is irrelevant. According to the court, it is important to consider that the period between a criminal complaint and a final judgment can be several years. It would be unreasonable to expect a contracting authority, having knowledge of the perpetrator's or tenderer's wrongdoings, to continue a business relationship based on mutual trust and integrity. According to relevant German case law, even the existence of an indictment may not be necessary if criminal investigations provide sufficient evidence of criminal wrongdoing.

From a procurement law perspective, the ruling has manifold implications for both bidders and contracting authorities.

- For contracting authorities, it is clear from the case at hand that the level and means of proof required in order to demonstrate grave professional misconduct need not correspond with a final judgment. An indictment, a regulatory decision or a confession involving a bidder can provide sufficient evidence for exclusion. However, contracting authorities should not consider this case to be the final word – in particular in relation to the level of proof of an indictment – as the relevant collusive tendering was directed against the contracting authority itself and therefore the court may have been more lenient as regards the level of proof. Hence, even in case of an indictment undermining the bidder's reliability and professional integrity, contracting authorities should at least assess whether the facts and accusations in the indictment are substantiated and conclusive.
- This ruling is a warning for tenderers and bidders. First, criminal or regulatory investigations must be taken seriously. In order to ensure that they can continue to participate in tenders, accused bidders should immediately implement self-remedying measures in order to prove their reliability despite the existence of relevant grounds for exclusion, including:
  - (i) comprehensively clarifying the relevant facts and circumstances;
  - (ii) compensating for any damages caused; and
  - (iii) taking the necessary structural, organisational and personal measures in order to ensure that the misconduct cannot reoccur.

The latter measure also includes dismissal of or dissociation from any employee, director or shareholder involved in the grave professional misconduct. Dissociation does not necessarily require the sale of shares; it can also be effected through transfer of the shareholder's property rights to a trust, or by requiring him or her to waive all ownership rights. Internally restructuring the implicated departments or portfolios is insufficient.

> Criminal or regulatory investigations must be taken seriously, as an indictment is already sufficient to demonstrate the tenderer's unreliability. Therefore accused bidders should immediately implement self-remedying measures in order to prove their reliability despite the existence of relevant grounds for exclusion.

[1] For example, the Frankfurt Court of Appeal in 11 Verg 6/4, 20 July 2004.

A New Era for Coal-Fired Power Plants in Turkey

Murat Kutluğ

New incentives and opportunities are in place for coal-fired power plants to attract local and international players in the energy market.

The importance of coal energy in Turkey

Turkey's energy needs are growing daily due to its growing population and developments in national industry. Coal is clearly the main local energy resource, and since its reserves consist almost exclusively of lignite (also known as brown coal) and small amounts of hard coal, the country is currently dependent on imports of oil, gas and hard coal. According to worldwide statistics, Turkey is ranked at a medium level in terms of reserves and production of lignite and at a low level in terms of hard coal.

Incentives for local coal-fired energy investment

Turkey's new investment incentive system, launched in April 2012, became effective by Council of Minister's Decree No. 2012/3305 on Government Subsidies for Investments *(Yatırımlar Devlet Yardımları Hakkında Karar)* on 15 June 2012 (the **"Decree"**). The Decree aims to encourage investments with the potential to reduce dependency on imports of intermediate goods vital to the country's strategic sectors.

In order to reduce dependency on imports of energy resources, through an amendment to the Decree on 28 January 2013, power plants generating electricity based on local coal resources may benefit from incentives granted to 5th region investments, including, but not limited to (i) governmental support in social security premium payments; (ii) increased support for corporate and income tax reduction to be applied on investment expenses; and (iii) exemption from payment of the Resource Utilisation Support Fund *(Kaynak Kullanımı Destekleme Fonu)*.

In line with the government's plans, 90 coal-fired power plant projects are under construction to produce an additional 18,500 MW installed power capacity by 2023.

Government commitment on purchase of electricity and tenders

The Turkish government is planning to invest heavily in coal facilities. It has announced that high-scale coal energy tenders will be announced in the upcoming months.

A major incentive is that the energy produced by coal-fired power plants will be purchased by Elektrik Üretim A.Ş. (Electricty Generation JSC) or Türkiye Elektrik Ticaret ve Taahhüt A.Ş. (Turkish Electricity Trade JSC) for a certain period. The terms, conditions and beneficiaries will be determined through a tender held by the relevant authorities.

In line with the government's aim to reduce the country's dependency on imported energy sources, more incentives for coal-fired power plants in Turkey to attract local and international investors may be expected.

