Law in transition *online* 2006

Focus on central Europe

European Bank
for Reconstruction and Development

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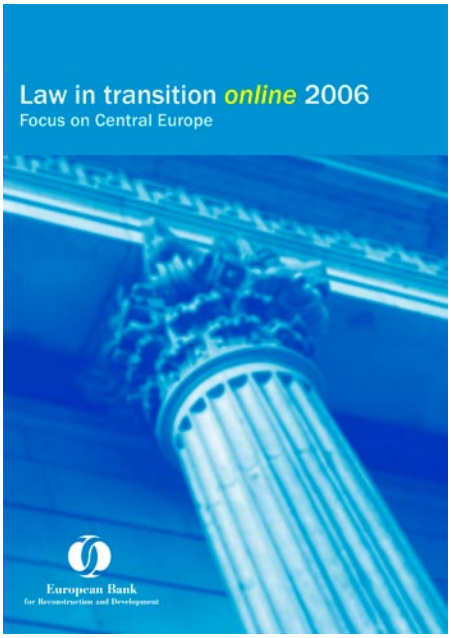
Abstract

Following their accession to the European Union on 1 May 2004, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovenia and the Slovak Republic have entered a new stage of economic growth and development. Sweeping legal, economic, political and social changes in these countries have transformed the investment climate.

This edition of *Law in transition online* assesses current legal developments in central Europe.



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Law in transition online

European Bank for Reconstruction and Development

Foreword

The EU embraces a Central Europe transformed with EBRD assistance

Following their accession to the European Union on 1 May 2004, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovenia and the Slovak Republic have now been integrated into the European Union structures and thus entered a new stage of economic growth and development. Sweeping legal, economic, political and social changes in these countries have transformed the investment climate and encouraged substantial trade, especially with the existing member states of the EU. The changes have been so far reaching and profound that within 5 years EBRD will have withdrawn from the region, its work in fostering the transition to market economics having been achieved. Political and economic competition, now firmly established in the EU-8 countries, can and will be entrenched by EU membership.

The EU-8 countries will continue to benefit from the policy of development carried out by the Regional Policy Directorate General (DG) of the European Commission. The Regional Policy DG is responsible for assisting in the economic and social development of the less prosperous or structurally underdeveloped regions in the EU. This includes helping the new member states to achieve a high level of competitiveness and employment within the European Union, thus ensuring their further high growth rate and sustainable development. Among other things, the Regional Policy DG's work is aimed at developing member states' transport infrastructure, promoting innovation and research, employment, enterprise and tourism. The goal of the Regional Policy DG is to eliminate development gaps among regions and disparities among citizens in terms of well-being, and to further strengthen the economic, social and territorial "cohesion" of the EU.

The Regional Policy DG has recently developed new guidelines for its cohesion policy. Guidelines are in particular concerned with promoting the intelligent and efficient allocation of funds available for regional aid programmes. The Regional Policy DG has identified the following priorities for 2007-2013:

- improving accessibility of the regions and their investment attractiveness;
- encouraging innovation, entrepreneurship and the growth of research and innovation capacities;
- developing new information and communication technologies;
- creating more and better jobs and enterprises and increasing investment in human capital; and
- restructuring industrial regions.

Since the end of the Cold War, the EBRD has vigorously supported legal and economic development and investment initiatives in the EU-8 countries, including by being the first to make direct investments in the region at a time where other investors were still cautious. Over the years, there has been a successful history of collaboration with the EU, both on the investment and the technical assistance fronts. An example of such collaboration is the EBRD/EU SME Finance Facility aimed at supporting small and medium-sized enterprises, which is described in one of the articles of this journal. From 2007 onwards, within the framework of the technical assistance project JASPERS (Joint Assistance in Supporting Projects in European Regions), the EBRD will partner the European Commission

Danuta Hübner, EU Commissioner for Regional Policy

and the European Investment Bank in assisting with the preparation of development projects, notably in the transport and environmental sectors, to be submitted for approval to the European Commission. Another area where EBRD expertise is relevant and where the Regional Policy DG will be following up with particular attention is the growing PPP (public-private partnerships) sector, where the EU will support projects by providing finance via the Structural and Cohesion Funds.

The current issue of *Law in transition online* reflects upon the various aspects of transformation in the EU-8 countries. Articles by EBRD staff look into a series of themes: recent political and social changes, EBRD support to the SME sector, bankruptcy and secured transactions regimes, and securities markets laws in Poland. External contributors have examined further topics such as the new supervisory role of the Czech National Bank, bankruptcy law reform in the Slovak Republic, public-private partnerships in the Baltics, and execution of judgements in the EU-8 countries.

Law in transition online

European Bank for Reconstruction and Development

A commercial law perspective on the "graduation" of eight central European countries

This article looks at the varied approaches to legal reform, including both bankruptcy and secured transactions, pursued by the eight central European countries that joined the European Union in 2004. Because these areas of legal reform were not preconditions to EU accession, reform has been internally driven and has depended on international support and technical assistance.

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At its annual meeting on 22-23 May 2006, the Board of Governors of the European Bank for Reconstruction and Development (EBRD) considered the "graduation"[2] of the eight central European countries that joined the European Union on 1 May 2004. The EBRD governors determined that, during the five-year period between 2006 and 2010, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic and Slovenia will graduate from the EBRD as multiparty democracies and open market-oriented economies. As EBRD President Jean Lemierre remarked in his opening speech to the Bank's governors, "graduation is a marvellous mark of success… for the eight countries concerned, it is the success of transition, reflecting historic achievements in their economic and political transformation."

There is no doubt that the eight countries' progress over a fifteen-year period between the end of Communism and their accession to the European Union was substantial – economically, politically and socially. The road towards EU membership has not always been straightforward – each country had its own challenges and its own ups and downs in the course of its transition.

Take, for example, the Slovak Republic; between 1993 (the year when Czechoslovakia split into the Czech Republic and the Slovak Republic) and 1998 (when the authoritarian regime led by the populist government of Vladimir Meciar was replaced by a coalition government led by Prime Minister Mikulas Dzurinda), the country was virtually in political isolation, economically and legally unreformed. Between autumn 1998 and May 2004, the country transformed itself. During this period, not only did it managed to fulfil the political criteria for the EU membership and the requirements of the *acquis communautaire* but, in several reform areas, it went beyond what was necessary for the EU accession and rapidly improved the overall business climate and the conditions stimulating foreign direct investment. It did this by adopting, among other measures, a flat corporate and personal income tax and by implementing a radical collateral-law reform that substantially improved the availability of credit for small and medium-sized enterprises.[3]

When analysing the current state of commercial law reform in these eight countries, while overall progress has been substantial, a more detailed review of the selected areas reveals a varied degree of progress that is often the reflection of the peculiarities of a particular country, its political climate and the compromises reached in adopting and implementing the relevant legislation. The purpose of this article is to look at two key reform areas in which the EBRD has particular experience as a provider of legal reform

assistance – bankruptcy and secured transactions – and to highlight the state of the legal reform and the difference in the approach to reform among the countries. These areas are also particularly revealing of the transition process because they were not covered by the EU legislation that the candidate countries had to adopt. Reform in this field was a self-driven exercise, with some degree of international support and technical assistance from organisations such as the World Bank and the EBRD.

Bankruptcy Law Reform

The 2004 EBRD bankruptcy assessment, which comprised two elements – the Insolvency Sector Assessment[4] and the Legal Indicator Survey on Insolvency[5] – revealed that, as of the end of January 2004 (in other words, on the verge of their accession into the EU), the insolvency legislation of the countries in question did not fare favourably in all areas of assessment against that of the other 18 surveyed countries, including some of the least developed EBRD countries of operations.

The first assessment, the Insolvency Sector Assessment, was an extensiveness study, which measured the extent to which the country's key insolvency legislation complied with the most widely accepted international standards adopted, among others, by the World Bank and the UN Commission on International Trade Law (UNCITRAL).

The assessment focused on five core areas: commencement of proceedings, treatment of estate assets, treatment of creditors, reorganisation processes and terminal/liquidation processes. The results were measured against the objectives under which an insolvency legal regime should allow for relatively easy and predictable access to insolvency proceedings by both debtors and creditors; provide for alternative remedies for the financial problems of an insolvent creditor; permit the efficient, proper, and timely administration of an insolvency case; and on balance, treat the interests of creditors as paramount.[6] The results of the survey were transformed into final numerical scores which were assigned to each country; the countries were then rated, according to the degree of their compliance with international standards into five categories, ranging from "very low" to "very high" compliance, as per Table 1.

As is apparent from Table 1, some of the countries in question only achieved very low compliance (Lithuania) or low compliance (Hungary and Slovenia) and none of them achieved high compliance or very high compliance.

The second assessment, the Legal Indicator Survey on Insolvency focused on the implementation of the laws on the books and, in particular, the extent to which the insolvency regime, in practice, achieves the results in a timely, predictable and efficient manner (in other words, an effectiveness study). The survey assessed how the legislation works together with the available institutional framework (including from the perspective of the rules of procedure, insolvency administrators and judicial officials). The survey presented the recipients of the survey[7] with two separate scenarios: the first, where the insolvency proceedings are commenced by a creditor and, the second, where such proceedings are commenced by a debtor. Specific emphasis was put on the assessment of the ability of either the creditor or the debtor to effectively initiate the insolvency proceedings in such a manner that future matters relating to the insolvent debtor could be dealt with under the umbrella of such proceedings. The two hypothetical scenarios were followed by a set of around 20 questions focusing on

Table 1: Level of compliance with international insolvency standards

Very High Compliance	High Compliance	Medium Compliance	Low Compliance	Very Low Compliance
	Albania	Armenia	Azerbaijan	Lithuania
	Bosnia and Herzegovina	Belarus	Georgia	Tajikistan
	Bulgaria	Czech Republic	Hungary	Turkmenistan
	Croatia	Estonia	Latvia	Ukraine
	Moldova	FYR Macedonia	Slovenia	
	Romania	Kazakhstan	Uzbekistan	
	Serbia	Kyrgyz Republic		
		Poland		
		Russia		
		Slovak Republic		

Source: EBRD Insolvency Sector Assessment, 2003-04
Notes: Data for Mongolia and Montenegro were not available.

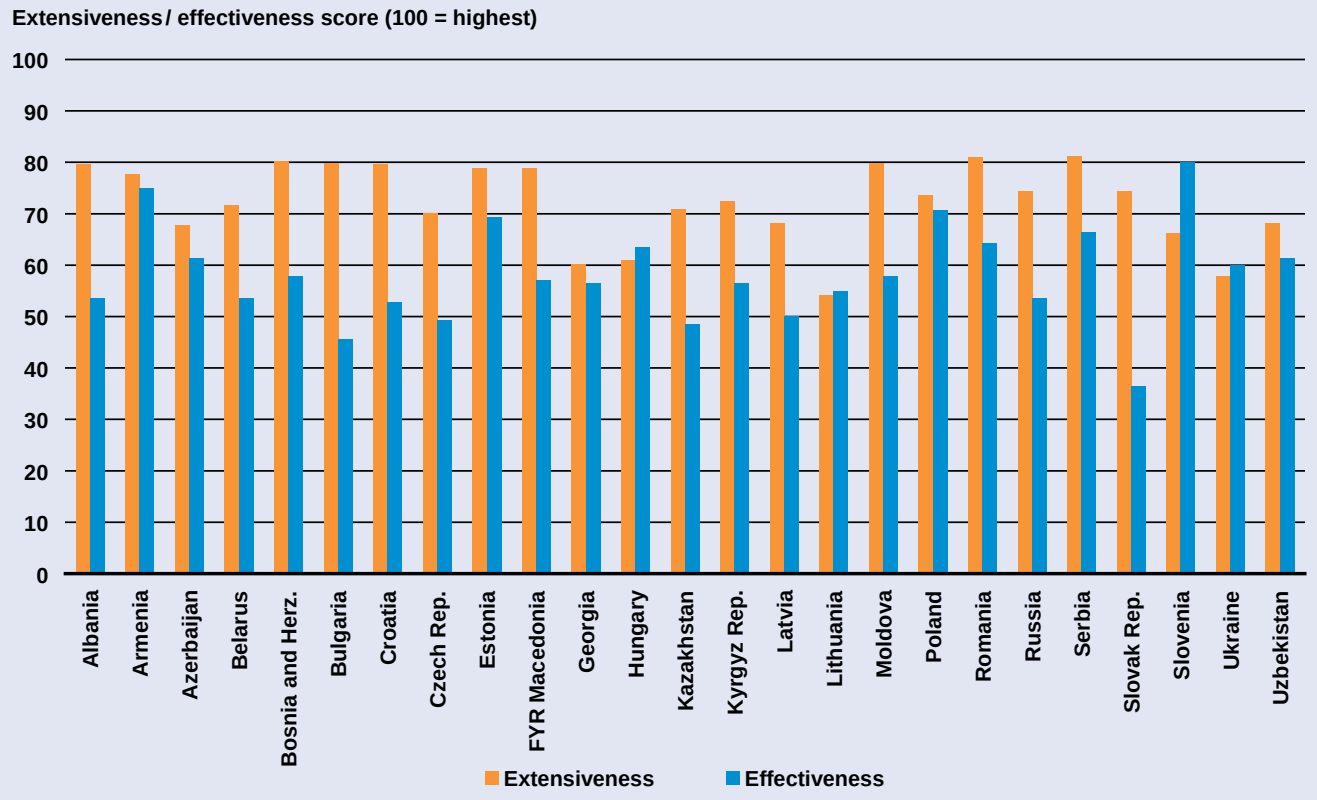
the ease of access to the insolvency proceedings, including the experience of the relevant court, the degree to which the rule of law is observed, the speed, cost and complexity of the process and the competence of the judicial and other officials involved in the process.

The answers were scored on a five-point scale, ranging from "very low effectiveness" to "very high effectiveness" and the results were then broken down into three basic measurements – speed, efficiency and predictability/transparency. Interestingly, some of the countries that scored relatively high under the first assessment (that is, the compliance of the law on the books with international standards) achieved a fairly low score on the implementation side (for example the Slovak Republic and the Czech Republic). By contrast, other countries with relatively low scores for compliance of their law to international standards fared well on the practical implementation side (for example, Hungary and Slovenia). For further illustration of the results, see Chart 1.

The above-described survey illustrated the need for improvement in bankruptcy legislation and its implementation in most of the eight countries. Since then, the Slovak Republic, which fared fairly low on the effectiveness score, has made a focused effort and prepared a new bankruptcy law, Act No 7/2005 Coll., On Bankruptcy and Restructuring, which came into force on 1 January 2006. On balance, the new Slovak bankruptcy law could be characterised as creditor-friendly: it is designed to ensure that, among other things, the value of the assets that are subject to insolvency proceedings can not be decreased by last-minute transactions that would negatively affect the rights of the creditors; and it creates conditions that motivate the parties to the proceedings to move without undue delay and in a proactive fashion. It creates, where feasible, conditions for informal restructurings as an alternative to formal court-sponsored insolvency proceedings and increases the responsibility of all the parties to the bankruptcy proceedings with a special emphasis on the liability of the bankruptcy administrators. It is further designed to ensure consistency between the new Bankruptcy and Restructuring Act and the existing law on secured transactions (which provides for the separate treatment and satisfaction of secured creditors from the assets secured expressly for the benefit of such creditors), thus giving secured creditors clear priority in bankruptcy proceedings by allowing the assets secured for their benefit to be treated separately from the rest of the bankruptcy estate. The new law also includes provisions that should decrease the possibility for cases of corruption in the insolvency proceedings, including corruption by the bankruptcy administrators.

In the first half of 2006 the Czech parliament also adopted a new insolvency law, although this law will only become effec-

Chart 1: Extensiveness and effectiveness of insolvency legal regimes



Source: EBRD Insolvency Sector Assessment Survey 2003-04 and EBRD Legal Indicator Survey, 2004.

Notes: The extensiveness score is based on an expert assessment of the insolvency laws in each country. The effectiveness score refers to the findings of the Legal Indicator Survey. Scores are calculated as a percentage of the max score. Data for Mongolia, Montenegro, Tajikistan and Turkmenistan were not available.

tive from 1 July 2007. The insolvency act (i) strengthens the creditors' role and their rights in the insolvency proceedings, which should enable the creditors to help decide both the appointment of a bankruptcy trustee and the most efficient means of processing the insolvency case, (ii) puts a strong emphasis on the restructuring and revitalisation of failing businesses, rather than relying primarily on their liquidation in all situations (for example, "leading-in" reorganisation and debt clearance, as opposed to bankruptcy), and (iii) establishes certain measures, (such as those relating to the delivery of documents) designed to accelerate the insolvency process.

Regarding the remainder of the eight countries, certain recent changes were made to the insolvency legislation in Poland, Hungary, Lithuania and Slovenia, but these changes only affect relatively narrow issues under the law. As was the case in Poland, some of these amendments were made primarily to facilitate the accession by the country into the EU and to harmonise any discrepancies between the local insolvency legislation and the relevant EU regulations and directives and, in particular, to facilitate cross-border bankruptcies, bankruptcies in relation to specific types of undertakings (namely banking, insurance, and other financial institutions) and close-out netting.

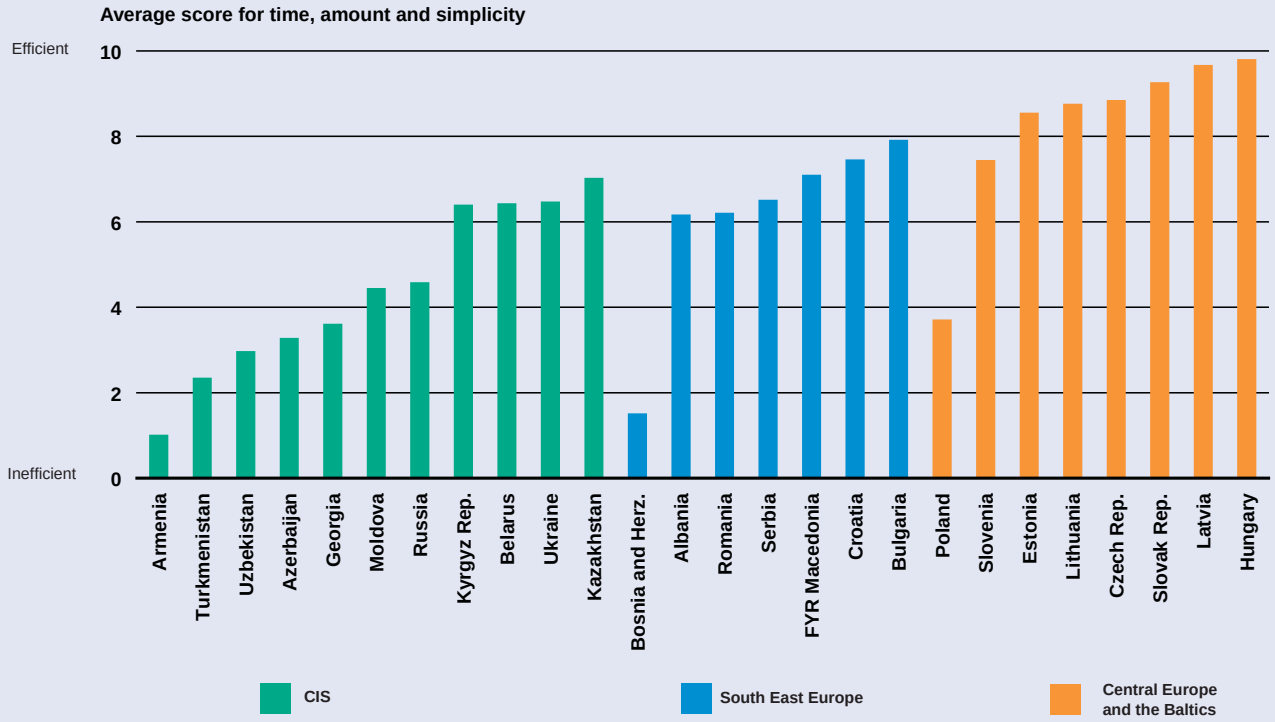
While there has been progress made in improving the bankruptcy legislation in countries such as the Czech Republic and the Slovak Republic, there is still much to be done, especially on the implementation/effectiveness side. Progress in the bankruptcy area will also depend on the governments' appetite to proceed further with judicial reform, including improved training of judges, bankruptcy administrators and other officials involved in the insolvency proceedings. The EBRD will assess these areas again as part of the forthcoming 2006 Insolvency Sector Assessment Update.