" New incentives and opportunities are in place for coal-fired power plants to attract local and international players in the energy market.

The New Anti-Tax Avoidance Directive and its Effects on Austrian Taxation

Marco Thorbauer | Christopher Jünger

As part of the EU Commission's Anti-Tax Avoidance Package, the Anti-Tax Avoidance Directive establishes new rules against tax avoidance practices in Europe.

Introduction

On 12 July 2016, the Council of the European Union agreed on a directive laying down rules against tax avoidance practices that directly affect the functioning of the internal market (2016/1164/EU) – the Anti-Tax Avoidance Directive (**"ATAD"**). The ATAD is a result of the OECD's BEPS (Base Erosion and Profit Shifting) project and the CCCTB (Common Consolidated Corporate Tax Base) proposal. It addresses situations where corporate groups – mostly multinational corporations – use disparities between national tax systems in order to reduce their overall tax liability.

The ATAD applies to all taxpayers that are subject to corporate tax in at least one Member State, including permanent establishments (**"PE"**) in at least one Member State of companies resident for tax purposes in a third country. In order to prevent tax avoidance, the ATAD consists of the following five measures:

(i) Interest limitation rule
According to the ATAD, borrowing costs shall basically be deductible only up to 30 % of the EBITDA (Earnings Before Interest, Tax, Depreciation and Amortisation) in the tax period in which they are incurred. By derogation from this general rule, the taxpayer may be given the right to deduct exceeding borrowing costs up to EUR 3 million or to fully deduct exceeding borrowing costs if the taxpayer is a standalone entity. In addition, there are special "intra group rules" which allow the taxpayer to deduct a higher amount of borrowing costs. Member States may also provide for rules which allow the taxpayer to carry forward exceeding borrowing costs that cannot be deducted in the respective tax period.

Currently, Austrian tax law prohibits the deduction of interest payments to affiliated companies in low-tax countries (taxation under 10 % corporate tax) and deduction of foreign intragroup acquisitions of investments.

(ii) Exit taxation
International reorganisations often lead to the loss of Austria's right of taxation in favour of other countries. Under Article 5 of the ATAD, there should generally be a realisation of hidden reserves if (i) assets are transferred between a head office and its PE, or between PEs out of Austria or (ii) if the tax residence is transferred out of Austria (except to the extent a PE remains in Austria) or (iii) the PE is transferred out of Austria. The tax therefore could be deferred and paid in instalments over five years if the transfer is within the EU (or the EEA to the extent the country has signed up to mutual assistance on recovery claims).

In Austria, a new exit taxation system was introduced on 1 January 2016. The option for a tax deferral was replaced by the option to apply for the payment of instalments if business assets are transferred from Austria to an EU or EEA member state with comprehensive administrative and enforcement proceedings. With regard to assets that are part of the business' fixed assets, the instalment period amounts to seven years, while it is two years for current assets.

(iii) General Anti-Abuse Rule
The ATAD proposes a General Anti-Abuse Rule to set a common minimum standard across all Member States. By applying this rule, the tax authorities can disregard a company's legal arrangements if they are entered into for the sole purpose of creating tax advantages without having any non-fiscal reasons. The existing Austrian tax provision of Section 22 of the Austrian Federal Fiscal Code already corresponds to this General Anti-Abuse Rule.

(iv) Controlled Foreign Company ("CFC") rule
Under certain circumstances, the non-distributed income (eg interest payments, allocation of profits, royalty payments or leasing income) of a controlled foreign subsidiary is included in the corporate tax base of the parent company by applying the CFC rule. The CFC rule applies if a subsidiary (i) is directly or indirectly controlled (50 % of voting rights or capital or rights to profit) and (ii) is situated in a low-tax country (meaning that the corporate tax paid by the subsidiary is lower than the difference between the fictitious Austrian corporate tax on the income and the effective corporate tax in the country where the subsidiary is resident). Concerning Austrian tax law, the CFC rule is therefore applicable if the corporate tax rate of the country where the subsidiary is resident is lower than 12.5 %. At

present, Austrian law does not know any comparable CFC rule. However, under certain requirements, the repatriation of profits (eg in the form of dividends) is not exempt from Austrian corporate tax.

(v) Hybrid mismatches
Multinational corporations sometimes exploit the fact that Member States possibly treat the same income or entities differently for tax purposes (hybrid mismatch). The aim of this provision is to eliminate the double non-taxation created by the use of certain hybrid instruments. In cases of a double deduction, the deduction shall be given only in the Member State where such payment has its source. In cases of a deduction without inclusion, the Member State of the payer shall deny the deduction of such payment.