Secured Transactions Reform

An important aspect of a well-functioning economy is to ensure a sufficient supply of credit to all segments of the economy. This is partly achieved by providing lenders with the legal means for taking valid and enforceable security over assets. Once the money is disbursed by the creditor and there is a problem with the borrower, the creditor should be able to rely on three things: the quality of the legal documentation, the value of the collateral and a speedy and smooth enforcement of the security. The quality of the legal documentation relating to security is directly determined by the quality of the legislation underpinning such security instruments and the implementation of such legislation by the relevant agencies and by the judiciary.

As with the bankruptcy legislation, the EBRD has carried out a series of regional surveys on both extent and effectiveness of the existing legal frameworks for taking security by creditors. The key study – the 2003 Legal Indicator Survey[8] – focused on the efficiency of the recovery process upon enforcement of security, with a specific focus on the time involved, recovered

Chart 2: Enforcement of charged asset by region



Source: EBRD secured transactions case study, 2003

Note: Data for Mongolia, Montenegro and Tajikistan were not available. This graph shows the unweighted average scores for time, amount and simplicity. Ratings for each dimension range from 0 (worst) to 10 (best).

amount and the simplicity of enforcement. The assessment a scale of 1 to 10, with 10 being the best score. For the combined score (see Chart 2), the eight countries ranked ahead of the rest of the surveyed jurisdictions, with the exception of Poland (see above).

The most advanced of the countries considered here in the area of secured transactions appears to be Hungary, followed closely by Lithuania (which also seems to have a good and effective system in place). Hungary was one of the central European pioneers in this field when it set out, with EBRD technical assistance, to create a system that allowed a non-possessory charge[9] over movable assets. The system also introduced a central registry of charges as a necessary prerequisite for ensuring a smooth, transparent, publicly accessible and prioritised a registration system of charges. The Hungarian Charges Registry was set up in 1997 and is operated by the Hungarian National Chamber of Public Notaries. The reform was further enhanced in 2000, resulting in the elimination of certain inconsistencies and deficiencies from the relevant legislation.

The system now allows for the creation of non-possessory pledge over virtually any movable and immovable asset. There is only one exception – the enterprise charge[10] – which, while permitted, is still subject to uncertainties in enforcement. Also, charges over rights and receivables do not seem to be registered anywhere. In principle, the Hungarian system recognises contractual freedom among pledgers and pledgeholders, however, this is only insofar as the substance of their basic contractual arrangement is concerned. As to the form of the pledge agreement, it must be concluded in the form of a notary deed, following which the entry in the registry of charges is carried out by the notary office. Any searches in the registry may only be performed by the notaries. While the basic principles used by the Hungarian model are still quite advanced (and have been used as an example for the reform in this area in other countries in the region), today the registration system has begun to show the constraints and limitations of the existing information technology system, which was introduced almost ten years ago and may be in need of some upgrading and/or replacement.

Simultaneously with the secured transactions reform in Hungary, Poland introduced a new pledge law; this law, which came into effect in 1998, allowed for non-possessory pledges over movables. However, as identified by various EBRD analyses of this subject matter in Poland[11], there is a continuing need for improvement of the existing pledge regime, both from the perspective of pledge registration and the enforcement of pledges. In 2006, at the request of the Polish National Bank, the EBRD prepared a set of recommendations for improving the Polish secured transactions legal system. In particular, the review provided a detailed comparison between the Polish system and that of Poland's peers in central Europe.[12] The review concluded that "the Polish legal framework for pledge and mortgage imposes costs, complexities, delays and uncertainties which are considerably greater than those in other countries of the region."[13] The EBRD expressed a series of recommendations on the improvements needed with respect to the simplification of the registration of pledges, cost efficiency of the registration process, simplified enforcement including through out-of-court proceedings, efficient involvement of the court in the supervision of the enforcement process in the out-of-court enforcement and the change of the rules under which secured creditors obtain control over secured assets in the enforcement process. It remains to be seen whether the Polish authorities will follow these recommendations.

The EBRD has been instrumental in pursuing secured transaction reform in the Slovak Republic. The new state-of-the-art system, which was adopted in 2002 and became effective from 2003, allows for taking of charges over any single or collective thing, asset or right. This includes, among other things, future assets, groups of assets, a constantly fluctuating pool of assets, as well as enterprise pledges. The charge is registered in a centralised registry which is run by the Slovak Chamber of Notaries and the entries into the registry (the creation, deletion and changes in the pledges) are performed via notary offices evenly distributed throughout the country. Searching in the registry is available via the internet, free of charge, 24 hours a day and seven days a week. It is not necessary to submit a pledge agreement in order to enter a pledge into the system, which makes the registration process expedient and easy. It is literally just a question of couple of minutes to perform both an entry and a search in the registry. The priority is strictly determined by the order of registration of pledges and neither the tax authority, nor any other state body has a priority against a prior secured creditor.

The Czech secured transactions law, introduced through amendments to the Civil Code, has been in effect since 1 January 2002. It allows for a non-possessory pledge. It also uses a centralised pledge registry (as in Hungary and the Slovak Republic, it is managed by the Chamber of Notaries). However, the system continues to suffer from several deficiencies; it is not clear whether a general description of the pledged assets is sufficient for the creation of an effective pledge; the treatment (that is, the inclusion among the secured assets) of after-acquired property is also uncertain (unless such after-acquired property could be classified as forming part of the "aggregate thing" or "collection of things"); the same could be said about pledges entered into in respect of the fluctuating pool of debt. Searches of the registry can only be conducted via an intranet link from a notary office (rather than a direct internet search). A person wishing to conduct a search needs to fill out a request form and must show some form of legal interest or reason for requesting such information.

For most of the countries in question, the secured transactions reforms have proved to be successful – by and large, the reforms are believed to have encouraged the availability of credit, including for small and medium sized enterprises. In some countries, however, further effort is still needed to improve the quality of the existing legislation, the simplicity and speed of the registration process and enforcement and the quality of the information technology supporting the registration system.

Conclusion

All eight countries have travelled a long way on the road to reform since the end of Communism some seventeen years ago. The Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic and Slovenia transformed

themselves into dynamic transition economies, with private businesses representing a substantial percentage of the countries' economies. All these countries have been successful in attracting foreign direct investment, re-training and improving the skills of their labour forces and, in many cases, substantially decreasing unemployment levels. Among other things, these measures have enabled the integration of these countries into the EU framework.

Despite their overall success, as illustrated by the above-described examples of the bankruptcy and secured transactions reform, there is still a substantial need for continued improvements in the legal system that cannot be separated from the successful continuation of the political and economic reforms. The method and pace of such reforms are likely to continue to vary from country to country. One may agree or disagree with a specific approach to legal reform in the individual countries but what really matters for each of them is a sense of the overall direction of the reform – if this direction continues to be maintained by these countries, they are likely to keep on track and stimulate further development of their economies.

Endnotes

1 Disclaimer: The views expressed in this article do not present the views of the European Commission.

2 The eight countries (Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic and Slovenia) are among the recipient countries in which the EBRD invests; their graduation from the EBRD means that they will remain EBRD member countries but will no longer receive additional Bank investments in their respective territories.

3 Commentators observe the recent return of populist governments in the Slovak Republic and Poland, the deadlock after the June 2006 Czech election and the impact of such changes on the pace of the legal, economical and other reforms in these countries.

4 See Ronald Harmer and Neil Cooper (July 2004), "Insolvency Law Assessment Project, Final Report on the Results of the Assessment of the Insolvency Laws of Countries of Operations", http://www.ebrd.com/country/sector/law/insolve/insolass/sector/index.htm.

5 See Mahesh Uttamchandani, Ronald Harmer, Neil Cooper, Irit Ronen-Mevorach, "What consumers of insolvency law regimes need to know", Law in transition 2005, p. 5.

6 For further information, see Mahesh Uttamchandani, "Insolvency law and practice in Europe's transition economies", The European Restructuring and Insolvency Guide 2005/2006, Globe White Page Ltd, 2005.

7 In conducting the survey, the EBRD worked with private practitioners in the relevant countries, ranging from lawyers working in large offices of international law firms to sole practitioners.

8 See Frederique Dahan, Eliska Kutenicova, John Simpson, "Enforcing Secured Transactions in Central and Eastern Europe, an empirical study", Law in transition 2004, p. 4. All data are available at www.ebrd.com/st.

9 Non-possessory charge is a charge where the charger retains the right to possession of the charged assets.

10 Where a class charge covers (i) all the things and rights used in an enterprise which is capable of operating as a going concern, or (ii) such part of the things and rights of an enterprise as needs to be transferred to enable an acquirer to continue the enterprise as a going concern, then the charge may be registered as an enterprise charge.

11 See the EBRD 2002 Regional Survey on Secured Transactions and the 2003 EBRD Legal Indicator Survey.

12 The full report is available at www.ebrd.com/country/sector/law/st/facts/poland/index.htm. See also John Simpson and Frederique Dahan, "The impact of the Legal Framework on the Secured Credit Market in Poland", Butterworth Journal of International Banking and Financial Law, April 2006.

13 See John Simpson and Frederique Dahan, "The impact of the Legal Framework on the Secured Credit Market in Poland", Butterworth Journal of International Banking and Financial Law, April 2006, p. 174. Czech Republic's financial market was undertaken by four separate regulatory bodies. The Czech National Bank (CNB) performed banking supervision, while three other authorities (referred to as the non-bank supervisors) oversaw the securities market and non-bank financial institutions.

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Central Europe's democratic transition

This article evaluates the democratic transition in central Europe since 1989 and examines the important political role the European Union has played in the process. It analyses the backlash against the changes that has motivated recent political developments in the region and suggests how support for reform could be revived.

Christopher Cviic, Senior Political Counsellor, Office of the Chief Economist, EBRD

The purpose of this paper is to assess the attempt in the past decade-and-a-half to establish the rule of law and democracy in post-communist central Europe.[1] It is important to stress at the outset that, contrary to conventional wisdom, the region was never a homogenous one and most certainly was not a monolith – even at the height of the Stalinist period in the late 1940s and early 1950s. True, all the states of the region lived under Communist rule, but the actual political and economic conditions on the ground varied quite considerably from state to state. This had important implications, not least the fact that when the individual states embarked on the process of political and economic change in 1989-90, they did so from often widely differing starting points.

A good illustration of the different situations the individual countries found themselves in is provided by the three Baltic Republics (Estonia, Latvia and Lithuania) on the one hand, and Slovenia on the other. The first three countries, annexed by the Soviet Union in 1940 and then, from 1941 to 1944, occupied by Nazi Germany, were forcibly re-incorporated into the Soviet Union in 1944 and kept under its firm control. During the decades preceding the onset of Mikhail Gorbachev's policy of *glasnost* and *perestroika* in the mid-1980s, they were able to maintain only minimal contact with the non-Communist world, including the neighbouring Nordic countries, (Estonia was the exception because its population was able not only to receive, but also to understand, TV and radio broadcasts from Finland, which is both geographically and linguistically very close.) In contrast, Slovenia, as a federal republic of the Communist-ruled but non-aligned Yugoslavia, enjoyed from the early 1960s increasingly free and close contact with – including virtually free travel to – its democratic neighbours Austria and Italy, as well as to the rest of Europe and the United States.

Another example is provided by the difference between Czechoslovakia and Poland**.** The Communist Party was weak throughout central Europe before 1944-45, but the Czechoslovak Communist Party was an exception. In the Czech parts of the country (Bohemia and Moravia) it enjoyed quite considerable public support dating back to pre-World War II days. This enabled it to emerge in the Czech part of the country as the strongest party in the first (and relatively free) post-1945 election but also, in 1948, to destroy relatively easily the remnants of the country's strong pre-World War II democratic institutions. Then, after 1968, the Communist Party once again, and equally efficiently, suppressed the incipient revival of democracy in the guise of liberal Communism embodied in the so-called Prague Spring. In contrast, Poland's extremely weak Communist Party, installed in power in 1944-45 only with considerable Soviet support, never managed to bring the country's popular and strong Roman Catholic Church under its control. The result was that a good deal of independent intellectual and political activity continued to take place under the church's wing throughout the country over several decades.

There was also a considerable difference between the position of East Germany and Hungary. Because of its exceptional geopolitical importance and geographical proximity to West Germany, East Germany was not only closely watched by Moscow, but also kept on a tight leash by it. In contrast, Hungary, having earned a reputation as an awkward country because of its anti-Communist uprising in 1956, managed to carve out a special position for itself. This enabled its post-1956 leadership, headed by Janos

Kadar, to manoeuvre and experiment with a freedom not available to other central European Communist governments. Largely as a result of its special position, Hungary became, by 1990, the most experienced and advanced reformer in the whole region.

An amazingly speedy transformation

Yet**,** despite the individual countries' very different circumstances at the start of this dramatic decade-and-a-half-long process of transformation, both locals and outside observers agree that the outcome of the transformation process has been amazingly uniform throughout the region.[2] The reasons for this uniformity will be discussed below but, first, what has the post-1989 process of change in central Europe achieved? A detailed, authoritative assessment is provided in a recent study by the world-renowned Hungarian economist, Professor Janos Kornai.[3] His summary of the six most important characteristics of what he calls an "unparalleled success story" is well worth quoting:

- The changes in the economic sphere were in the direction of the capitalist economic system
- The changes in the political field were in the direction of democracy
- A complete transformation took place in all spheres: in the economy, in the political structure, in the world of political ideology, in the legal system and in the stratification of society
- The transformation was non-violent
- The transformation took place under peaceful circumstances
- The transformation took place with incredible speed

Professor Kornai elaborates further, making some very valid observations with which it would be difficult to disagree: the politicians of the former regime were neither executed nor imprisoned; there were no campaigns of revenge conducted against them; in some of the countries the preparations for a new constitution took place in the context of civilised discussions between the leaders of the former ruling party and the new opposition leaders preparing to take power; the power shift took place without bloodshed and without chaos at the highest levels of power.

Most of the credit for the uniformity, speed and overall success of the post-1989 transformation process in central Europe belongs, of course, to the people of the countries concerned. But they did not do it alone. In fact, they received a considerable amount of encouragement and practical help on a bilateral basis from western governments and from a number of institutions, particularly the Council of Europe in Strasbourg. The geographical proximity of western Europe played an important role, benefiting in particular the states located directly on the borders of the developed European states. However, there is a consensus view that the European Union played quite a special role in assisting central Europe's transformation**.**

The EU's crucial role

Almost as soon as the eight countries under discussion regained their freedom of action, following the Soviet Union's withdrawal from the role of the region's hegemonic power under Mikhail Gorbachev's leadership, they adopted membership in the EU (as well as NATO) as their key policy objective. The EU's first response to the new geopolitical realities in the region was purely economic. It poured massive bilateral and multilateral aid into the region from 1991 onwards, with the aim of preserving the newly established democracies by encouraging economic and political reforms, establishing trade links, investing and, generally, tying the region more closely to western Europe and the world economy. Of even greater importance was the flow of direct investment beginning in 1990, once it was clear that the process of democratisation and economic reform was going to succeed.

However, it was the EU's constructive political response that proved of greatest long-term significance. Brussels responded positively to post-communist central Europe's EU membership aspirations by concluding association agreements, the so-called Europe Agreements, with the countries that would soon apply to become EU members (the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia). At the EU summit in Helsinki in December 1999 the crucial decision was made that talks with the countries accepted as candidates for EU membership would depart from the same starting line.

The progress of each country would be judged according to the same criteria. Crucially, to the various economic requirements contained in the 31 'chapters' of the *acquis communautaire* were added the so-called Copenhagen criteria agreed within the EU earlier. These called on EU candidates to maintain democracy, the rule of law, respect for human rights and the protection of minorities. It was hoped that improvements already reached by the first five candidates from the group accepted at the Amsterdam Summit in June 1997 (the Czech Republic, Estonia, Hungary, Poland and Slovenia would help speed up their accession , while the new candidates (Latvia, Lithuania and Slovakia) would have a chance to accelerate their reform process and catch up with the rest.

Thus the EU de facto climbed into the driving seat of the region's reforming process both in the economic and political fields. Applying the principle of conditionality, it used its considerable leverage to synchronise throughout the region the various stages of the reforming process right up to the eight countries' accession on 1 May 2004. In its role as arbiter of the group's reforming progress, the European Commission issued regular annual monitoring reports. These reports were attentively studied not only in the 'official' candidate countries (which also included Bulgaria and Romania), but also in the other states aspiring eventually to join (Albania, Croatia and the Former Yugoslav Republic of Macedonia) as well as in the group further down in the queue (Bosnia, Montenegro and Serbia).

The reports provided full documentation on a comparative basis about, among other things, the competitive process of catching up within the group. The laggards were strongly

motivated to work harder in order to improve and catch up with, or avoid being left behind, next-door neighbours who were more often than not also regional rivals. Slovakia is a good example. It had been lagging behind both in terms of economic and political reforms for much of the 1990s under the authoritarian nationalist regime of Prime Minister Vladimir Meciar, which showed scant regard for the rule of law. Unlike its neighbours – the Czech Republic, Hungary and Poland – it failed to obtain the EU's candidate status and was also kept out of NATO. Prior to the parliamentary elections in 1998, senior EU and US figures went out of their way to emphasise that, if Meciar was re-elected and formed the next government, Slovakia stood no chance of getting into the EU or, for that matter, NATO. Meciar's party, the Movement for a Democratic Slovakia (HZDS) did emerge once again as the strongest party, but a broad coalition made up of leftist and rightist parties was formed and succeeded in keeping the HZDS out of power. Under a new, broadly based reformist government led by Prime Minister Mikulas Dzurinda, Slovakia quickly made up for lost time, caught up with its neighbours, joined the EU on 1 May 2004 and ended up as the region's reforming star.

Another example is provided by Lithuania, also a laggard, which, like Slovakia, made a big reform effort and succeeded in making the grade. Like Slovakia, it joined the EU together with the rest of central Europe and the other two Baltic Republics in May 2004. Just over a year before, in March 2003, it had joined NATO together with Bulgaria, Estonia, Latvia, Lithuania, Romania, Slovakia and Slovenia.[4]

The road back to the rule of law

The task facing those attempting to reform central Europe's legal system was truly daunting. It should be noted on the positive side that they were not starting from scratch. To some degree they were able to draw upon central Europe's experience of the not-so-distant pre-Communist era, when the countries of the region could boast good laws, interpreted by honest and independent judges and assisted by professionally competent lawyers. There was a good reason for it. The Habsburg Empire, under which most of central Europe lived for several centuries, was a *Rechtsstaat,* a state living under the rule of law. Even after the Empire's demise in 1918, the tradition of respect for the rule of law and rules in general lingered on in the successor states in the 1920s and 1930s, all the way up to the second world war. That was of some help but, all in all, the challenges of transformation were huge.

The biggest problem was that after central Europe came under Soviet domination in 1944-45, the entire legal system was, in line with Marxist-Leninist ideology and practice, made subservient to the dictates of Party policy. This was based on the Marxist view of law in history as no more than a part of the ideological superstructure reflecting the infrastructure of class society. Having thus cleared the air by stripping law of any pretence to objectivity and neutrality, the Communist rulers proceeded to use it first as an instrument of establishing their power and then, later, as a tool for maintaining it. No excuses were made for the political guidance of the judiciary by the Party cadres authorised to provide it. The judges were enjoined not to be too legalistic, but rather to fall in with the (usually) informal instructions from the political authorities.[5]

Perhaps inevitably in such a system, it became more and more possible for the ruling politicians and their families and friends to become above the law as far as the legal system was concerned. The upshot was that errant sons and daughters of senior Party functionaries never got as far as the courts or into the newspapers. The only time when members of the ruling group and those associated with it actually fell foul of the law was when a political decision was made by the Party that they should do so. In other words, the legal system was used not as an instrument for the pursuit of justice but for the protection of those within the circle of power. Only in legal cases that did not touch on the Party establishment's political and economic interests were the courts allowed a certain amount of latitude. Not surprisingly, this led to widespread cynicism about the legal system and the law itself among the public. The widespread, deeply ingrained negative attitude towards the whole legal system was one of biggest barriers for the reformers to surmount after 1989-90.

How have the eight done as a group in the past decade-and-a half as regards the establishment of the rule of law? One of the most authoritative assessments is provided in the European Commission's comprehensive monitoring report on the state of the eight countries' preparedness for EU membership (as well as that of Malta and Cyprus). It was published in October 2003 on the eve of the group's accession to the EU.[6] Its importance is that it should be seen as the equivalent of an official certificate testifying to the eight's eligibility for EU membership. Having postulated an effective and reliable public administration and an independent judiciary as essential for the effective implementation of the *acquis,* the report goes on to confirm unambiguously that they exist in the eight countries discussed here and that, therefore, the rule of law is in place. Quite understandably, the European Commission uses the opportunity to blow its own trumpet a little by spelling out in some detail just how much the EU has helped the process. This was done by using a range of dedicated instruments, including technical assistance and investment in infrastructure needed for applying the *acquis*, the twinning of administrations of the present member states with their counterpart institutions in acceding countries, peer reviews or the joint elaboration by the Commission and the acceding country experts of concrete action plans.