Entry into force
The provisions under the ATAD shall generally be applicable as of 1 January 2019. The exit taxation rule shall be transposed by 1 January 2020. Additionally, the implementation of the interest limitation rule has to be transposed only by 1 January 2024 if (i) the OECD does not previously reach an agreement on a minimum standard and (ii) the EU Commission confirms that Austria has targeted a rule that is equally effective to the rule on interest limitation.

> The Anti-Tax Avoidance Directive will lead to substantial changes in Austrian law concerning the taxation of corporate groups. Especially in order to deal with the interest limitation rule and the CFC-rule, companies will have an increased planning effort and higher costs. Companies therefore must deal with the Anti-Tax Avoidance Directive provisions at an early stage and carefully examine the effects on their business structure.

Romanian Tax in 2016 – One Step Forward, Two Steps Back

Theodor Artenie | Anamaria Tocaci

Since the entry into force of the New Fiscal Code in 2016, the Romanian Ministry of Finance has been working on issuing secondary legislation aligned with the newly introduced provisions. Several amendments and additions have already been introduced into the New Fiscal Code and official statements have been made to assure investors that the Romanian tax environment is stable.

For the first time in a long time, we feel that the redraft of Romania's tax legislation has pretty much hit the mark. But the road from the tax legislation – no matter how taxpayer-friendly – to Romanian businesses is full of potholes which are managed with the utmost efficiency by the Romanian tax watchdog (the National Agency for Tax Administration or **"NATA"**). Simply put, the main problem with the Romanian tax environment remains the administrative apparatus in charge of implementing, overseeing and enforcing the tax legislation.

One particular aspect of this apparatus – which remains one of the worst examples of administrative procedure that all countries should avoid if they want to be attractive for foreign investors – is the VAT registration process.

Since the beginning of 2015, a number of legislative changes were enforced regarding the VAT registration of Romanian companies established in accordance with Romanian Company Law no. 31/1990. As recent practice has shown, these changes have caused serious issues for Romanian companies, since they introduce the concept of "assessing one's intention and capability to carry out a business activity" as an essential criterion for approving VAT registration applications or for maintaining existing VAT registration numbers.

Of course, a foreign investor always has the option to set up a branch of its foreign business and this branch will undergo a much less painful VAT registration process. It is not less true that this loophole, whether intended or accidental, is not always the best operational solution for penetrating a new market, but is definitely one that can be considered and should be considered quickly because the door is closing on it, if one were to take into account recent statements made by Romanian officials.

On the other hand, Romanian companies that apply for VAT registration in Romania have no other chance but to follow the "regular" process and submit a special form proving their intention and capability to carry out economic activities. This form is long and contains a number of questions regarding the company, its administrators and shareholders, and needs to be submitted together with a number of additional documents.

The good news is that following discussions with the Romanian business community, this form was recently simplified and now contains fewer questions and documents to be attached. The bad news is that according to this latest set of amendments, the category of taxpayers who can receive the request to submit the VAT form in order to prove their intention and capability to carry out a business and therefore keep their VAT number has been extended to cover all taxpayers who are found by the NATA to have a high tax risk. The tricky part is that the criteria based on which the risk is assessed are not necessarily public. You can draw your own conclusions from this.

Secondly, once the VAT form is submitted, the information therein is assessed by tax officers against criteria which, again, is not publicly known. For all these reasons, one can never anticipate if or when they will receive the request to submit this form or what the outcome will be once the form is submitted.

While it is true that the current form of the relevant legislation prevents tax officers from refusing VAT registration applications or from cancelling VAT registration numbers arbitrarily, without offering the proper legal or factual grounds that lead to the rejection or cancellation, the entire process remains unpredictable and this unpredictability is a major deterrent for investors to set up shop in Romania.

The NATA is now undergoing a major modernisation process from which it wants to emerge as a well-functioning revenue administration, based on voluntary compliance.

However, as this process implies shifting both the organisation and its people towards a desired future state, we wonder how effective this will be, considering that the organisational culture of the Romanian administrative process mostly resists change. In this day and age, the main requests for tax advisory services come from taxpayers, who are in one form of conflict or another with tax officers.

> The main problem with the Romanian tax environment remains the administrative apparatus in charge of implementing, overseeing and enforcing the tax legislation.

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