The report emphasises that an effective and reliable public administration and an independent judiciary are essential for the effective implementation of the *acquis*. As to whether the eight meet those criteria, the report provides its answer (though in rather opaque EU jargon) as follows: "the acceding countries have successfully undertaken a wide-ranging legislative and administrative adjustment over the past years in order to implement the *acquis* as it has developed in the current member states over several decades". The result is that "sufficient conditions are in place for the implementation of the *acquis* by the public administration and judiciary". Put in simpler language, the verdict is positive.

However, the report notes that there is considerable room for improvement in all the eight countries. Therefore, reforms aimed at strengthening the judiciary now being implemented should continue. This need for improvement also applies to the regulatory and supervisory authorities, which need to

be sufficiently independent and receive adequate resources to fulfil their tasks. Further, the report states that, with a few notable exceptions, the perception remains that the level of corruption in the countries concerned is still high, and very high in some cases, which can affect confidence in the public administration and the judiciary. The fight against corruption must, therefore, remain a policy priority in the coming years. The report signals that the European Commission will, in the coming years, pay particular attention to the need to protect EU funds from being diverted from their rightful beneficiaries as a result of fraud and corruption. In addressing the integrity issue in individual countries, the report notes the differences in the level of corruption between, for example, Estonia, where it is low, and Poland, where it is already high and is perceived to be increasing.

Democracy's disputed fruits

What has been said so far about the region's success in establishing the rule of law with great rapidity in the period since 1989-90 applies equally to the establishment of democratic systems**.** In the first place, all eight countries have fulfilled the so-called alternance requirement, that is, that least two changes of government should take place following the first one that saw the Communist Party step down from power.[6] Further, the elections throughout central Europe since 1991 have been free and fair, as attested to by such official bodies as the Council of Europe and the Office for Democratic Institutions and Human Rights, the Warsaw-based election arm of the Organisation for Security and Cooperation in Europe (OSCE). There have been no coups – successful or unsuccessful – by either the left-wing or right-wing forces. There is a general consensus that all the eight countries discussed here are now functioning democratic states, meeting – among other things – the European Union's Copenhagen criteria on democracy, respect for human rights, protection of minorities and, as already described above, the rule of law.

Once again, as in the case of the process of the establishment of the rule of law, the so-called conditionality approach adopted by the European Union has provided a hugely important incentive. An example was the success that the European Union, in close cooperation with the Council of Europe, the OSCE and a number of non-governmental organisations, had in persuading the Estonian and Latvian authorities to relax and liberalise their policy towards Russian and other Slavic minority populations settled there during the period of Soviet rule as part of Moscow's demographic engineering in the Baltic region. As a result, the OSCE concluded it was appropriate to withdraw its missions from Tallinn and Riga.

While celebrating the establishment of democracy in central Europe as a considerable achievement, it is also true that there has been widespread disillusionment throughout the region with various aspects of transition. A sizeable proportion of the population has seen its living standards deteriorate or, at best, stagnate. Job security that made the Communist system acceptable, even to many of those who disapproved of it, has disappeared. There is open unemployment unknown under Communist rule. There has been a marked increase in the levels of inequality. Corruption is everywhere and, thanks to the mass media, most corruption cases come out into the open, provoking public anger. (Corruption had existed under the old regime, but mostly in the form of mutual favours procured through political and personal contacts; however, it had largely remained unseen.) People are also angry and upset about the disorder they observe in the political arena. The multi-party system, instead of creating a framework for fair and constructive political competition, is seen by many (particularly older) people as having, instead, produced an unprincipled struggle for power combined with personal enrichment. What is the deeper message from the easily observable backlash against the dramatic changes in post-communist central Europe?

As Professor Kornai rightly points out in his survey of the region's transformation since the fall of Communism,[7] it is not possible in every case to pin the various instances of general deterioration to the change in the political system. However, it cannot be denied that they have taken place since 1990.In addition, observers both in central Europe and elsewhere in the European Union have raised concerns about the relative political instability created by the results of recent parliamentary elections in the region,[8] in particular in Poland, Slovakia, the Czech Republic and Hungary. If one also takes into account the fact that the coalitions currently ruling Estonia, Latvia and Lithuania are chronically unstable and fragile (Estonia, for example, has had 12 governments since 1991), it is difficult to disagree with those analysts who see today's central Europe in an increasingly negative light. It is certainly true that the region is at present governed by hard-pressed and mostly politically weak coalitions. The individual countries' leaders' preoccupation with staying in power, while understandable, appears to make them all too ready to ally themselves with almost any political party or force that can help them do so, without looking too closely at its ideological pedigree or even its current political programme. At the very least, this puts a question mark over the future both of economic and of political reform.

Whither central Europe?

The immediate danger for central Europe, according to *The Economist,*[9] which has paid much attention to central Europe recently, lies not in the possibility that the present political trends may damage the individual countries' chances of joining either the Schengen passport-free area or the euro, or both. Given today's fears in western Europe over legal and illegal immigration, the expansion of Schengen is some way off. As for the euro, joining it could be quite a risky step, especially for the larger ex-Communist states, and so a delay in the timetable may not be a bad thing.

The real dangers, according to the paper, are twofold. First, slowing down reforms may be dangerous for the central European states just when they need deeper reforms to stay ahead as their labour costs rise. They now face competition from countries that are cheaper than they are: Romania and Bulgaria and, further afield, China and India. That puts the emphasis on quality, flexibility and innovation, none of which is central Europe's strong point. Secondly, unstable and populist governments in the new democracies may lead the voters in the rest of the EU to feel disappointed in past enlargements and make them hostile to any future one. The serious implica-

tion of this forecast is, to put it bluntly, that a large chunk of Europe – including not only central but also south-eastern Europe – will remain backward.

All this is grist to the mill for the perennial western pessimists about central Europe, who have never believed the region could make it, but have been relatively quiet in recent years. They are vocal again and are beginning to argue that, the disillusionment having set in and the reforming momentum having petered out, the new democracies of central Europe may gradually be slipping back to a version of the bad old days in the 1920s and 1930s, which were characterised by statism, nationalism, xenophobia, populism and, not least, anti-Semitism.The pessimists may prove right: their sombre predictions for central Europe may well materialise. However, another reading of present trends in central Europe, while recognising the dangers mentioned above as real enough, does not see the admittedly widespread disillusionment with aspects of transition as a decisive rejection of the economic and political reforms of the past decade-and-a-half. Indeed, a closer look at the recent parliamentary election results throughout the region reveals a more complex picture, which suggests that the view that the cause of reform in central Europe is dead because the losers from transition have given it a thumbs-down is not proven.

In fact, the widespread supposition that popular support for reform rises and falls with unemployment and job creation is challenged in a new study by two Georgetown University academics.[11] The authors argue that the empirical evidence for the link between the economic effects of market-oriented reforms and their level of public support is tenuous. They argue, in contrast, that the support for reform rises when voters believe that political leaders are not likely to steal from the public or to become clients of privileged elites - and vice versa. In that light, the initial success off the anti-corruption "moral renewal" electoral programme of the Kaczynski brothers' Law and Justice Party (PiS) is easily understandable given the sorry record of the previous scandal-ridden Democratic Left Alliance (SLD) government. An anti-corruption backlash has clearly played an important role in the success of the parties concentrating on the issue of corruption such as Smer in Slovakia, the ODS in the Czech Republic, the New Era in Latvia and Res Publica in Estonia.

From that perspective, it is not difficult to agree with the authors of the Georgetown University study that "credibility is enhanced by…the establishment of a stable set of rules that distribute power away from individual politicians, and enable voters to monitor, reward, and punish politicians – in other words, rules that make politicians and public officials more accountable to citizens and that shield courts and certain other bodies from political interference".[12] The Georgetown study makes an important topical point: in a situation like the present one in central Europe where the social component needs to be emphasised, constitutional constraints - properly explained and understood- could serve political leaders as credible signals of their intent to pursue welfare-enhancing reforms, and could thus be instrumental in generating popular support.

The moderately encouraging conclusion to be drawn from this is that, while public support for market reform in central Europe may have been weakened by the failures of governance, it could, by the same token, be re-invigorated by improvements in the same sector. In that way, like in many others, today's central Europe has come to resemble the continent's western half, whose problems it has come to share to a remarkable degree, including that of bringing new, often raucous, voices into the national political choir. Whether, after the present pause for breath and reflection, central Europe recovers its reforming momentum will depend – as it will in western Europe – ultimately on the courage and the wisdom of its political class. In many ways, obviously, the reforming might be harder without both the stimulus and the pressure of the EU accession process, now successfully completed. But Central Europe's record during the past decade-and-a-half provides a good basis for hope that the region will, as on so many occasions before, confound the pessimists.

Endnotes

1 Central Europe, as defined here, compromises the Czech Republic, Hungary, Poland, Slovakia and Slovenia as well as the three Baltic Republics (Estonia, Latvia and Lithuania).

2 There were, inevitably, some variations. Intriguingly, it was the long-cut-off and shut-in Baltic Republics (especially Estonia) that have proved to be more zealous reformers than, for example, the relatively wide-open Slovenia. Indeed, the Slovenes have surprised many outsiders by opting for extreme caution not only in economic reforms but also in the political sphere, where they demonstrated it by keeping their post-communist successor parties in power longer than any of the other seven countries under consideration here (from the proclamation of the country's independence in 1992 till 2004, with a few months' interruption under the centre-right government of Prime Minister Andrej Bajuk in 2000).

3 Janos Kornai, *The Great Transformation of Central Eastern Europe. Success and Disappointment* (in *Economics of Transition*, Volume 14, No.2 – 2006. pp. 207-244). The German-language version of Professor Kornai's paper was published under the title '*Transformation Mitteleuropas: Erfolg und Entauschung*' in the Vienna quarterly *Europaische Rundschau* (2005/4 – *Herbst*, pp. 3-32)

4 For Lithuania as well as Estonia and Latvia, their close proximity to Russia and their recent memory of the exceptionally harsh experience of direct Soviet domination, made membership of NATO as important as that of the EU. (NATO membership was somewhat less important and urgent for the Czech Republic, Hungary, Slovakia and Slovenia, though for Poland, as for the Baltic Republics, NATO was from the start an absolutely top priority). The special challenges and prospects for the Baltic states as members of NATO in the political and security fields are discussed expertly and fully in *The Baltics: from nation states to member states* by Kestutis Paulauskas, a senior official in Lithuania's Ministry of National Defence, in *Occasional Paper No. 62* (Paris, The European Union Institute for Security Studies, February 2006, 42 pages).

5 Yugoslavia's President, Josip Broz Tito admonished the country's judges on 22 December 1971, the Yugoslav People's Army's Day "not to cling to the letter of the law as the drunk clings to the fence" ('*Sudije, ne drz'te se paragrafa zakona kao pijan plota*')

6 Comprehensive monitoring report of the European Commission on the state of preparedness for EU membership of Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia: COM (2003) 675; European Commission, Bulletin of the European Union, 11-2003, point 1,5,3.

7 In fact, so enthusiastic have the voters of central Europe been to use their democratic prerogative to kick out the incumbents at successive parliamentary elections that for a decade and a half since 1991 no sitting government has succeeded in being re-elected. The only exception so far has been the centre-left coalition government of Prime Minister Ferenc Gyurcsany in Hungary, which bucked the trend by getting itself re-elected in April 2006.

8 Kornai, op.cit., page 228 (German version, p. 18).

9 The above-mentioned parliamentary elections took place in Poland on 25 September 2005; in Hungary on 9 and 23 April 2006; in the Czech Republic on 2 and 3 June 2006; and in Slovakia on 17 June 2006. The crop of recently published studies of those elections in the context of the current political situation in individual central European countries includes some that deserve particular attention.

Czech Republic.

The Czech Deadlock by Jiri Pehe, Director of New York University in Prague and former adviser to President Vaclav Havel, in the *Analyst* (Budapest, Vol 2. No.2, June 2006, pp. 15-26)

Hungary.

Uberflussige Unannehmlichkeiten – Ungarn nach der Wahl by Laszlo Lengyel, political scientist and Chairman of the Financial Science Association in Budapest, in Europaische Rundschau (Vienna, 2006/2 – Fruhjahr, pp. 49-57).

Gravedigger or Innovator? The Gamble of Ferenc Gyurcsany by Paul Lendvai, journalist and former Director of the External Service of Austrian Radio and Television (ORF), in the Analyst (Budapest, Vol.2, No.2, June 2006, pp. 5-14).

Hungarian Foreign Policy from Antall to Gyurcsany by Endre Gomori, journalist and columnist of Figyelo, Hungarian economic weekly, in the Analyst (Budapest, Vol. 2, No. 2, June 2006, pp. 57-82).

Poland.

Zuruck in die Zukunft. Polens Weg in die IV. Republik by Joana Radzyner, central Europe correspondent of Austrian Radio and Television (ORF), in Europaische Rundschau (Vienna, 2006/2 – Fruhjahr, pp. 39-57).

Slovakia.

Catastrophic Scenario in Bratislava by Miroslav Kusy, head of the political science department at the Komensky University in Bratislava, in The Analyst (Budapest, Vol. 2. Number 2, June 2006, pp. 27-40).

Slowakei – kleine Nation, grosse Mythen by Rudolf Chmel, former Slovak Minister of Culture and Czechoslovakia's last Ambassador in Budapest (1990-1992), in Europaische Rundschau (Vienna, 2006/2 – Fruhjahr, pp. 59-69), reproduced from The Analyst, Budapest, March 2006.

10 'The shoelace handicap', *The Economist*. 22 July 2006, pp. 45-46.

11 *'Constitutionalism and credibility in reforming economies'* by Raj. M. Desai and Anders Olofsgard (in *Economics of Transition*, Vol. 14, No.3 – 2006, pp. 479-504).

12 *ibid.*, p. 480.

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Law in transition online

European Bank for Reconstruction and Development

Supporting small and medium enterprises in central Europe

The EU/EBRD SME Finance Facility supports the development of small and medium-sized enterprises in the new EU member states and the EU accession countries. This article discusses the role of the facility and its impact on small businesses and the financial sector in the region.

Carine Smith, formerly Senior Counsel, EBRD

Introduction

Small and medium-sized enterprises (SMEs) are widely recognised as being engines of sustainable economic growth, job creation and exports. A financial sector with the necessary technical ability, strategic commitment and long-term financial resources to address the requirements of SMEs is seen as a cornerstone of a healthy economy.

A key element of the EBRD's small business strategy is the sustainable provision of finance and financial services to local enterprises through financial institutions. The EBRD's main instrument for financing small businesses in central Europe is the EU/EBRD SME Finance Facility, which is co-sponsored by the European Commission.

The primary objective of the EU/EBRD SME Finance Facility is to support the development of small businesses in the new European Union (EU) member states and EU accession countries. This is done by improving access to finance and ensuring sustainability of finance through local institutions. The facility was established in 1999 and has proved to be a success, becoming a major provider of funds to SMEs in the beneficiary countries.

Promoting SME finance

SMEs play a central role in the European economy. They provide a major source of entrepreneurial skills, innovation and employment. In the enlarged EU of 25 countries, some 23 million SMEs provide around 75 million jobs and represent 99 per cent of all enterprises. These businesses make a major contribution to growth in the EU and are at the heart of the so-called Lisbon Strategy. The major objective of the Lisbon Strategy, set out by the European Council in Lisbon in 2000, is to turn Europe into the most competitive and dynamic knowledge-based economy in the world.

The development of the SME sector is central to the EBRD's transition mandate. Long-term sustainable economic growth will only be achieved through the development of a vibrant entrepreneurial sector. Active promotion of this sector is both a means and an end to the transition to a market economy. The ability of SMEs to grow, however, highly depends on their potential to invest in restructuring, innovation and qualification. These investments need capital and access to finance. To assist SME development, the EBRD provides finance and financial services to small enterprises through local banks and other financial institutions.

Financial institutions and markets are underdeveloped in even the most advanced of the EBRD's countries of operations. The EBRD targets SME support since the participation of SMEs in the formal financial sector is inadequate and instruments beyond foreign bank entry and bank privatisation are needed to accelerate their development.

Providing sustainable lending and universal financial services to the SME sector is a key element of financial sector development in the region. EBRD investment is designed to bring benefits both to SMEs and the financial institutions that engage in SME financing with the view to ultimately making these financially sustainable.

The EU/EBRD SME Finance Facility

In April 1999 the EBRD and the European Commission launched the EU/EBRD SME Finance Facility. The facility provides medium and long-term funds for SMEs in central Europe, in particular enterprises in Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia. Enterprises in Croatia also now benefit from the facility following the country's acceptance as a candidate for EU membership. The facility has widely demonstrated the potential for banks and leasing companies to serve the SME market segment in the beneficiary countries.

The primary objective of the facility is to support the development of the SME sector through improved access to finance and by ensuring the sustainability of SME finance through local financial intermediaries. This is achieved through a combination of:

- EBRD credit lines
- technical assistance from the European Commission
- EU performance incentives.

Together these factors aim to ensure participating financial institutions have the necessary tools and capacities not only to enter into or expand their SME finance business, but also to remain committed to SME finance even after the end of the facility and in the absence of incentives.

The facility is well established and a major provider of funds to small business. Under the facility, participating banks and leasing companies receive loans and lease finance from the EBRD for on-lending to SMEs. The European Commission supports the programme with grants in the form of technical assistance and performance fees. These encourage the participating financial intermediaries to enter into or expand their SME finance business. In addition, the facility has an equity window for investments in specially focussed SME equity funds.

By the end of 2005 the facility had €1,100 million of EBRD financing committed under the loan and leasing "window", €32.5 million investments in equity funds and a contribution of €173 million from the European Commission in technical assistance and performance fee funding. With a focus on institution building, the facility has played a key role in the development of SME finance at the participating financial institutions.

EBRD credit lines

Under the loan and leasing window of the facility, financing is provided by the EBRD in the form of a credit line extended on a competitive basis to participating banks and leasing companies. These institutions are selected on the basis of their financial strength, branch network and, most importantly, their commitment to engage in SME financing.

EBRD loans are usually extended for five years, with a maximum maturity of eight years. The average loan size ranges from €5 million to €20 million, depending on the capacity of the financial institution to utilise the funding over a two year period of availability. The EBRD charges a market based interest margin which reflects the participating financial institution's credit risk and country risk.

SMEs financed under the facility are subject to specific eligibility criteria. They must be locally incorporated and privately owned legal entities, including sole proprietors. They must also satisfy the European Commission's definition of an SME, which has been widely applied throughout the EU.[1]

According to this definition, an SME should employ fewer than 250 persons and have an annual turnover not exceeding €50 million and/or an annual balance sheet total not exceeding €43 million. There is also an independence criterion. There are, in addition, separate thresholds in respect of headcount, annual turnover and annual balance sheet for small and micro businesses.

The sub-loans and sub-leases extended by the financial institution under the facility will normally be for:

- small enterprises with up to 100 employees, with an annual turnover ranging from €30,000 to €125,000 (average €50,000)
- micro enterprises with less than 10 employees, with an average turnover of up to €30,000 (average €10,000).

EBRD funding under the facility may be used by the eligible SMEs to finance investments in fixed assets and working capital and may not be used for any products listed in the EBRD environmental exclusion list.

At the end of December 2005, the EBRD had committed €934.5 million in projects across 10 of the eligible 11 countries. The first project in Croatia was recently signed and a number of potential projects in the country have been identified. Poland remains the largest recipient country, with €230 million extended to local financial institutions.

The committed credit lines are divided as follows: 59 per cent are extended to banks and 41 per cent are extended to leasing companies. Under the facility, funding for more than 64,000 sub-projects has been disbursed to SMEs for a total amount of €1.4 billion. Disbursements to SMEs from participating financial institutions have continuously outpaced disbursements from EBRD credit lines (see Chart 1). This indicates that the participating institutions are efficiently recycling repaid funds back into the SME sector and that most of them are building up their portfolios before requesting disbursement of further EBRD funds.

Technical Assistance

Local banks in the new EU member states and the EU accession countries are becoming increasingly involved in the SME sector. These banks can, however, benefit from building stronger skills in SME finance.

As part of the EU/EBRD SME Finance Facility, funding from the European Commission in the form of technical assistance is provided to participating financial intermediaries to support institution building or institutional reform. The technical assistance programmes are exclusively designed to contribute to institution building goals. These programmes provide for the transfer of know-how and technology that not only improves the participating financial intermediaries' capacity to finance small businesses, but also helps them to build sustainable SME financing activity.

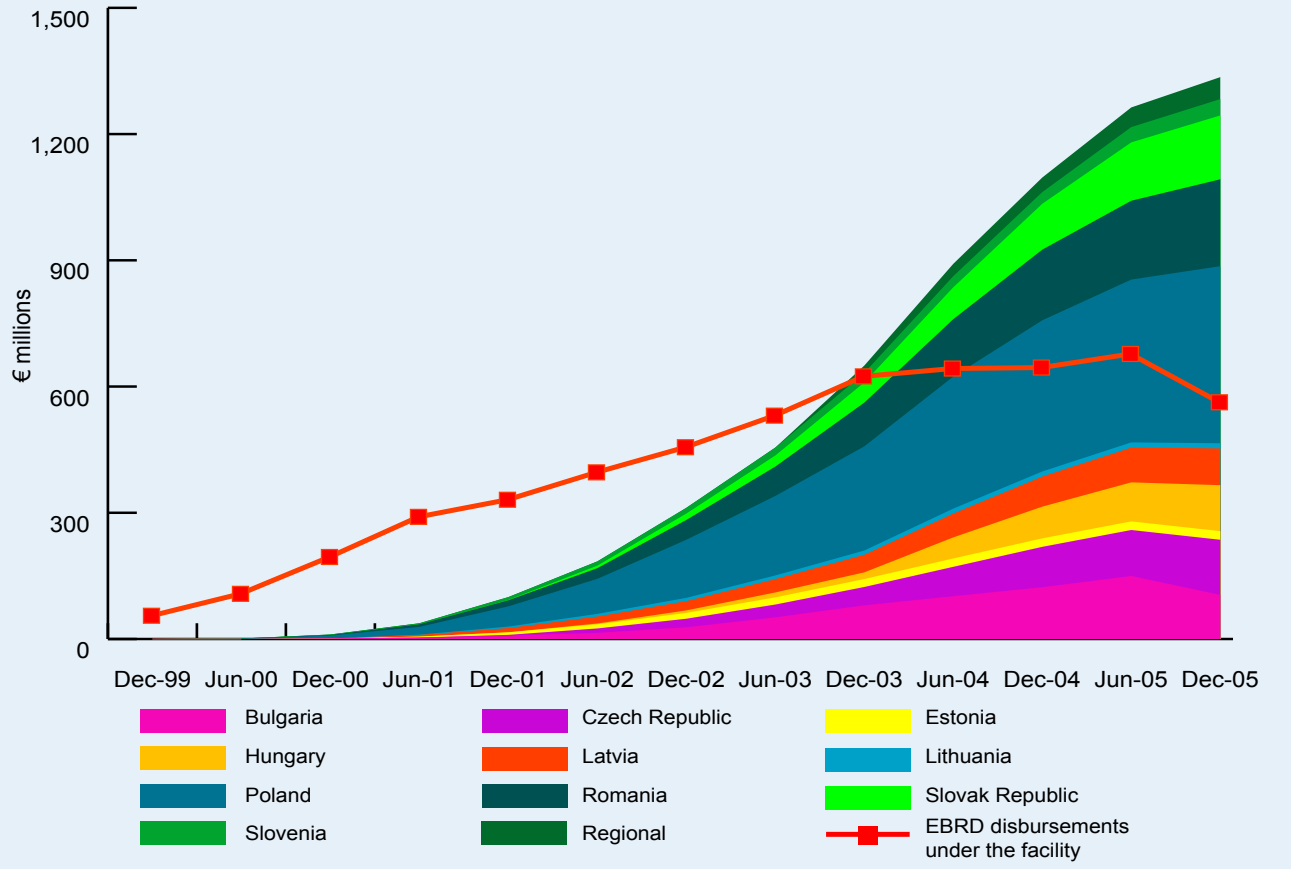
The technical assistance element of the facility aims to ensure that, in time, these institutions will have the capacity to continue successfully expanding SME financing and make it a sustainable and integral part of their business in the long term. In addition, the best practices introduced as a part of the facility benefit the entire business of participating financial intermediaries.

Under the technical assistance component of the facility, participating financial institutions benefit from training programmes which are tailored to enhance their SME lending skills. This training may focus on one or more of the following areas:

- streamlining or strengthening lending procedures and management practices needed for SME lending
- training staff with respect to best practice in micro and small loan appraisal, supervision and administration
- developing and implementing credit scoring schemes to fit the participating financial intermediary's needs and requirements
- improving management information systems which are specifically geared towards SME portfolios and, in particular, micro loan portfolios
- strengthening the participating financial intermediary's marketing of loans and other financial services to SMEs.

The technical assistance structure and amount are based on the needs of each participating financial intermediary. It normally provides for an experienced Western adviser and local consultants to work with the participating financial intermediary over a defined period. The consultants are selected on a competitive basis and are paid by EU grant funds.

Chart 1: EU/EBRD SME Finance Facility
Disbursements from participating financial institutions to SMEs



Souce: EBRD

Technical assistance has played a central role in encouraging financial institutions to support the SME sector. It has also helped to broaden the reach of the facility across international and local commercial banks. Through the technical assistance programme, the EBRD has been able to accompany its investment with significant institution building support.

The programme addresses all aspects of SME finance including credit methodology, information technology, universal banking services and corporate governance. As of December 2005, 4,429 staff across all participating financial intermediaries had received training. These programmes are successfully achieving their objective of helping the participating financial intermediaries to build stronger skills in small and micro business finance.

EU performance incentives

In addition to technical assistance, EU grant funds provide participating financial intermediaries with a performance fee to compensate for the administrative costs and risks of entering into or expanding their activity in the SME business segment. In order to earn the performance fee, the participating financial intermediaries must expand their SME business and provide finance to new SME clients.

The participating financial intermediaries must also maintain a sound quality portfolio by ensuring that the SME loan portfolio at risk for 60 days or more does not exceed a certain percentage of the total SME portfolio funded by the EBRD credit line. This limit is 5 per cent for participating banks and 8 per cent for participating leasing companies. To ensure these institutions do not exceed these limits, rigorous credit analysis, frequent amortisation of principal payments and active problem solving are undertaken.

The performance fee starts at a maximum of 5.5 per cent per annum of the outstanding SME loan portfolio for micro loans and 3.5 per cent per annum for small loans in the first three years after receiving the EBRD credit line. It is phased out over the two following years. The payment is set off against semi-annual interest payments due to the EBRD and is based on the EBRD-funded SME loan portfolio outstanding during the month prior to such payment.

The performance fees are allocated to each project on the basis of estimates at project approval stage. These estimates are based on certain assumptions regarding the disbursement schedule of the EBRD credit line and the composition of the outstanding sub-project portfolio (micro versus small) over the life of the loan. In some cases the actual performance fee payments may fall below the estimated amount. This is typically due to slower than expected disbursements or a different portfolio composition than originally expected. For well performing projects where it is likely that the approved performance fee amount may not be fully utilised, the EBRD may increase its loan amount to the participating financial intermediary in order to achieve a greater impact and, at the same time, ensure the efficient utilisation of the European Commission's resources.

Reaching out

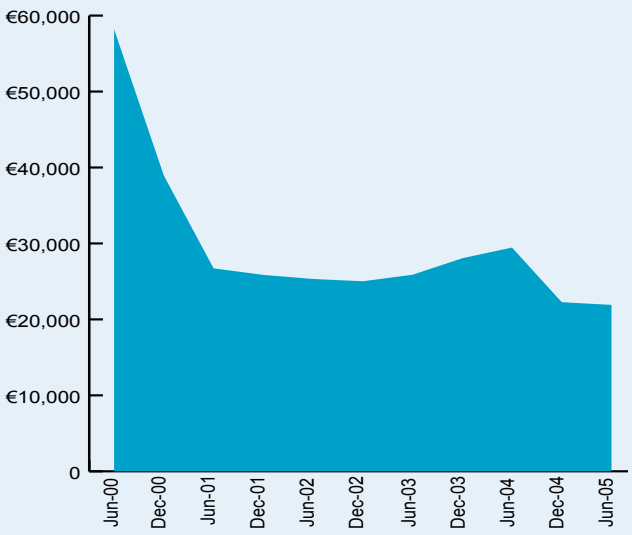
The facility aims to ensure that both the low end of the SME spectrum and SMEs operating in regional areas benefit from financing. The facility is successfully reaching micro businesses and achieving a balanced regional coverage in the beneficiary countries in line with the programme objectives.

SME beneficiaries and sub-project size

The extent to which the facility reaches the lower end of the SME sector can be measured both in terms of the actual size of the SME beneficiaries, measured by number of employees, annual turnover and balance sheet, and the size of the sub-loans provided to such SMEs. The average number of employees at the SMEs benefiting from the facility is well below 100. Similarly, the average annual turnover and balance sheet of the SME beneficiaries ranges from €0.6 million to €0.9 million for small businesses and from €0.3 million to €0.5 million for micro businesses. These indicators, which match or are below the facility's targets, demonstrate that it is successfully reaching micro and small businesses.

The average project size financed under the facility is small and has been steadily decreasing (see Chart 2). As of December 2005 the average project size was €18,316 for leasing projects, €23,134 for lending projects and €21,513 overall. This figure is expected to decrease further as more participating financial intermediaries concentrate on micro clients. With an average transaction size of €22,000 in the more advanced countries, the facility has proved to be an effective instrument in encouraging banks and leasing companies to provide financing to SMEs at the lower end of the market.

Chart 2: EU/EBRD SME Finance Facility
Average SME loan or lease size



Source: EBRD

Regional coverage

The EBRD and the European Commission decided in 2004 to introduce a rural window to the facility. This was due to SMEs in rural areas and in the agricultural sector having limited access to financial resources. Reforms to the rural economy in the beneficiary countries had been relatively slow and the rural areas still faced a number of transition challenges. Lack of finance had, in particular, been a key barrier to economic development. Rural and agricultural firms faced severe obstacles in obtaining credit, in particular long-term loans, but also short-term financing which would take into consideration the seasonality of their business.

The EBRD's mandate complements the EU's interest in deepening rural credit markets and assisting financial intermediaries to obtain the skills and funding needed to provide finance in rural areas. It was, therefore, agreed to use the umbrella of the facility, combining institution building and financial incentives funded by the EU with EBRD credit lines, to achieve credit market deepening and further regional coverage. The rural window of the facility makes finance available to both agricultural and non-agricultural enterprises and provides credit to farms and agribusinesses which show growth potential and demonstrate repayment capacity.

Funding for the rural window is following a similar approach to the rest of the facility. The participating financial intermediaries receive a risk mitigation fee in order to compensate them for the costs and risks of entering into or expanding their business in rural areas. The European Commission also provides technical assistance funding, tailored to help the intermediaries to better analyse and manage the risks of lending to farmers and enterprises which are dependent upon the agricultural economy. In respect of the credit line, the EBRD offers flexible loan repayment schedules which reflect business seasonality and less restrictive collateral policies.

The introduction of the rural window has resulted in balanced country coverage by the facility. Loans to SMEs located outside of capital cities account for 66 per cent of the facility portfolio, with the activities of the participating financial intermediaries being widely distributed throughout the regions (see Chart 3). The achievement and maintenance of good regional coverage will continue to be one of the objectives of the facility.

Despite significant improvements over recent years, the need for medium and long-term SME financing remains high, particularly in regions outside the capital cities where access to finance is more limited. With a structure that combines funding with an incentive package, the facility provides important support and encouragement to participating financial intermediaries to reach out to small businesses in rural areas.

Evaluating the facility's impact

Since 2004 the EBRD has regularly evaluated the technical assistance programmes under the facility. Upon completion of each sub-project, the relevant participating financial intermediary is requested to provide feedback and evaluate the assistance received. The main finding of these evaluations has been that the facility has a significant impact on encouraging participating financial intermediaries to recognise the SME segment as one of the most promising business opportunities in terms of growth potential and profitability.

Chart 3: EU/EBRD SME Finance Facility

Volume of SME sub-projects outside of capital cities as of 31 December 2005

Source: EBRD

Showcase – Financing a family bakery in Romania

An ever-growing number of entrepreneurs are turning to banks supported by the EU/EBRD SME Finance Facility to develop their small businesses. A typical example is the case of Mr and Mrs Bugescu from Timisoara in Romania. In 2001 the couple approached the Romanian Commercial Bank for a loan to support the development of their family bakery. Using financing provided under the facility, the bank extended a loan of €40,000 for four years to finance the purchase of ovens and pastry equipment.

Benefiting from a long-term loan at a competitive interest rate, the couple have more than doubled their sales, increasing production from 6,000 loaves a day to 15,000. As well as expanding their distribution network, the Bugescus have reduced energy costs by converting from diesel to gas. As a result of the expansion, the workforce has grown from two people in one bakery to 36 staff across five bakeries. Annual sales have grown to €325,000 and consumers now have a wider choice of higher-quality fresh bread.

The participating financial intermediaries consider the advisory services provided in the areas of risk management processes, specialised SME finance training, optimisation of business and approval processes and marketing to have been most beneficial. As a result, the participating financial intermediaries have broadened their range of products to include long-term financing. In addition, they have adapted their loan procedures by introducing new solutions and reducing the amount of documentation required, simplifying the loan process and focusing on the creditworthiness of the borrowers. The programme has, furthermore, improved the organisational structure of the participating financial intermediaries and the development of SME strategy. This has, in turn, increased the number of SME clients and improved regional coverage.

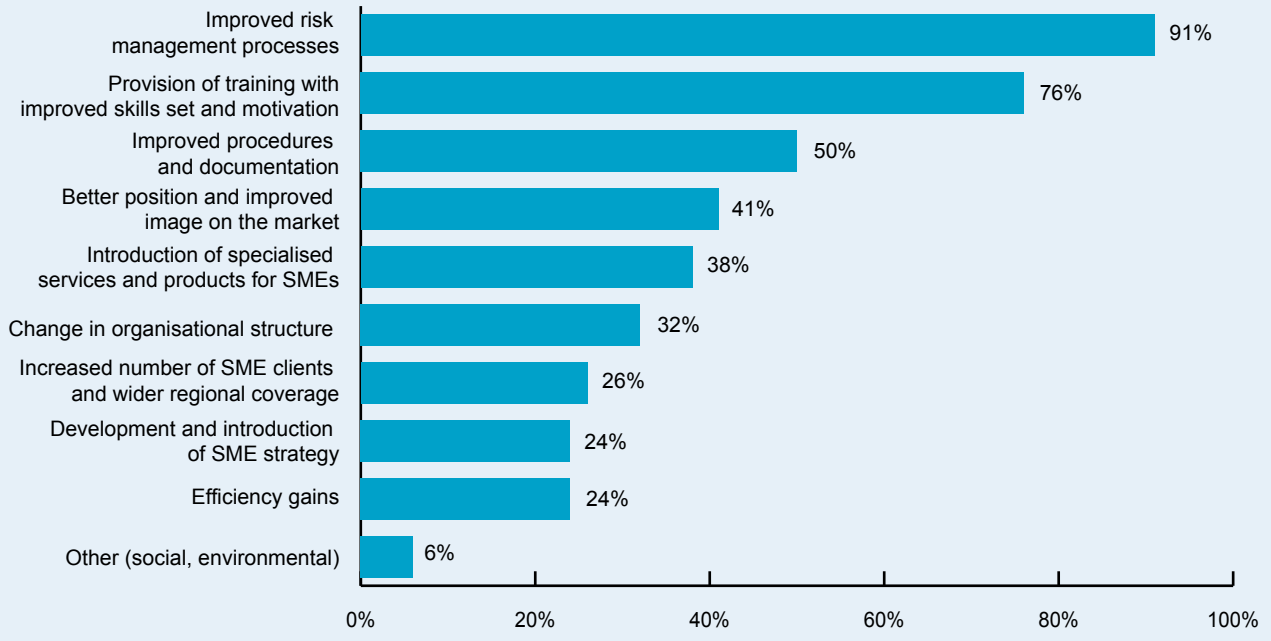
The most important long-term impacts and benefits of the technical assistance programme achieved under the facility, as perceived by the participating financial intermediaries, can be seen in Chart 4.

The facility has now reached a certain degree of maturity. Many of the projects have met the facility's key objectives, making SME financing a sustainable business for the participating financial intermediaries and facilitating SME access to finance. The facility has already successfully lowered barriers for SMEs to receive financing and achieved broad regional coverage.

Participating financial intermediaries have enhanced competition in the SME finance sector. In a number of cases, second credit lines under the facility are being used to address the persistent demand for long-term funding in the market and help the participating financial intermediaries build significant business volume.

In 2005, for the first time, projects under the facility graduated from EU support. EBRD evaluation demonstrates that institution building, one of the key objectives of the facility, was achieved in all graduated projects. In total, 17 projects with 12 participating banks graduated from grant funding during 2005. All of these projects achieved the key performance targets and institution building objectives.

Chart 4: EU/EBRD SME Finance Facility
Main long-term impacts of the technical assistance programme



Note: The bar shows the percentage of participating financial intermediaries who reported such perceived impact. Source: EBRD

Due to the technical assistance programmes, the financial intermediaries which have graduated from EU support have expanded their businesses, strengthened their SME financing skills, improved and streamlined their SME lending procedures and built a sustainable SME business, which they are actively continuing with their own funds.

Despite the success of the facility and the substantial progress made in improving access to finance in central and eastern Europe, additional work remains to be done. The main challenges in the financial sector in relation to SME financing are the low level of financial intermediation and the limited financial instruments available to SMEs, particularly in rural areas. This remains true even in the new EU member states. The EBRD, together with the EU, is committed to continuing to support the development of SME finance through the facility.

Endnotes

1 Commission Recommendation 2003/361/EC of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises, which entered into force on 1 January 2005.

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Law in transition online

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Implementing public-private partnership projects in the Baltic states

This article examines the legal and policy environment for implementing public-private partnerships (PPPs) in the Baltic states – Estonia, Latvia and Lithuania. The article also provides an overview of PPP projects which have already been implemented in these countries and defines current trends.

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Introduction

Over the past several years, public-private partnerships (PPPs) have became an increasingly important financial instrument for the funding of public sector projects. Private entities are showing more and more interest in PPP projects and view them as a form of safe and reliable investment. Public entities perceive PPPs as a good way of attracting private investment in public projects and carrying out their functions without taking all of the related risks. However, to date there have not been many PPP projects in the Baltic states and the public sector often lacks the ability to manage such projects with the necessary level of expertise.

The concept of PPP

In the Baltic states, as well as throughout the European Union, PPPs are understood to be contracts between private and public entities. Under these contracts, a private entity performs the functions traditionally undertaken by a public entity. The parties to the contract also agree to share the risks related to the project.

Usually the parties to PPPs enter into long-term contracts (normally between three and 30 years) under which the private partner undertakes to develop a public infrastructure project. The private partner is also given the subsequent right to operate this infrastructure. Alternatively, the private partner may be given the right to operate an existing public infrastructure project and will undertake to renovate and maintain it and provide certain public services.

The private partner is compensated for its undertaking either by receiving income from end-users of the infrastructure or by being paid a fixed amount by the public partner. Alternatively, a mix of these two types of compensation may be paid. The main feature of PPP projects is the distribution of risk whereby the private partner must take all or part of the risk associated with the project, whether it be construction, availability or demand risk or a combination of these factors.

A significant level of technical assistance was provided by the European Bank for Reconstruction and Development (EBRD) to Latvia and Lithuania between 2002 and 2006. This assistance has helped the countries upgrade their PPP legal frameworks. The legislation of each of the Baltic states generally follows the PPP formats described above, however, it does not establish a statutory definition of a PPP.

Broad definitions of PPPs can be found in non-binding legislative instruments. In 2005 the Cabinet of Ministers of Latvia adopted guidelines for facilitating PPPs in the country. Under these guidelines a PPP is described as "...cooperation between a public entity and a private person, within which any public service is assigned to the private partner on a contractual basis for a certain period of time and on the condition that the private partner will provide public services and attract resources from the private sector".

Quite a similar definition has been adopted by several institutions in Estonia. The Estonian Accounting Standards Board, for instance, issued guidelines in which a PPP is defined as a "long-term cooperation project between a public entity and a private entity according to which the private sector partner constructs, renovates or acquires assets for a specific PPP project (PPP assets) and provides services of the agreed scope and quality that are based on the use of such created PPP assets and where the public sector partner is the main purchaser of the services provided by the private sector partner".

The legal form of PPP contracts

Generally, private and public entities can enter into PPPs in three main ways:

- by undergoing a concession granting tender and subsequently concluding a concession agreement
- by undergoing public procurement procedures and concluding a procurement agreement[1]
- by concluding a civil law contract between the public and private partners.

Legislation in the Baltic states does not require PPP contracts to be in one particular form. In Lithuania, for instance, public and private entities can enter into PPPs under the first two forms indicated above, either as a concession agreement or a public procurement agreement. In theory a civil law contract is also possible, but only in cases where the project cannot be classified as either a concession or a public procurement contract. This is due to recent legal developments which have introduced a very broad concept of concession and the changes in public procurement legislation which allow long-term public procurement contracts.

Future PPP projects in Lithuania will be implemented by way of public procurement. This is due to the permitted length of procurement contracts being prolonged. Prior to the revision of concessions and public procurement legislation, all PPP contracts in Lithuania were concluded in the form of civil law contracts (for example, the lease of the Vilnius central heating company and the Hales market reconstruction and long-term lease).

Following the revision of the laws, the situation substantially changed and now a number of PPP contracts that involve risk sharing and/or compensation from end-users have started to be entered into as concession contracts. These include the Trakai heating system concession agreement and the construction of the Panevėžys fitness centre.

According to the guidelines facilitating PPPs in Latvia, public and private entities can enter into PPP projects either by concluding concession agreements under the Law on Concessions, or under any other agreement (for example, a service agreement, a design construction agreement, or a maintenance agreement) by way of public procurement.

In contrast, the legislation of Estonia adopts an even wider approach. PPP contracts in Estonia can be entered into as ordinary civil law contracts in which the parties agree on the distribution of their rights and obligations. Examples of this type of PPP agreement include municipal housing projects and the renovation and maintenance of secondary schools in Tallinn, which were concluded in the form of lease agreements.

Institutions most interested in PPPs

According to legislation in the Baltic states, PPP contracts can be entered into by central or municipal governments. However, according to accepted practice, central government institutions treat PPPs with great caution and remain reserved about them. In clear contrast, municipal governments have indicated a high level of interest in and initiative towards PPP projects.

Currently in Lithuania there are a number of pending concession granting procedures including a project for the construction, maintenance and operation of a tramway in Vilnius, a project for the renovation and maintenance of schools in Vilnius and Kaunas and a project for the provision of primary health care services in Vilnius. In addition, a project for the construction of sports arenas in Kaunas and Šiauliai and a project for the operation of a sports arena in Panevėžys are also being considered. All of these projects are being implemented at the municipal level. One of most important factors driving the municipalities towards concessions is the municipalities' limited ability to borrow and fund projects by way of traditional procurement.

Similar situations have also arisen in Latvia and Estonia. According to data from the Register of Enterprises in Latvia, up until June 2006, 13 concession agreements had been concluded and all of them had been entered into at the municipal level.

PPP guidance institutions

Currently Lithuania and Estonia do not have strong institutions responsible for monitoring and providing guidance on PPP projects. However, appropriate steps have been taken to rectify this situation. The parliament of Lithuania recently adopted amendments to the Law on Concessions whereby it allowed the establishment of a single institution which would be responsible for the provision of methodological support for concession projects.

In addition, Lithuania's Ministry of Finance launched a separate initiative and established a special unit which is responsible for the fiscal supervision of PPPs. However, this institution does not produce products which would facilitate PPP type investments, such as policy guidelines or plans of areas which would be good for PPP type investments.

In Estonia the establishment of institutions responsible for the guidance of PPP projects is in the project phase. It is projected that these types of institutions will be established in Estonia in 2006-07 and shall accumulate best practices and statistics and provide consulting on the implementation of PPP projects.

The most advanced Baltic state in this sphere is Latvia where the responsibility for PPP projects has been assigned to two main institutions:

- the Ministry of Economics, which is responsible for developing PPP policies and coordinating their implementation
- the Latvian Investment and Development Agency (LIDA), a state agency which implements PPP projects, draws up proposals to facilitate PPP development, and supports the implementation of PPP projects.

According to a February 2006 briefing on the implementation of guidelines facilitating PPPs in Latvia, the Ministry of Economics stated that it plans to create an Advisory Board on PPP issues in 2006 and set up a PPP web site which will include interpretative materials, laws and regulations, methodology and guidelines, standard documents, current events, executive updates, information from abroad and useful links. The Ministry also plans to organise informative seminars for public institutions on the methodology behind the PPP project management cycle and on standard documents necessary for the development of PPP projects.

LIDA has also been active. It carried out research on five pilot projects submitted by municipalities. LIDA also plans to develop methodology on the PPP project management cycle, to make frequent updates and to develop a standard agreement for PPP projects. To date, LIDA has developed a series of methodological materials, including a description of the PPP project cycle, recommended content for a standard agreement for PPP projects, an overview of the advantages and drawbacks of the most common PPP agreements and a questionnaire on the project concept.

In this respect, Latvia is ahead of the other two Baltic states in monitoring and providing guidelines for PPPs. Lithuania and Estonia have made no significant attempts to draw up guidelines or model agreements. However, this situation is expected to change in the near future, as Lithuania and Estonia make steps toward establishing institutions which will be responsible for the support and accumulation of best practices.

PPP projects being undertaken in the Baltic states

Estonia

Only two major PPP projects are being undertaken in Estonia:

- Six hundred and fifty new apartments are being developed and maintained over the next 30 years by a private partner. The municipality has agreed to provide the private partner with additional land that can be used for commercial needs and to pay a yearly service payment. The approximate amount of investment is €25 million.
- Ten secondary school buildings in Tallinn are being renovate and maintain by a private partner. The municipality has agreed to pay a yearly service payment for the services. The approximate amount of investment is €33 million.

Latvia

Several interesting PPP projects have already been undertaken in Latvia. In addition, five pilot projects will be implemented, pursuant to research carried out by LIDA. These include:

- In Salaspils, a private partner has agreed to construct 150 apartments, 50 of which are designated for the needs of the municipality. The municipality will provide the private partner with the land necessary for the construction of the houses. The approximate value of the project is €6.6 million.
- In Cesis, a private partner will construct and manage a preschool educational establishment. The municipality has agreed to provide the private partner with the land necessary for construction and to pay a monthly fee for the provision of services. The approximate value of the construction is €4.6 million.
- In Jekabpils, a private partner is set to modernise and operate the local heating system. The municipality has leased the heating system to the private partner for 30 years and has granted it the right to receive income for the services from end-users. The approximate amount of investment is €4.3 million.

Various Latvian institutions, including the central government, are currently considering the implementation of extensive PPP projects. These include the reconstruction and management of state main roads (valued at approximately €960 million), the construction of the administrative centre of the Riga City Council (approximately €61 million), the renovation of the Riga light system (approximately €283 million) and the construction of the Via Baltica northern corridor in Riga (approximately €1.3 billion).

Lithuania

Three key PPP projects have been implemented in Lithuania:

- The Siemens arena, water and amusement park in Vilnius involved the investment of €38.5 million by a private partner for the construction and operation of the facility. Ten per cent of arena operator shares have also been transferred to the municipality. The municipality provided the private partner with a 61 hectare plot of land without charge and invested €4.5 million in road infrastructure.
- The heating system of Trakai has been leased to a private partner. The private partner has taken over all of the debts of the municipal company which previously operated the heating system and has been granted the right to receive income for services from end-users. The private partner will also modernise, operate and maintain the infrastructure and pay to the municipality a concession fee amounting to €2.1 million over a 25 year period.
- The concession contract for the Panevėžys fitness centre stipulates that the private partner will construct in the area assigned by the municipality a fitness centre for three major sports, maintain and operate it and ensure the provision of sports services. The municipality is required to lease to the private partner the land required for the construction.

In addition, there are several municipal projects currently in the initial stages of development. The most interesting include the design, development, maintenance and operation of the tramway in Vilnius, the provision of primary health services in Vilnius, the construction of arenas in Kaunas and Šiauliai and the reconstruction of transport intersections in Kaunas.

PPPs in the future

Although the legal basis for the proper implementation of PPP projects is quite well developed in the Baltic states, to date not many PPP projects have come to a financial close. However, a number of very interesting projects have been launched and are ongoing. It can be anticipated that in the future PPPs will become an increasingly important instrument for funding public sector projects. It remains to be seen whether the Baltic states will manage to avoid the past failures of other countries where PPPs were sometimes based on incorrect revenue and market assumptions or where project costs were underestimated. The Baltic countries must learn from the best examples of PPPs; projects which have provided good value for money for the public sector as well as a fair return for private investors.

Endnotes

1 Procurement is included in the concept of PPP for the purpose of this article, although the authors appreciate that in most articles, commentaries and assessments, PPPs and conventional procurement are treated separately.

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Law in transition online

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Integrating financial supervision in the Czech Republic

On 1 April 2006 the Czech National Bank became the integrated supervisor of the country's financial market, overseeing banking, securities, insurance companies and pension schemes, and credit unions. This article discusses the process of integration, including the role of market forces and institutional factors, the rationale behind integration, the development of legislation and the organisation of activities.

Michaela Erbenova, Member of the Czech National Bank Board and Chief Executive Director of the Czech National Bank

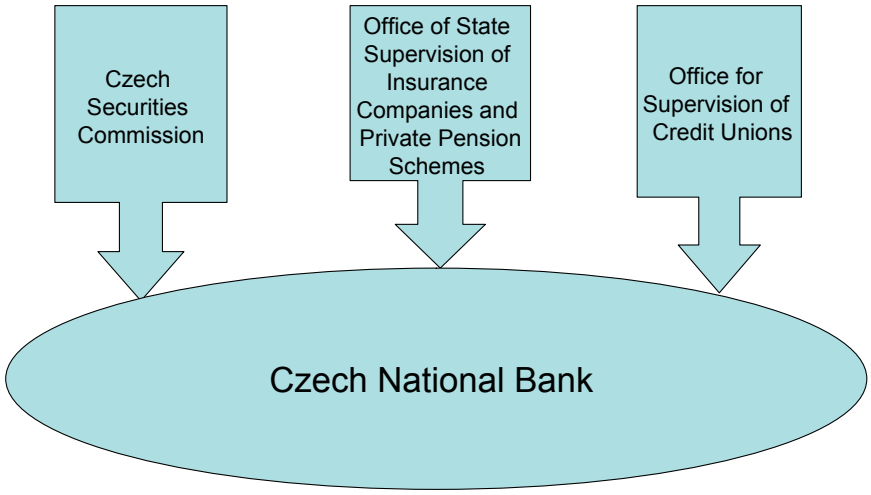
Introduction

Following transition, supervision of the Czech Republic's financial market was undertaken by four separate regulatory bodies. The Czech National Bank (CNB) performed banking supervision, while three other authorities (referred to as the non-bank supervisors) oversaw the securities market and non-bank financial institutions.

The first of these non-bank supervisors was the Czech Securities Commission, acting as a securities regulator. The second was the Office of State Supervision of Insurance Companies and Private Pension Schemes, a department of the Ministry of Finance responsible for supervising the insurance and pension fund industry. The third was the Office for Supervision of Credit Unions, which supervised the credit union sector.

On 1 April 2006 the responsibilities of the three non-bank supervisors were transferred to the CNB as financial supervision in the country moved from a traditional sectoral approach to an integrated model. The CNB became the unified supervisor and regulator of the Czech financial market (see Figure 1).

Figure 1:
Integration of financial supervision in the Czech National Bank



This paper deals with the integration process and covers five topics:

- the role of market forces and institutional factors, and the international experience
- the integration project
- the rationale for integrating financial supervision in the Czech Republic
- the legal basis for integration
- the organisation and activities of integrated financial supervision.

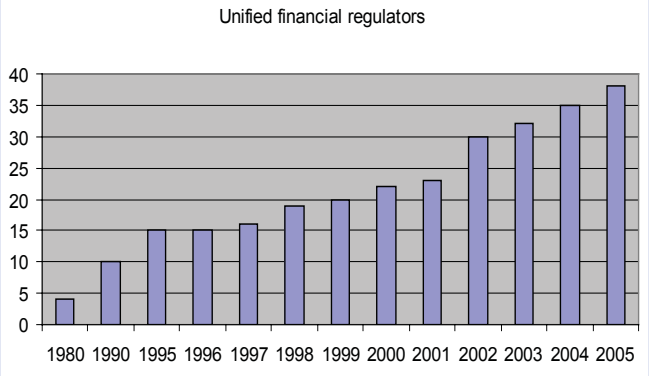
Theory and international experience versus country-specific factors and policy decision making

Until the 1980s, the institutional structure for financial supervision[1] was not a hot topic, with discussions about it mostly academic. During the past two decades, however, strong market forces encouraging the integration of financial supervision have emerged worldwide and moved the issue into the spotlight.

Safeguarding financial stability has become an increasingly dominant objective in economic policy making.[2] Financial systems have expanded significantly faster than the real economy. This financial deepening has been accompanied by changes in the composition of the financial system, in particular a growing share of non-monetary assets and thus greater leverage of the monetary base.

Financial systems have become more integrated, both nationally and internationally, a fact reflected in the rise of financial conglomerates. The systems have become more complex in terms of diversity of activities and cross-sector financial instruments, as well as mobility of risks.[3] This development not only is contributing to economic efficiency, but also has implications for the nature of financial risks and vulnerabilities and their potential impact on the real economy.

Chart 1: Number of unified finacial regulators worldwide



Source: N. Courtis, ed. (2005), How countries supervise their banks, insurers and securities markets 2006 London: Central Banking Publications.

As a result, the role of policymakers in promoting financial stability and soundness is also changing. Research on the institutional infrastructure for financial regulation and supervision has gained momentum and has attracted the attention of policymakers. Numerous governments have taken the decision to create a unified financial regulator that would be in a better position to reflect the growing complexity of the financial system (see Chart 1).[4]

The institutional structures for financial supervision being developed worldwide are quite diverse, in terms of the number of resulting agencies, their precise responsibilities as regards the regulation and supervision of particular sectors and the role and mandate of central banks. This demonstrates that each particular institutional structure is the result of country-specific historical development, and also indicates that there is no single model for financial supervision.[5]

The impact of market forces is always combined with country-specific institutional factors. The integration of financial supervision can follow different patterns and neither the rapidly increasing number of unified regulatory agencies nor the market factors themselves offer a simple blueprint for any particular country. The timing and scope of the integration of financial supervision remains a country-specific and political issue. Nevertheless, theoretical concepts, international experience and analysis of market forces represent an important source of arguments for or against various possible solutions in each country.

Development of the integration project

The efficiency of the Czech Republic's institutional infrastructure for financial supervision was challenged in the second half of the 1990s. At first the authorities coped with market factors, as well as institutional factors such as the overlapping powers of the four existing supervisors, by improving the cooperation between the agencies.

In 1998, the Ministry of Finance, the Czech National Bank and the Czech Securities Commission concluded a memorandum of understanding on the performance of banking supervision and state supervision in the financial market. In 2003, this memorandum was replaced by a new one that, among other things, stipulated that the supervisory authorities would assess performance both on an individual and consolidated basis in the following areas: licensing and granting approvals, inspection, imposing remedial measures and sanctions, exchange of information, regulation of the financial market and international relations.

Although this cooperation developed quite well, the conditions of the Czech financial market suggested that integrated supervision would offer a better outcome. In May 2004, the government first discussed the idea of integrating financial supervision and decided that full integration would be performed in two steps.

The first step was scheduled for January 2006 and consisted of a "two-peak model" whereby the CNB would assume responsibility for supervision of all credit institutions (banks and credit unions), and the Czech Securities Commission would

supervise the securities market and the remaining regulated non-bank financial institutions (pension funds and insurance companies). The second step was planned for 2010 and consisted of setting up a single unified supervisor of the Czech financial market. At that time, no decision was made about the location of this agency and consequently about the role of the central bank in the future institutional design.[6]

In July 2005 the Ministry of Finance and the Czech National Bank made a joint proposal to accelerate the integration process. Instead of a gradual integration by 2010, the establishment of the unified regulator was scheduled to occur in a single step effective as of 1 April 2006. The main rationale for a speedier integration process was to reduce the costs and risks stemming from the reorganisation process itself, reduce the uncertainty about the final institutional design, deliver faster efficiency gains and give a greater assurance of continuity in the supervision process.

In August 2005, the government approved the proposal. Following the decision, First Deputy Prime Minister and Minister of Finance Bohuslav Sobotka explained that: "This integration will allow us to significantly bolster the effectiveness of financial market supervision and at the same time reduce the related costs both for the supervised institutions and for the state". The government's decision provided an important impetus for accelerating the integration process.

The proposed integration schedule was as follows:

- adoption of legislation allowing integration – beginning of 2006
- integration of supervisors – 1 April 2006
- evaluation of the experience and comprehensive legislative audit; incorporation of results into legislation concerning CNB and financial market supervision – 2008.

The project quickly found wide political support. While the government possessed only a thin majority in the lower house of parliament, the Senate (the upper house) was controlled by the opposition. The legislation was nevertheless adopted smoothly by both houses. Financial market participants also welcomed the plan for faster integration of supervision, as they expected that it would foster both better regulation and a decrease in the regulatory burden.

Factors supporting the integration of supervisors into the Czech National Bank

The Czech Republic has a small and very open economy and a relatively small, bank-based financial system (see Table 1). Assets of banks represent almost three-quarters of the total assets of the financial system. Diversified banking groups play a pivotal role in the financial market, underscoring the importance of consolidated supervision.[7] The existence of the bank-based system and the important role of banking groups meant that the CNB, which has traditionally performed banking supervision and regulation, was the obvious candidate for the role of unified regulator.

The other main factors that supported the choice of the CNB as the ultimate candidate for integrated supervisor included:

- *Capacity and cost efficiency*
  The CNB possesses a developed technical infrastructure (premises, IT systems) as well as an efficient system of support services (research, statistics, human resources management, financial control). These systems have sufficiently large capacity to support extended supervisory activities and at the same time to generate economies of scale and scope.

- *Know-how*
  The CNB has accumulated considerable know-how in the field of banking supervision and supervision of financial groups on a consolidated basis, which represents an important asset for the role of unified regulator.

- *Comparative advantage in the labour market*
  In comparison with state authorities, the CNB has a competitive advantage in the labour market. The CNB can offer more competitive and performance-related salaries to specialists in the area of financial supervision.

- *Financial stability issues*
  The integration of financial supervision into the CNB strengthens the links between supervision on a micro-economic level, the role of lender of last resort and macro-prudential analysis. In this way, the integration creates favourable conditions for maintaining financial stability and dealing with possible crisis situations.

  In the Czech Republic, this advantage outweighs the reputation risk related to the central bank carrying out financial supervision. This risk is frequently cited as a reason for appointing an agency separate from the central bank.[8] However, as part of the European System of Central Banks (ESCB), the CNB has a natural basis for international cooperation on financial stability issues.[9]

- *Independence of the CNB*
  The status of the ESCB guarantees the CNB's ability to carry out supervision in line with world's best practice, without being compromised by political pressures or lobbying. In addition, legislation prevents the CNB from having excessive power and establishes greater accountability. In its capacity as unified regulator, the CNB must report to the parliament and receive feedback from the government and industry. Moreover, an agreement between the Ministry of Finance and the CNB guarantees cooperation in the area of financial regulation (see the next section).

Legal basis for the integration

Act No. 57/2006 Coll., on the amendment of acts in connection with the integration of financial market supervision (hereinafter the "Act on the integration of financial market supervision" or the "Act"), creates the legal basis for transferring supervision to the CNB. This law, which entered into force on 1 April 2006, is a large and complex piece of legislation. The Act contains 20 parts and 52 articles. Its complexity can be demonstrated by the fact that it amends 33 other laws, among them:

- Act No. 6/1993 Coll., on the Czech National Bank
- Act No. 21/1992 Coll., on banks
- Act No. 363/1999 Coll., on insurance and on the amendment of some related acts (Insurance Act)
- Act No. 37/2004 Coll., on insurance contracts and on the amendment of related acts (Insurance Contract Act)
- Act No. 38/2004 Coll., on insurance intermediaries and independent loss adjusters and on the amendment of the Trade Licensing Act (Act on Insurance Intermediaries and Loss Adjusters)
- Act No. 190/2004 Coll., on bonds
- Act No. 591/1992 Coll., on securities (Securities Act)
- Act No. 15/1998 Coll., on the Securities Commission
- Act No. 256/2004 Coll., on business activities on the capital market (Capital Market Undertakings Act)
- Act No. 87/1995 Coll., on credit unions
- Act No. 377/2005 Coll., on supplementary supervision of banks, credit unions, electronic money institutions, insurance corporations and investment firms in financial conglomerates and on the amendment of certain other acts (Financial Conglomerates Act)
- Act No. 513/1991 Coll., on the Commercial Code
- Act No. 61/1996 Coll., on some measures against money laundering and on the amendment of related acts.

The Act assigns the supervisory powers of the former non-bank supervisors to the CNB. It explicitly provides that on the effective date, the non-bank supervisors will be dissolved and their statutory competences passed to the CNB. At the same time, the Act ensures continuity of financial supervision, stating that from the effective date the CNB shall substitute for any other supervisor in any proceedings to which it was a party and which commenced prior to the effective date.

To meet the requirements of the ESCB, the Act expressly provides that the state will meet any financial obligations incurred by the CNB as a result of the CNB substituting for any of the other supervisors in any proceedings to which the latter was a party on the effective date. The state will also meet any financial obligations incurred by the CNB in any proceedings which commenced after the effective date but which relate to the activities of the other supervisor under the then existing legal regulations.[10]

The Act deals with the assets of the non-bank supervisors. It sets forth that on the effective date any right to manage state-owned property which is necessary to carry out supervisory functions (apart from real estate) and was previously held by the non-bank supervisors shall cease to exist and this property (and obligations relating to that property) shall pass to the CNB. The details of these property transfers are set in an agreement between the CNB and the Ministry of Finance.

The Act creates preconditions for transferring human resources and know-how to the CNB. It stipulates that the employees of the Czech Securities Commission and the employees of the Office of State Supervision of Insurance Companies and Private Pension Schemes shall, on the effective date, become employees of the CNB. However, there is no specific

Table 1: Financial system in the Czech Republic

Financial institutions	Assets in € billions					
	2000	2001	2002	2003	2004	2005
Banks	71.36	76.72	80.27	78.23	86.00	101.94
Credit unions	0.08	0.09	0.04	0.04	0.07	0.14
Insurance companies	5.13	6.26	7.60	8.08	9.59	11.05
Investment companies and open-end funds	2.98	2.73	4.07	3.44	3.48	5.06
Pension funds	1.27	1.69	2.21	2.54	3.33	4.26
Leasing companies	3.58	5.40	6.10	6.50	7.28	7.55
Other non-bank financial institutions	3.68	6.05	5.42	6.88	7.36	8.12
Total assets	88.09	98.94	105.72	105.70	117.11	138.13
CZK/EUR exchange rate, yearly average	34.817	32.592	31.192	32.313	30.647	28.975

Source: Czech National Bank

reference to employees being transferred from the Office for Supervision of Credit Unions. As credit unions are regulated in a similar fashion as other credit institutions, the supervisory and regulation activity in this case is very similar to banking supervision and so only four of the former 20+ employees of this Office transferred to the CNB.

In line with internationally acknowledged principles for financial supervision, the Act gives the CNB the power to create and amend regulatory rules in the field of the securities market and in the field of collective investment, the insurance and pension fund industries and the credit unions sector. The CNB has had regulatory powers in the area of banking supervision since its establishment in 1993. In addition, the Act on the Czech National Bank specifically entrusts the CNB with powers in the area of financial stability, in addition to its supervisory responsibilities.[11]

With the Ministry of Finance, the CNB has concluded an agreement on the preparation of legislation in the financial market and other areas of common interest. The agreement determines the division of labour and cooperation in the area of financial regulation. Responsibility for preparing primary legislation in the financial market is delegated to the Ministry of Finance, while the CNB is authorised to issue secondary legislation.[12]

This is a significant change from the previous situation, where banking legislation was drafted by the CNB. The CNB will continue to participate in the preparation of primary legislation by providing expert assistance to the Ministry of Finance. Conversely, drafts of secondary legislation for all sectors of the financial market will be prepared by the CNB with the expert assistance of the Ministry of Finance.

This new arrangement is in line with most other European countries and will create a reasonable balance of power. It will also preserve the authority of the CNB to issue regulatory rules, an important prerequisite for the effective conduct of supervision.[13]

The Act significantly enhances the accountability of the CNB in its capacity as unified regulator, without challenging the CNB's independence. The Act amends the Act on the Czech National Bank in such a way that it requests the CNB to submit a financial stability report to the Chamber of Deputies (the lower house of parliament) at least once a year. At the same time, the amendment ensures feedback from the government and market participants through a newly established "Committee for the Financial Market" (CFM).

The role of the CFM is to act as an expert consultative body to the CNB Board on the financial market and on the strategy and longer-term outlook for financial market supervision. The CFM comprises seven expert members:.

- three members (including the Chairman and Vice-Chairman) are elected by the budget committee of the Chamber of Deputies; suitable candidates are proposed to the committee by professional associations and self-regulatory bodies
- two members are drawn from the Ministry of Finance and appointed and dismissed by the Minister of Finance
- the two remaining members comprise one member of the CNB Board and one of the Financial Arbiter.

CFM members are required to exercise their functions independently and they are not remunerated. The CFM will be a purely consultative body whose main tasks will be to issue opinions and recommendations to the CNB Board. In no circumstances will the CFM be able to directly or indirectly determine the Board's decision making.

Legislative work revealed that a more precise definition of the CNB's statutory goals in the area of financial supervision was desirable. The statutory goals of banking supervision on the one hand and of non-bank supervisors on the other hand differed considerably with respect to consumer protection issues.

The transfer of the powers of non-bank supervision to the CNB internalised these differences by converting them into statutory goals of the CNB. Hence, new arrangements concerning consumer protection on the financial market are to be put in place in 2008, together with an appropriate re-definition of the above-mentioned goals.

Structure and activities of financial supervision

The structure of integrated financial supervision within the CNB currently still follows the previous sectoral model (see Figure 2). The structure of responsibilities of the CNB Board and the department directors has not changed. Individual board members have no direct executive powers; these rest either with the whole Board (for, among other things: strategies, legislation, appeals against administrative acts, appointments and dismissals of department and division heads) or with individual department directors (regarding day-to-day management, administrative proceedings, and so on.).

This approach to integration has its advantages and disadvantages. The main advantage is that it reduces the operational risk of discontinuity in supervision. The main disadvantage is the postponement of benefits offered by the establishment of cross-sectoral departments for licensing, for supervision of risk management and internal control systems, for consolidated supervision and so on from the very outset.

The CNB intends to deal with this problem without delay. For example, work on a project to streamline reporting for supervisory purposes is in progress, so that duplications in reporting will be eliminated by 1 January 2007. Other measures intended to achieve economies of scope and reduce the regulatory costs borne by the supervised entities will follow in the course of 2007.

As of 1 April 2006, the three supervisory departments employed around 240 supervisory staff and were divided into 13 divisions. The banking regulation and supervision department is divided into the following five divisions: regulation, off-site banking supervision, on-site banking supervision, licensing and enforcement, and supervisory support. The capital market regulation and supervision department consists also of five divisions, namely collective investment and pension funds, investment services providers, markets and settlement, securi-

ties issues and sanction procedures. And finally, the insurance companies regulation and supervision department consists of the insurance sector regulation division, the supervision division and the licensing division.

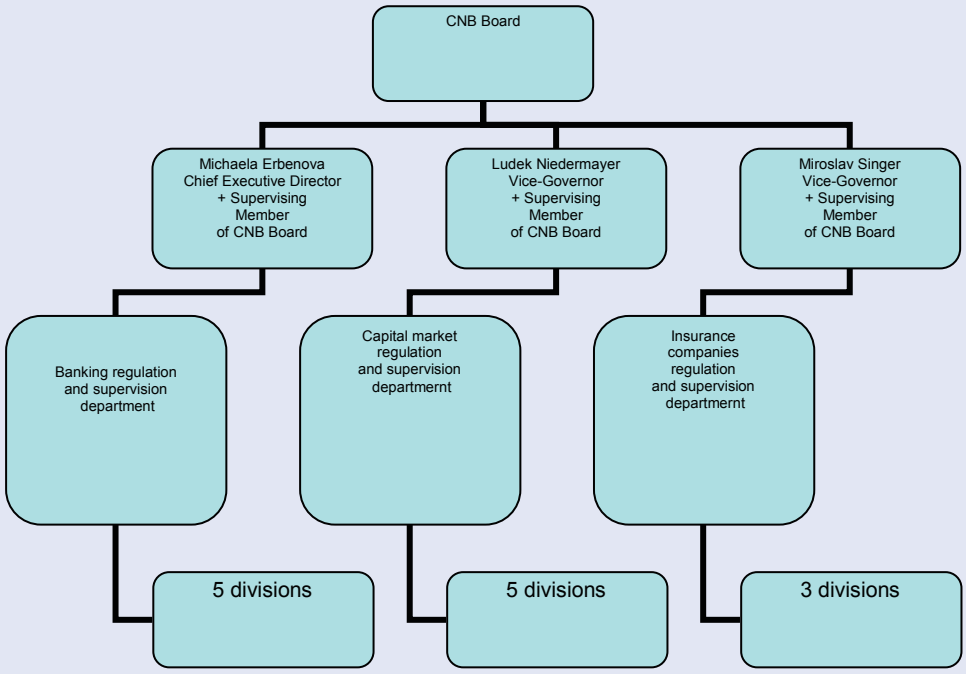
The core activities of financial supervision include financial regulation (see the previous section), licensing, off-site surveillance, on-site inspections and the imposition of remedial measures where the CNB detects shortcomings in the activities of supervised entities. Since the financial market of the Czech Republic is a part of the single EU financial market and most of the assets of the Czech financial system are under the direct or indirect control of large European financial groups, the CNB is heavily involved in cooperation with the supervisory authorities of EU member states under the Lamfalussy process. Hence, international cooperation can also be considered a core activity of financial supervision.

At present, the CNB is responsible for the supervision of:

- 24 banks
- 13 branches of foreign banks (as host supervisor)
- 19 credit unions
- 33 insurance companies
- 11 branches of foreign insurance companies (as host supervisor)
- 24 pension funds
- 1 stock exchange
- 1 OTC market organiser
- 35 management companies
- 53 brokerage houses
- 66 open-end investment funds
- 23 depositories.

Furthermore, the CNB registers more than 1,000 foreign funds and 38,000 insurance intermediaries and investment services providers, most of them natural persons. It also has authority over approximately 3,000 entities in the area of foreign exchange regulation and supervision, with the primary objective of protecting the rights of those who participate in the foreign exchange market via intermediaries.[14] The role of foreign exchange regulation as an important means of preventing or detecting money laundering is also constantly growing.

Figure 2: The structure of financial supervision in the Czech National Bank (CNB)



Note: The Board is the supreme governing body of the CNB and decides as a collective body. It has seven members: the Governor (who chairs the Board), two Vice-Governors and four Chief Executive Directors. The Board takes decisions by a simple majority of the votes cast. The members of the Board supervise the main activities performed by the CNB's departments and branches (executive management areas) in line with the Board's decisions.

Source: Czech National Bank

Conclusion

The decision to integrate financial market supervision into the central bank is clearly a political decision. It is, however, based on a set of practical arguments. The experience of the Czech Republic indicates that for a country with a small and very open economy and financial market and relatively limited skilled human resources, the integration of financial supervision can be a sensible solution. At the same time, this experience demonstrates that although country-specific factors play a key role in the design of the institutional infrastructure for financial supervision, both international experience and careful analysis of market factors can facilitate the political decision-making process.

Dealing with operational risk is a high priority when integrating financial regulation and supervision. This risk is minimised by good legislation enabling smooth transfer of powers, obligations and responsibilities from the former supervisory authorities to the unified supervisor. The risk is also minimised by the creation of adequate conditions for the transfer of the know-how accumulated by the former supervisory authorities.

While the importance of this institutional change for the internal functioning of the CNB should not be underestimated, it is its impact on the quality of regulation and supervision and on the costs of regulation borne by market participants which is crucially important and is of interest to the general public. While immediately following the integration it is necessary to ensure continuity of processes and human resources, in the medium term the goal should be to create truly integrated supervision by:

- creating a single, common institutional culture
- identifying and resolving unwarranted regulatory differences between the sectors
- balancing sector-specific technical issues with consistency of the whole process so that ultimately the same activities will be supervised in the same way, thereby avoiding arbitrage opportunities as much as possible.

Equally important is the need to be sensitive to the costs that regulation imposes on market participants. The ultimate aim should be to accompany each new regulation with a sound cost-benefit analysis.

The integration of financial supervision can offer considerable economies of scope and scale and greater efficiency in utilising support services. However, greater benefits, including higher efficiency of financial supervision, better regulation and reduction of the regulatory burden, can only be achieved in the longer term. This is because these benefits depend to a large extent on consolidation of the regulatory framework and on the creation of a new organisational structure. These changes will enable unification of the regulatory rules and supervisory procedures applied to different sectors of the financial market wherever possible and desirable.

The most striking trend in financial sector supervision over the past two or three decades has been the realisation that regulation should respond to the realities of the market, rather than the other way round. The main goals of present day financial supervision cannot be achieved without collective involvement of the financial industry and without financial institutions being sufficiently transparent towards customers and consumers (of their products).

At the same time, resilience of the financial system cannot be attained without a sufficiently, financially educated general public. Although this lies outside the integration process as such, it is necessary, since successful integration cannot be accomplished only through logistical and technical or procedural change. Facilitating greater market transparency and discipline through private collective and general public involvement has to be a significant part of the CNB's efforts.

Finding the right balance between ensuring the stability and safety of the financial system on the one hand and cultivating a competitive, innovative and diversified environment on the other hand, will be one of the major tasks of integrated financial market supervision in the Czech Republic for the years to come.

Endnotes

1 Institutional structure refers to the number and structure of the agencies responsible for the regulation and supervision of financial institutions and markets, including the role of the central bank in this area. D. Llewellyn, in J. Carmichael, A. Fleming, D. Llewellyn, eds. (2004), Aligning financial supervisory structures with country needs, World Bank: Washington, D.C., p. 20.

2 See G. J. Schinasi (2005), Safeguarding financial stability: theory and practice, International Monetary Fund, Washington, D.C.

3 See, for example, S. Ingves, in J. Carmichael, A. Fleming, D. Llewellyn, eds. (2004), Aligning financial supervisory structures with country needs, World Bank: Washington, D.C, p. 150.

4 Recent examples range from Norway (in 1986), Denmark (in 1988), Sweden (in 1991), the UK (in 1997) and Estonia (in 1999) to Hungary (in 2000), Japan (2001), Austria, Ireland, Germany, Malta (all in 2002), the Slovak Republic and the Czech Republic (in 2006). In many other countries there is partial unification, such as a common supervisor for banks and insurance companies or for banks and securities.

5 See, for example, D. Llewellyn, in J. Carmichael, A. Fleming, D. Llewellyn, eds. (2004), Aligning financial supervisory structures with country needs, World Bank: Washington, D.C, pp. 25-26.

6 Czech Government Decree No. 452 of 12 May 2004, www.vlada.cz.

7 The assets of the four largest financial groups controlled by banks represent 51 per cent of the total assets of the Czech financial sector. The assets of the eight largest groups represent almost 60 per cent.

8 See, for example, C. Briault (1999), "The rationale for a single national financial services regulator", Financial Services Authority, Occasional Paper No. 2, May, www.fsa.gov.uk.

9 Following the privatisation of the major state-owned banks, the share of non-resident owners of bank assets reached around 97 per cent in 2004 (up from 23 per cent in 1997), with the owners coming predominantly from EU-15 countries.

10 See Opinion of the European Central Bank of 28 October 2005 at the request of Česká národní banka on a comprehensive proposal to amend the draft law on the amendment of laws in connection with the integration of financial market supervision (CON/2005/39), www.ecb.int.

11 See Article 2(d) of Act No. 6/1993 Coll., on the Czech National Bank, as amended.

12 In the Czech Republic, financial regulation includes primary legislation and secondary legislation. Primary legislation includes laws that are usually drafted by the government and approved by the parliament and that create the basic legal framework for financial regulation. Secondary legislation includes decrees and provisions (regulations) that are issued by the supervisory authority under the law, which authorises the authority to do so.

13 See Core principles for effective banking supervision, Basel, 1997, www.bis.org. Basel Core Principle 1 states, "An effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banking organisations. Each such agency should possess operational independence and adequate resources. A suitable legal framework for banking supervision is also necessary, including provisions relating to authorisation of banking organisations and their ongoing supervision; powers to address compliance with laws as well as safety and soundness concerns; and legal protection for supervisors. Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place." While referring specifically to banking, the prerequisites identified in this Core Principle are applicable to the regulation of any financial institution or activity.

14 The Czech Republic's foreign exchange legislation is based primarily on the Foreign Exchange Act (No. 219/1995 Coll.) and the Act on the Czech National Bank (No. 6/1993 Coll.).

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Law in transition online

European Bank for Reconstruction and Development

New regulations governing public trading and securities in Poland

This article outlines major revisions made to Polish laws regulating public trading and investment securities. Some of the revisions covered include information obligations relating to shareholder thresholds, tender offers, mandatory buy-out provisions and new prospectus rules.

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Introduction

On 23 October 2005, major revisions to the Polish legal regime governing public trading and investment securities (the so-called Securities Acts) came into effect. These changes were implemented in an effort to make Polish law consistent with European Union (EU) norms and to take into account the particular experiences of the Polish securities market.[1] The new regime is embodied in the following acts:[2]

- the Act on Trade in Financial Instruments (the Act on Trading) which regulates:

  (i) the functioning of brokerage houses and banks conducting brokerage activity as well as brokers and investment advisers

  (ii) the registration of dematerialised securities on the accounts of the national securities clearinghouse (*Krajowy Depozyt Papierów Wartościowych S.A.*)

  (iii) the transfer of securities on the stock exchange and the over the counter (OTC) market

  (iv) the creation and operation of securities exchanges[3]

- the Act on Public Offers and Terms of Introducing Financial Instruments into an Organised System of Trading and on Public Companies (the Act on Offering) which regulates the public offer, disclosure and reporting obligations and obligations related to the acquisition of "significant" blocks of shares in a public company.[4]

This article discusses selected topics of interest with respect to the Securities Acts.[5]

Significant changes in shareholdings

Information obligations on shareholdings crossing "significant" thresholds

Under the Act on Offerings, a shareholder[6] is obligated to inform the Financial Supervision Commission (FSC) as well as the issuing company generally within four days when:[7]

- (i) shareholdings meet or cross the thresholds of 5 per cent, 10 per cent, 20 per cent, 25 per cent, 33 per cent, 50 per cent, or 75 per cent[8] of the total votes at the general meeting[9] of the company[10]

  (ii) shareholdings which gave it the right to votes at the shareholders' meeting equal to or exceed the thresholds specified in (i) drop below such thresholds

- (i) shareholdings exceed 10 per cent of the total votes at the shareholders' meeting of a public company and whose shareholder votes held:

  (a) change by 2 per cent of the total votes of a company listed on the official stock exchange (for example, the main Warsaw Stock Exchange [WSE])

  (b) change by 5 per cent of the total votes of a company trading on an otherwise regulated market (for example, the Polish over the counter [OTC] market)

  (ii) shareholdings exceed 33 per cent of the total votes at the shareholders' meeting of the issuing company and whose shareholder votes held change by 1 per cent of the total votes.

In addition to the strictly numerical information that must be provided, the notification (where the 10 per cent threshold is met or crossed) must include information on any intention to further increase the shareholders' share in the total vote within 12 months of the notification date as well as the purpose of any such increase. If there is a change in intention, notification of that change must be given within three days.

Required tender offer for purchases above certain thresholds

Old rules (prior to 23 October 2005)

Prior to 23 October 2005, under the old regulations an investor that intended to purchase shares entitling it to 25 per cent, 33 per cent or 50 per cent of votes at the general meeting of a public company had to acquire the consent of the Polish Securities and Exchange Commission (PSEC) in order to effect such a purchase. Moreover, the purchase of a block of shares entitling its holder to at least 10 per cent of the votes at the general meeting of a public company within a period of 90 days had to be conducted by way of a public tender offer. The purchase of shares entitling its holder to over 50 per cent of votes involved a requirement to publish a tender offer for the remaining shares in the company.

Rules under the Securities Acts

The new regulations abolished the requirement for the consent of the PSEC for the purchase of significant blocks of shares. However, the Act on Offering requires that share acquisitions in a public company crossing certain thresholds may only be effected by means of a tender offer. The key thresholds are 33 per cent and 66 per cent of total votes of the public company's shares.

1. Shareholders with a capital engagement below 33 per cent

A tender offer is required for the acquisition of shares in a public company which increases a shareholder's share in the public company's total share vote by more than:[11]

- in the case of a shareholder owning less than 33 per cent of the total vote at the company, 10 per cent within less than 60 days
- in the case of a shareholder owning 33 per cent or more of the total vote at the company, 5 per cent within less than 12 months.

Some practitioners have held the view that these provisions do not clearly specify how the relevant periods should be calculated or how to interpret and calculate the purchase of 10 per cent or 5 per cent of shares. The view has been expressed that, as long as a shareholder did not make a one-off purchase of a block of shares amounting respectively to more than 5 per cent or 10 per cent, they did not have to purchase by tender offer.

The PSEC has taken the position that it is only the amount of the purchase that actually crosses the applicable threshold during the relevant period that must be made by a tender offer.[12] The view of the PSEC[13] is not legally binding but it reflects current practice. Each situation should be looked at based upon its specific facts.

The original objective of establishing an obligation to purchase a majority shareholding in a short period of time by way of a tender offer was to protect the market from a sudden increase in the share price due to a rapid increase in demand. In addition, the provisions were aimed at supporting the policy that all shareholders similarly situated be treated equally.

2. Shareholders with a capital engagement between 33 per cent and 66 per cent

A shareholder may exceed 33 per cent of the total vote in a public company only as a result of a tender offer.[14] Under this tender, the purchasing shareholders offer to purchase not less than the number of shares which represent 66 per cent of the total votes.[15] Thus, the tender offeror would be required to accept all sale offers up to that amount which represent 66 per cent of the total votes.[16] The tender offer could, of course, be issued for the purchase of more than 66 per cent of the shares (this is discussed further below).

If the 33 per cent threshold is exceeded as a result of:

- purchasing shares in a public offer of a new share issue
- contributing shares as an in-kind contribution
- division or merger of the company
- amendment of the company's articles of association
- expiry of share privileges
- a legal event, other than a transaction (for example, a share redemption of other shareholders' shares)

the shareholder must decide whether, within a period of three months from the date the 33 per cent threshold is exceeded in the abovementioned manner, to either: (i) announce a tender to purchase shares ensuring 66 per cent of the total votes, or (ii) dispose of shares so that their shareholdings fall to not more than 33 per cent of the total votes. This issue practically resolves itself if, within the said three month period, the shareholder's holding in the issuing company falls below the number of shares which represent 33 per cent of the total vote as a result of an increase in the share capital, an amendment of the articles of association or the expiry of its share privileges. In such cases, the shareholder is not required to take any action.[17]

The interplay of these provisions produces a somewhat anomalous result. If a public company wishes to increase its share capital it can do so by either a public offering or a private placement. In the case of a public offering, the 33 per cent shareholder can participate and cross the threshold provided that he then: (i) makes a further tender offer to the 66 per cent threshold: or (ii) reduces his shareholding to the 33 per cent level.

If a private offering were to be made, the 33 per cent shareholder[18] could not buy such shares as it would be in violation of Article 73.1 of the Act on Offering. This is due to the fact that there is no opportunity to issue a further tender offer or to divest shares as is permitted in a public offering. Of course, one can argue that, by analogy, a private offering should have the same effect as a public offering, but this stretches the literal language of the relevant provision more than a fair bit.

3. Shareholders with a capital engagement above 66 per cent

The 66 per cent threshold in a public company may only be exceeded by way of a tender offer for the purchase of all outstanding shares of the company.[19] Of course, the tender offeror may fail to acquire 100 per cent of the outstanding shares, which can lead to a variety of difficulties (which are discussed below).[20]

If a shareholder, that holds shares which entitle it to more than 66 per cent of the outstanding votes in a public company, acquires additional shares in the company within six months following a mandatory tender offer (the earlier tender offer) at a price higher than that paid in the earlier tender offer, then the shareholder is obliged to pay the difference in share price to all persons who sold shares into the earlier tender offer.[21] There is a limited exception to this price make-up provision, namely that no 'price make-up' is required to be paid to a selling shareholder in the earlier tender offer if: (i) a specific agreement as to pricing was entered into; and (ii) the shares subject to such an agreement constitute at least 5 per cent of all of the shares in the company.

The price make-up provisions were intended to prevent differences in the price of shares purchased pursuant to a tender offer and after a tender, thereby, protecting shareholders that responded to a previous call. In practice and, in particular, in connection with the mandatory buy-out provisions (see below) this has given rise to certain difficulties. The problem is made all the more difficult due to the excessive period of this protection. The exception to the price make-up provision is useful, particularly for purchasing from relatively large shareholders where a bargain can be struck as the parties deem appropriate.

4. Exemptions from the obligation to publish a tender offer

In the above cases, the purchase of shares gives rise to an obligation that the purchase be made through a formal tender offer. This means that the shares cannot be purchased other than through a tender offer. [Is the edit to the above sentence correct?] However, the law provides for a situation in which an investor can acquire shares without active participation, for example through an inheritance. In such a case, the new shareholder should submit a subsequent tender offer.

The Act on Offering sets a three month deadline from the date of the acquisition of the shares, during which the person acquiring the shares should publish a tender offer. This allows the person acquiring the shares the opportunity to provide conditions for entities that do not accept the change of the controlling party in the company to exit the investment.

A similar situation occurs where there is a change in voting strength without the purchase of shares. For example, the company redeems shares purchased on the market or a shareholder previously holding 30 per cent of shares in the company passively sees its shareholding increase (for example, above 33 per cent of the shares).

The obligation to publish a prior or subsequent tender offer does not arise if the shares purchased:

- only function in an alternative trading system, are not simultaneously admitted to trade on a regulated market and do not form the subject matter of an application for admission to a regulated market
- are purchased within a capital group
- This does not apply to a situation in which the entity, as a result of a legal transaction merely joins an existing capital group in such a way that it becomes a dominant entity as regards a company or companies holding shares in a public company. This can be achieved, for example, by purchasing all shares of companies that directly hold shares in a public company. In this case, such an entity is required to publish a call despite the fact that, in practice, not a single share in a public company has changed hands.
- are purchased under the provisions of the Insolvency and Reorganisation Act or in enforcement proceedings
- are purchased pursuant to an agreement on establishing financial security concluded according to the conditions laid down in the Act of 2 April 2004 on certain types of financial security
- are encumbered with a pledge in order to satisfy a pledgee that is entitled, on the basis of other statutes, to obtain satisfaction by appropriating ownership title to the subject matter of the pledge.

5. Conditional tenders

In the event that an investor intends to purchase a number of shares and, thereby, simultaneously exceed the thresholds of 33 per cent and 66 per cent in a company, it may do so through one tender offer (for example, for 100 per cent of the shares).[22] According to the applicable regulation,[23] the tender offer's effectiveness can be optionally conditional upon a selected minimum of shares being tendered.[24]

The obligation to publish a call as a result of the passive acquisition of shares by way of redemption is an interesting issue. If a person inherits shares entitling him to precisely 66 per cent of the votes in a public company or if a person inherits a lower percentage of shares but, together with his existing shareholding, holds exactly 66 per cent of the votes in the company, the person is required by law to publish a call. If he only exceeds the 33 per cent threshold rather than the 66 per cent threshold, he should publish a call for 66 per cent of the

shares. However, even if shareholders respond to the call, the entity publishing the call has no obligation and even no right to purchase shares which are for sale in response to a call by investors.

To summarise, the obligation to issue a tender offer only arises in the four cases, as stipulated in the Act on Offering. These are:

- meeting the 5 per cent and 10 per cent thresholds (Article 72)
- crossing the 33 per cent threshold (Article 73)
- crossing the 66 per cent threshold (Article 74)
- the rematerialisation/delisting of a tender (Article 91.6).

This means that a shareholder cannot demand the sale of shares by way of a tender offer unless the precise legal conditions have been satisfied.[25]

6. Minimum price requirements

The price that may be offered for shares in a tender offer is subject to strict regulation. The Act on Offering provides for a minimum price that may be presented in the tender offer.

As a rule, the price presented in a tender offer cannot be lower than the higher of:

(i) the average market price during the last six months of trading in the subject company's shares on the principal market,[26] prior to the date of publication of the tender offer

(ii) the highest price paid for the subject company's shares by the tender offeror

(iii) in the case of a tender pursuant to which the acquisition of more than 66 per cent of the shares is contemplated, the average price during the last three months of trading.[27]

If trade in the shares forming the subject matter of the call was performed on the principal market for a period of less than six months (or three months if applicable), the average price of the shares during this shorter time period is utilised.

The price cannot be determined in the manner described above if, for example, the shares are not in a dematerialised form. This situation may arise in the event that a call for all remaining shares in a public company, including non-dematerialised shares is published. Hence, if a company has non-dematerialised and dematerialised shares (shares traded on a regulated market), two different prices will be given for all remaining shares.

In this case and where composition proceedings or insolvency proceedings have been commenced against the company, the prices in the tender offer may not be lower than the fair value of the two types of shares. The fair value of shares should be determined in each case, taking all circumstances into account. As a rule, specialised experts determine the value of shares.

Furthermore, the price may not be lower than the highest price paid for the shares which are the subject of the tender offer, during the 12 month period prior to the publication of the tender offer by the entity publishing the call, or its subsidiary, dominant entity or contracting party. No voting rights may be exercised for shares in a public company which were acquired for a price that was set in breach of these principles.[28]

The price offered in an announced public tender may be amended. The amendment does not, however, constitute a new tender offer inasmuch as price is considered only one element of a tender offer. A change in the offered price cannot be made more frequently than every five working days. The price may be increased or decreased, subject to the conditions for determining the minimum price. If another entity submits a competing tender offer for the same shares (a counter-tender), the entity which published the earlier tender offer may change its offer price without a waiting period.

Instead of, or in addition to, a cash price offered in a tender offer, a tender offer may enable the exchange of shares. In this case, the price proposed in the tender offer is deemed to be the value of the securities offered. Provided that they are traded on a regulated market, the value of the offered securities is determined according to their average market value over the last six months of trade on a regulated market preceding the submission of the call. If trade was conducted on a regulated market for a period of less than six months, the average price over the period would be used. If the price cannot be determined in this manner or if composition proceedings or insolvency proceedings are commenced against the company whose shares are being offered, the value of such securities is to be their fair value.

Shares in a tender offer may be purchased for cash or state treasury bonds, dematerialised shares of another company (that is, publicly traded shares), depositary receipts or mortgage bonds. Depositary shares and mortgage bonds are characterised by high liquidity and are, therefore, deemed to be cash equivalents. The medium of payment must be published as part of the tender offer.

The issuer of a tender offer is required to post security with the brokerage house which is acting as the intermediary in the tender. The issuer must post an amount that is equivalent to at least 100 per cent of the value of the shares sought to be purchased in the tender. Cash as well as other rights or items with pecuniary value may serve as security. The posting of the security should be documented by a statement from the bank or any other financial institution with whom the security is posted or who is acting as an intermediary.

A tender offer is made through a brokerage house which conducts business in Poland. It must be published by at least one information agency in at least one Polish daily newspaper at least one day before the acceptance of subscriptions is to commence. The FSC and the regulated market, on which the shares constituting the subject matter of the call are listed, must be notified about the call by the agent by way of written notification. This notification discloses the intention to publish the call and includes the content of the call.

Notification should be provided no later than seven business days prior to the commencement of the acceptance of subscriptions on the call. Having received the notification, the WSE or the MTS-CeTO (depending on where the shares are listed) may, but does not have to, suspend the trade in the shares which are the subject matter of the call at the nearest session or trade day. The brokerage house conducting the call may also create security for the shares by blocking the cash funds deposited in the cash account of a client of the brokerage house that intends to purchase shares pursuant to the call.

The regulations do not provide for the withdrawal of a published tender offer. A breach of the regulations on the inadmissibility of the issuer's withdrawal from a published call is subject to a fine by the FSC of PLN 1 million. The only exception is a counter-tender for the shares of the target company published by another tender offeror. However, a published tender offer for the purchase of all of the target company shares may be withdrawn if a counter-tender offer is for a higher price.

Moreover, should a counter-tender be published, a shareholder who had subscribed to the earlier offer may withdraw the subscription. This is provided that the earlier subscription did not have the effect of a transfer of shares by way of a relevant entry on the investor's account with the intermediary brokerage house.

The target company is obligated to publish its management board's opinion on a published tender offer for its shares not later than two business days prior to the commencement of the acceptance of subscriptions.[29] The management board's opinion about the tender offer may further influence a shareholder's decision-making process regarding his further capital engagement in the target company. It may also create pressure to increase the price or put the company in play for a counter-tender offer.[30]

The management board's opinion should include its view of the effect of the tender offer upon: (a) the company's interests, including the interests of its workforce; (b) the tender offeror's strategic plan in relation to the target company and its likely effect upon the workforce and the target company's place of business; and (c) whether the price proposed in the tender offer reflects the company's fair value, which can not be determined solely on the basis of the target company's trading prices. If the management board relies on the opinion of an external entity (an expert) in forming its view, the opinion of the external entity must also be disclosed.[31]

7. Delisting

Shares traded on the public markets in Poland are in a dematerialised form. In order to delist and, thus, effect a going-private transaction, cancellation of dematerialisation (colloquially rematerialisation) is a requirement. The rematerialisation process requires that a tender offer be announced.

The rematerialisation of shares takes place in accordance with the following procedure which must be completed before delisting:

- the shareholder(s) placing rematerialisation on the agenda of the company's shareholder meeting must first announce a tender offer (referred to in this article generally as a 'delisting' tender) for all the outstanding shares in the company
- a motion for a shareholders resolution approving the rematerialisation of shares must be submitted by a shareholder or group of shareholders which represent at least 10 per cent of the company's total votes and must be put on the agenda of the shareholders' meeting
- the general shareholders' meeting must approve the rematerialisation resolution by a majority of 80 per cent of the votes cast in a vote in which at least half of the shareholders representing the company's total votes participated
- the FSC must approve the rematerialisation.

The sale of shares in response to a delisting tender offer is the last chance for a minority shareholder to sell its shares prior to rematerialisation, subject to the legal conundrum discussed below wherein a minority shareholder may seek to have its shares sold in a mandatory buy-out even though it did not sell its shares in the delisting tender offer.

The obligation to publish a tender offer does not arise if all shareholders of the company, or one shareholder who holds 100 per cent of the company's shares, apply for rematerialisation.

The withdrawal from trade on a regulated market will occur, as a rule, by the deadline set in the decision of the FSC permitting rematerialisation. This deadline may not exceed one month from the date of the FSC decision approving rematerialisation.

The decision to delist shares from the stock exchange and the OTC market is at the discretion of the management board or majority shareholder of the company. A company whose shares have been delisted must still perform the reporting and other statutory obligations imposed upon public companies. The cessation of such public company related obligations is only possible after the effective date of rematerialisation.

Mandatory buy-out[32]

Prior to the entry into effect of the Securities Acts, a mandatory buy-out of shares in a joint-stock company (spółka akcyjna) could only take place in a privately held company. Mandatory buy-out and squeeze-out provisions now apply to public companies.

Mandatory purchase of shares (squeeze-out)

A shareholder that holds at least 90 per cent of the votes at the general meeting of a public company will be able to demand the mandatory purchase of the shares of all minority shareholders. Such a mandatory buy-out occurs without the consent of the minority shareholders.[33]

Mandatory buy-out of shares at the option of minority shareholders

As well as the right of a 90 per cent majority shareholder to force a mandatory buy-out of shares, minority shareholders have a corresponding right to call upon the 90 per cent majority to purchase their shares. The 90 per cent majority shareholder may not refuse such a demand and must purchase the shares itself or through a subsidiary, dominant entity or entity acting in agreement with it.

The subsidiaries and parent companies of the 90 per cent shareholder are jointly and severally liable for the repurchase obligation if the requisite minority makes the appropriate demand. Such a buy-out should be performed within 30 days of the date that the appropriate demand is made by the minority shareholders.

Delisting and the effect of a minority shareholder buy-out demand

A somewhat curious situation occurs if a delisting tender is announced but a 10 per cent or less minority has not sold its shares into the delisting tender. Arguments have been raised that, prior to the effectiveness of rematerialisation, a 10 per cent or less minority shareholder can demand that the 90 per cent shareholder conduct a mandatory buy-out of the minority shareholders' shares even though the minority shareholders did not sell pursuant to the delisting tender.

It is this writer's view that such a second bite at the apple creates the opportunity for unacceptable and manipulative trading activity aimed at causing price escalation. The accepted, but not definitive, counter-argument is that, on the date the company withdraws from stock market trade and rematerialisation is effective, inasmuch as the company is no longer a public company, no further obligation for a minority demanded mandatory buy-out remains.[34] Please note that, due to partisan views in disputed matters, different positions, have been taken.

Price manipulation

Under the Act on Trading,[35] manipulating securities is prohibited. The definition of manipulation includes, among other things:

- giving orders to trade or to make transactions which are or could be misleading as to the real demand for, supply of, or price of a security or, whereby, the price of a security is set at an abnormal or artificial level
- securing control of the demand for or supply of a security in contravention of the principles of fair trade or which result in the fixing, directly or indirectly of the price thereof.[36]

The opportunity to manipulate price may, however, exist, as shown in the following scenario.

A strategic buyer proposes to purchase 100 per cent of the shares of a publicly traded company at PLN 25 per share, with the condition that at least 80 per cent of the shares are for sale. Approximately 10,000,000 shares are outstanding at the initiation of the tender and 99 per cent of the shares are tendered. Normal turnover during the previous twelve months was in the range of 9,000 to 10,000 shares daily, with an average price of PLN 20 per share. Within two business days following the settlement date, the daily trade volume jumped to almost 100,000 shares with the price skyrocketing to PLN 100 per share (this indicates a 100 per cent turnover of the remaining free float). If one were to look at the trade ticker one would have noticed a specific number of shares being traded repeatedly at increasing prices (for example, a block of 14 shares were repeatedly traded). In this circumstance, given the minimum price rules and mathematics, an artificially created price increase could occur in the minimum price at which a mandatory buy-out could be demanded by the minority shareholders. Moreover, if shares are purchased at an inflated minimum price in a buy-out demanded by the minority, the difference in price must be offered to the original subscribing shareholders.[37]

Any entity wishing to launch a tender offer for 100 per cent of the shares needs to carefully consider the various results that could ensue. The following are just a few of the key thresholds:

(a) 80 per cent, which is required to rematerialise the shares of a public company and effect the going-private process

(b) 90 per cent, which is required to be able to squeeze-out the minority in a public company but which will also open one to a minority demanded mandatory buy-out

(c) 95 per cent, which is required to effect a mandatory squeeze-out in a privately held company. Depending on the situation, the prospective tenderor may wish to make the obligation to purchase pursuant to the tender offer conditional on the selected threshold being reached depending on the assessed risks in a given target's shareholding structure. In addition, if the prospective buyer is buying a company with relatively few shareholders which hold large blocks of shares, appropriate agreements would be entered into so that an increased price would not have to be paid to the sellers in the original tender. As part of the process, withdrawing a company from trading may also be a viable strategy against unwarranted price fluctuations.

New prospectus rules[38]

A prospectus must be drawn up, approved by the FSC and put into the public domain in the following cases:

- the public offering of securities
- the admission of securities to trade on the regulated market.

The new regulations have redefined the concept of a public proposal to offer securities. A public proposal means an offer of securities, made in any manner and any form, that is directed to at least 100 people or to an unspecified addressee. A public proposal in Poland may only take place by way of a public offer where a public offer means a disclosure, in any manner and form, of any information on securities and

terms of purchase thereof, which constitutes a sufficient basis for the investor's decision to purchase the same for remuneration.

In contrast to the regime of the previously binding act, a company that has publicly offered its shares is not bound to publicly offer each further issue of shares. At present, it may select with regard to each issue of any securities whether they will be publicly issued or not, provided that the company observes the condition according to which a non-public offering to purchase shares may be directed to less than 100 people.

The previous regulation imposed an obligation upon the issuer or an entity introducing securities into public trade to present an issue prospectus to the FSC in the form of a uniform document. According to the Securities Acts, the issuer or an entity introducing securities may select one of the following two permitted methods of proceeding:

- the presentation of the issue prospectus in the form of a uniform document
- the presentation of the issue prospectus in the form of three separate documents, namely:

  (i) a registration document

  (ii) an offer document

  (iii) a briefing document which clearly presents the information contained in the two previous documents.[39]

The possibility of dividing the issue prospectus into three documents was introduced in order to facilitate the public offer procedure and the admission of securities into trade on the regulated market.

Benefits arise from the autonomous character of the registration document, which may be presented to the FSC for approval prior to the preparation of the actual offer (in effect, a shelf registration). Pursuant to the registration document submitted, the issuer may, within the term of validity (12 months), conduct a number of issues of various types of securities (for example, issues of bonds and shares). Only the offer and briefing documents, as opposed to the registration document, shall be subject to approval by the FSC.

However, the regulations of the WSE require that the introduction of securities into trade on stock markets it operates involves an obligation to introduce each subsequent issue of company shares into trade on the relevant market within 12 months of the date the subscription is completed.[40]

The Act on Offering introduces a number of exceptions from the obligation to draw up a prospectus. These exceptions cover both a public offering and the introduction of securities into trade on a regulated market. In some cases, an exclusion from the obligation to draw up a prospectus means an obligation to draw up an information memorandum, that is a document with less information than a prospectus.[41]

Neither a prospectus nor an information memorandum is required to be drawn up when the offer is:

- addressed exclusively to so-called qualified investors
- The range of entities that may acquire the status of a qualified investor is rather broadly defined. Pursuant to the Securities Acts, a qualified investor means a financial or other institution authorised to operate on the financial market on the basis of regulations, as well as entities (natural and legal persons) entered on the list of qualified investors kept by the FSC. The Act on Offering lays down the requirements which must be fulfilled by an entity on the date of submitting an application for an entry on the list as a qualified investor. The FSC does not conduct supervision after an entity is entered on the list. Moreover, there is no statutory obligation to maintain the parameters required when submitting the application for an entry on the list whilst conducting business.
- addressed exclusively to investors who each acquire securities of a total value of at least €50,000 or the PLN equivalent
- concerns securities whose par/nominal value per unit amounts to at least €50,000 or the PLN equivalent
- concerns securities whose total value, as calculated by their issue or sale price over a period of 12 consecutive months, does not exceed €100,000 or the PLN equivalent.

Conclusion

The major revisions to the Polish legal regime governing investment securities and the public trading thereof of October 2005 made Polish law more consistent with European Union norms. Revisions to the law included: information obligations on shareholdings which crossed significant thresholds; required tender offers for share purchases above certain thresholds; mandatory buy-out provisions; and new prospectus rules. Even though the new regime takes into account past experiences in the Polish securities market, there are still areas of concern. These include delisting and the effect of a minority shareholder buy-out demand. Under the current regime, there is an opportunity for manipulative trading activity in situations in which a delisting tender is announced but a 10 per cent or less minority has not sold its shares into the delisting tender. Another area for concern is the possibility for price manipulation in certain mandatory buy-out scenarios.

Endnotes

1 Directive 2001/34/EC of the European Parliament and Council of 28 May 2001; Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003; Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003; and Commission Directive 2003/124/EC of 22 December 2003. The Securities Acts also partially implemented Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004.

2 The 2005 securities laws also included the Act on Supervision of the Capital Market which regulated the functioning of the Polish Securities and Exchange Commission (*Komisja Papierów Wartościowych i Giełd*, the PSEC). This act was replaced by the Act on Supervision of the Financial Market of 21 July 2006; which entered into force on 19 September 2006 and created a new supervisory body, called the Financial Supervision Commission (the FSC); the FSC succeeded the authority of the PSEC.

3 At present the following operate in Poland: *Giełda Papierów Wartościowych w Warszawie S.A.* (WSE) and MTS Centralna Tabela Ofert S.A. (MTS-CeTO).

4 During the course of this article the term public company is used interchangeably with company, issuing company, target company or target. All such references are to a public company within the usage of the Securities Acts.

5 Due to space constraints, some topics are covered in a somewhat summary fashion. The reader should be aware of this and consult the relevant original texts of law and seek legal advice from their lawyer of choice. In addition, no legal advice is intended to be rendered, the views are strictly those of the author.

6 The Securities Acts contain aggregation rules wherein the holdings and actions of a member of a capital group as well as those with whom they are deemed to be acting in concert by way of agreement are aggregated. See Act on Trading Article 87.

7 Act on Offering Article 69. The four days is measured from the date of crossing the threshold or from the date on which the shareholder becomes, or by exercising due care could have become, aware of such a change. In addition, the issuing company has further disclosure obligations as set forth in, among others, the Act on Trading Article 70.

8 The calculation of the thresholds takes into account, among other things, votes that would exist based on the conversion of convertible debt, the exercise of warrants and the like. Some interpretive issues arise, however. See Act on Trading Article 88.

9 When this article uses the phrase "votes at the general meeting", unless the context specifies otherwise the reference is to the sum of votes attached to all outstanding shares of the company. In addition, since listed companies are not allowed non-voting shares, or shares carrying more than one vote, a reference to a percentage of shares should be deemed to also be a reference to the percentage of the total vote.

10 The threshold measurements are taken at the end of the trading day.

11 Act on Offering Article 72 et seq.

12 Under the recent PSEC interpretation, if a shareholder purchased during the specified period 4.9 per cent or 9.9 per cent of shares (as applicable), it did not have to do so by tender offer. If one were to cross by means of purchase the 5 per cent or 10 per cent threshold one would be obligated to purchase such shares as caused the crossing of the threshold by way of a tender offer. To illustrate the point, albeit with a somewhat extreme fact pattern, if a buyer purchased 9.9 per cent and then within the applicable time period purchased an additional 0.2 per cent, the 0.2 per cent purchase would be required to be made by way of a tender offer.

13 The FSC has not expressed any opinion yet. However, it is expected that the FSC will continue with the direction of the PSEC in the interpretations of the Securities Acts.

14 Article 81 in the Act on Offering addresses the basic rules for the contents of a tender offer. The applicable regulation sets out the particular rules, required content which affords the opportunity to properly asses the transaction terms, the mechanics for subscription, payment and so on, while ensuring the equal rights of shareholders responding to the tender offer. [Is the above edit of this footnote correct?]

15 Act on Offering Article 73.

16 If, in response to the tender offer to purchase shares representing 66 per cent of the total company vote, shareholders subscribe to sell an amount of shares giving the tender offeror 66 per cent of the total company vote, the tender offeror must purchase all such shares offered. If the response would give him more than 66 per cent of the total company vote, he can not accept all such subscriptions in whole and there would be a proportional reduction in shares considered offered for sale in response to the tender.

17 Cases in which the 33 per cent threshold is exceeded as a result of inheritance have been regulated separately. The obligation to publish a call does not arise until a further purchase of shares, which gives rise to an increase in the amount of the existing shareholding. Such a shareholder may then choose between publishing a call and selling shares within a three-month deadline. This deadline is counted from the time of the event giving rise to a further increase in shareholding.

18 For instance, a fund or strategic investor that wishes the public company to raise capital for appropriate corporate purposes such as restructuring.

19 Act on Offering Article73. Following such a tender, the offeror – once he crosses the 66 per cent threshold – may purchase further shares without the need of an additional tender, subject to not crossing the 5 per cent limitation during a twelve month period.

20 Most of the aspects regarding the submission of a tender offer in such a case are analogous to the submission of a tender offer in connection with exceeding the 33 per cent threshold.

21 Act on Offering Article 74.

22 Act on Offering Article 79.

23 Regulation of the Minister of Finance of 19 October 2005 on standard forms of invitations to subscribe for sale or exchange of shares of a public company, detailed manner of their announcement and conditions for acquiring shares as a result of such invitations.

24 For example, the tender offeror offers to purchase 100 per cent of the outstanding shares of XYZ Company provided that at least 75 per cent of the outstanding shares are tendered; or the tender offeror reserves the right and may purchase such number of shares as are tendered even though the minimum amount specified is not tendered.

25 The provisions which require tender offers apply not only to the purchase of shares but also to bonds that are convertible into shares, securities involving the right or obligation to convert the same into shares and depositary receipts that are issued in relation to a public company's shares. These topics are not addressed in this article due to space limitations.

26 The principal market is the stock market or the OTC market on which the given shares are listed. If they are listed on several regulated markets, the principal market is the one on which the value of trade in shares in the calendar year preceding the year in which the principle market is determined was the highest. However, if the trade on the given market only occurred during the year the principal market is determined, the principal market is the market on which the shares were listed earlier.

27 In this case it is the highest price paid by the tender offeror, its affiliates or entities with which it concluded an agreement and are deemed to be acting in 'concert' with, as defined in the Securities Act

28 Moreover, no voting rights may be exercised by shares which were acquired in violation of the tender offer rules.

29 Act on Offering Article 80.

30 Whether the Polish market is sophisticated enough to take advantage of these opportunities is open to question.

31 In addition, the target company's management board must disclose its view and its response to its employees or their union.

32 See Act on Offering Division 3.

33 Notification of the buy-out is made via a brokerage house, which notifies the regulated markets on which the shares are listed that a mandatory buy-out is being conducted and freezes these shares on its securities accounts. After paying the price, the brokerage house may transfer the shares to the account of the purchaser. No derogation is permitted from the mandatory buy-out of shares by the majority shareholder from minority shareholders.

34 Likewise, the 90 per cent majority would no longer have the right to force a mandatory buy-out of a minority shareholder. [Is this correct?] The threshold for a majority shareholder buy-out in a private joint-stock company is 95 per cent. In a private company, the minority shareholder does not have a mandatory buy-out right.

35 Act on Trading Article 39 et seq.

36 An exception exists for actions which were legitimate and which did not infringe upon accepted market practice. The author will not speculate on a definition for the word legitimate in this exception. The definition of manipulation is much more extensive than that paraphrased herein.

37 This scenario may or may not have occurred in Poland. The numbers may or may not be based on an actual situation in the not so distant past. Any similarity between the example and actual events is purely coincidental and, of course, no allegation or conclusion has been made as to whether the activity actually constituted unlawful manipulative behavior. Perhaps this type of activity may even be legitimate.

38 While the changes to the prospectus rules are extensive, only the more interesting changes are highlighted in this article.

39 The Act on Offering, also referencing EU Regulation No. 809/2004, specifies the required contents of the prospectus.

40 The foregoing obligation does not refer to any securities other than shares.

41 The contents of the information memorandum are laid out in Regulation No. 809/2004 of the Commission of 29 April 2004 or the Polish regulation, depending on the type of securities offered or the type of addressee to whom the offer is directed.

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Reforming the judiciary in the Slovak Republic

Since 1998 significant efforts have been made to reform the justice system in the Slovak Republic. This article looks at the measures being undertaken to improve the credibility and efficiency of the judiciary and the major challenges ahead.

Lucia Zitnanska, Member of Parliament [1]

In the Slovak Republic a number of measures and legislative changes have been designed to increase the credibility of the justice system. Measures improving the efficiency of the judiciary focus primarily on materially equipping courts, system informatisation, organisational and structural changes, court administration and human resources.

Monitoring development, increasing transparency and improving the performance of the judiciary pose major challenges. To address these challenges new procedural regulations for deciding civil and commercial disputes must be established, the capacity of courts to efficiently deal with cases must be improved and an appropriate human resources management system should be put in place. The ultimate aim is to advance the proficiency, integrity and responsibility of the judge.

The starting point (late 1990s)

The legal standing of the judiciary in the Slovak Republic was established by the Constitution of the Slovak Republic 1992 and by legislation that was passed at the beginning of the 1990s.[2]

The Constitution of the Slovak Republic 1992 guaranteed the independence of judges in decision making and declared that the role of the judiciary should be carried out by independent and unbiased courts, separate from all other public authorities. Judges are initially elected by the National Council of the Slovak Republic for four years. After four years on the bench, a judge may apply at the recommendation of the government for re-election by the National Council for an unlimited period.

The number of cases before the courts rose considerably in the early 1990s. The post-revolution changes after November 1989 resulted in many restitution disputes and there were also more business disputes overall.[3] After the first wave of privatisation there were also a number of coupon privatisations and disputes between citizens and investment funds.

Compared with the stable judiciary of the pre-1989 period, the 1990s saw a period of dynamic change ushered in. However, legal proceedings were still being carried out in accordance with procedural regulations from the 1960s. Modifications made in the early 1990s did not change the spirit of these regulations which was based on the responsibility of the court to search for material facts.

Only a few judges were required to leave the justice system after 1989. Judges quickly learned the new procedures, but the application of these procedures was tinged by old reasoning due to the lack of systematic training. The judiciary was not able to adequately handle the explosion of new cases and new legislation. This, in turn, led to protracted proceedings and a low level of citizen confidence in the judiciary.

The situation in the late 1990s created social pressure for change in the judiciary. The leaders of this process were the judicial self-government and the third or non-profit sector, which was able to cooperate with the Slovak government after the elections in 1998. Preparations for European Union (EU) accession also prompted external pressure.

Independence of the judiciary (1998–2002)

The pressure to make changes in the judiciary resulted in the passing of a set of laws in 2000-02 that strengthened the guarantees of the independent judiciary.[4]

The biggest changes were the creation of the Judicial Council of the Slovak Republic and the abolition of the four-year term for judges.[5] The Judicial Council took over the decision-making responsibilities of the executive and parliament with respect to the appointment of judges, the placement of judges in courts and the career advancement of judges.

The Judicial Council is responsible for proposing who the President should appoint as a judge and decides on the assignment of judges to courts. A judge cannot be reassigned to a different court without his or her consent and they receive lifetime appointments without any time limitations. Judiciary councils were created at the court to work as organs of judicial self-government and the degree of their participation in the administration of the courts is set by law.[6]

A new status law guarantees that judges will be compensated as constitutional officers. The compensation system for judges has been separated from the compensation system for employees of public administration. Judges' wages are determined by the wages of MPs and are annually adjusted to inflation by law.

Partial changes to the law were made simultaneously with changes to the standing of the judiciary. The intention was to increase the responsibility of parties to the proceedings, thereby improving the results of proceedings. To this end, some elements of the adversarial procedure were introduced to the procedural law. A new act regarding the arbitration procedure was passed to support extrajudicial decisions made in proceedings.

A pilot court management project supporting senior court officials working with computers, which was to change the organisation of work at courts, was also launched at this time. The gradual computerisation of the courts, plus a related act to regulate the random assignment of judges to cases, created better conditions and a more efficient judiciary.

Changes in the standing of the judiciary, in accordance with the needs of a democratic state, brought high expectations for the functioning of the justice system. Opinion polls have shown that the independence of the justice system as a condition for unbiased decision making guarantees neither a trustworthy nor an efficient justice system.[7] An opinion poll carried out by Transparency International in 2002 pointed to a low level of credibility in the Slovak Republic's justice system from the point of view of perceived corruption as well as quality of work.[8]

Credibility and efficiency of the justice system (2002–06)

During 2002-06 the government thoroughly reformed the judiciary, strengthened rights' enforcement and made a breakthrough change in the state penal policy. This article deals with the changes to the justice system carried out by the government which were aimed at strengthening credibility, preventing corruption and improving the efficiency of the judiciary.

This article does not examine the measures dealing with state penal policies. Vital changes were made between the years 2002 and 2006. The penal code, which had originally been drafted in the 1960s, was re-codified and a new penal code and penal procedural code were passed. The Special Court and the Special Attorney's Office were created as separate specialised bodies which discover and prosecute corruption and organised crime.

Judicial reform to strengthen credibility and improve efficiency was based on a number of measures and government bills. These measures were aimed at materially equipping the courts, system informatisation, strengthening the courts with specialised staff, changing the organisation of work at courts, structural changes to the court system, changing the court administration and supporting human capital.

One of the key projects for increasing efficiency is the court management initiative, which was introduced to all Slovak courts by the government. This project is based on a radical change in the organisation of work in the courts, which enables the creation of a team which works around a judge. The team members relieve the judge of administrative work and create conditions for decision making, which in turn lead to quicker verdicts. A senior court official hands down simple verdicts and expert assistance.

This system is based on the informatisation of justice. Courts are equipped with computers and there is a search engine with everything necessary for a court's functioning, including EU regulations, the jurisdiction of the European Court of Justice and the jurisdiction of the European Court for Human Rights. The information system makes it possible to check the movement and transparency of cases and adds to the credibility of a hearing.

The random assignment of cases to judges through an electronic filing office is stipulated by law and is part of the system of court management. This is an important anti-corruption element of the court management initiative.

The court management project has substantially changed work conditions in the courts. In a short period of time, the conservative Slovak justice system has gone through the informatisation process, created a whole new category of employees (senior court officials) and been under strong pressure to change the organisation of work.

The implementation of the court management initiative has shown that establishing teams to work with judges, good technical support for courts and changes in the organisation of work can significantly increase the efficiency of a court's performance. However, it was evident that the conservative justice environment found it difficult to adapt to changes and that it resisted the changes to work organisation. The upshot is that various courts have various levels of court management, depending on how much they have managed to change the organisation of their work.

Reforms were also applied to the Commercial Register, which is administered by courts in the Slovak Republic.[9] Changes made to the Commercial Register proved that a combination of informatisation, transfer of a considerable amount of work to court officials and changes in the organisation of work are effective tools for streamlining court activities.

In the case of the Commercial Register, the change in the organisation of work was backed up by a new and simpler procedural law. This law saw the introduction of forms, to be used by registers of organisations, for filing demands. The shortening of the deadline for the registration of companies to a prescribed period of five days and the free availability of the Commercial Register on the internet has led to an improvement in the entrepreneurial environment and also had a positive anti-corruption effect.[10]

The government simultaneously created conditions for a more open relationship between the judiciary and the general public to underpin legal certainty. Courts also started to provide the public with information via the internet, including the publishing of court decisions.

This smooth access to the court's decisions enables the public and experts to become familiar with the courts' decision-making practices. It also enables judges to easily learn about each other's decision-making tendencies. This can create pressure for quality judgements.[11] The gradual introduction of audiovisual equipment for the recording of hearings will have a similar effect.[12]

These reforms have also influenced the court map. The government's aim was to create an efficient court network which was able to ensure a fully functional judiciary. In other words, the government wanted to establish a court network which creates good conditions for the performance of the judiciary and which is funded by the state.

The government implemented the concept of a three-layer system in the general judiciary whereby:

- each ordinary case is initially started at the district court level
- in cases where there is an appeal, the appeal is dealt with by an appeal court
- cases in which extraordinary legal remedies are sought are dealt with by the Supreme Court of the Slovak Republic.[13]

Within this three-layer system, district courts were formed with particular specialities, including courts administering the Commercial Register, bankruptcy courts and courts with particular courses of action with respect to criminal offences. These courts are also responsible for specialised judicial agendas.

The redistribution of judicial agendas required the creation of district courts and the allocation of an adequate number of judges and specialised court employees for the number of hearings. It was also necessary for judges to reach the required level of specialisation. The government considered the specialisation of judges as one of the conditions for satisfactory administration of the judiciary.

Many criteria were considered while drawing up the court map, including statistics on the numbers of hearings and the availability of courts. In an effort to create conditions in which a citizen could receive a quality decision on time, one of the government's priorities while preparing the court map was to create conditions for the specialisation of judges. The process of passing the changes made to the court map resulted in the merging of ten smaller district courts.[14] Political sensitivity marked the process of passing the changes and that compromised the result.

Activities supporting the efficiency of courts and the judiciary included changes made to the court administration. The government's aim was to create a system of court administration with a clear distribution of competences between all organs participating in the administration of the judiciary and the courts. The position of director of the court (court manager) was created. The aim of dedicating these basic administration functions was to enable the court chairman to be more fully engaged in the proper running of the judiciary, which represented a break from tradition in the Slovak Republic.

Considerable change was also made to court budgets. This involved judicial budgeting being managed by the Slovak Ministry of Justice. The only exception was the Supreme Court's budget, which has its own budget chapter. A special programme was created for the courts in coordination with the ongoing reform of public financing. This enabled the differentiation between money going to the courts from money going to the ministry or the penitentiary system. The creation of a separate budgeting programme for the judiciary ensured transparency of budgeting and the proper usage of court funds from the state budget. All levels of courts cooperated in the creation of the budget and this has aided in the management of the courts.

The creation of the Judicial Academy in 2005 was a systematic solution for improving the conditions necessary for the professional growth of judges, prosecutors and specialised court employees. The creation of the Judicial Academy was also one of the important points mentioned by the European Commission in the Regular Report regarding the fulfilment of requirements for joining the EU.

The Judicial Academy is an educational institution for judges, prosecutors, persons acquiring practical knowledge in order to become judges, persons acquiring practical knowledge in order to become prosecutors, senior court officials, court secretaries and other specialised court employees. The Judicial Academy was based on the principle of "judges training judges". That is why the director of the Academy is a judge and why the board of directors is dominated by judges.

A judge has the right and the responsibility to educate him or herself regarding the law. Judges can decide on the manner of their education. They do not have to do this at the Judicial Academy. The Academy is financed through the state budget. It is not able, at this stage however, to cover all the needs of the justice system. Increasing its capacity, being open to new training methods and interconnecting education with the human resources department are big challenges for the future.

Results and conclusions

According to a March 2006 Transparency International opinion poll, less than half of the respondents (47 per cent) consider the courts in the Slovak domain have widespread bribery. The opinion poll also shows that the extent of perceived corruption decreased from 59 per cent in 2004 to 47 per cent in 2006, which is the second largest decrease after the tax offices.[15] The assessment of the measures carried out by the government from 2002–06, from the perspective of the fight against corruption, implies that respondents consider these measures positively (see Table 1).[16]

Systematic measures that reduce the environment for corruption, by getting rid of the causes of corruption and at the same time making the system more functional, are reflected in the increasing credibility of the justice system. While the

Table 1: Positive anti-corruption measures carried out by the Slovak government during its four-year term (2002-2006)

Rank	Measures
1	Within the Commercial Register
2	Within court management
3	Increasing the competence of the Supreme Audit Office
4	Increasing the availability of information about operations of justice
5	Introducing thie principle of zero tolerance in juristic professions
6	Increasing the transparency of the decision-making process within the territorial self-government
7	Creating the Special Court and the Special Attorney's Office
8	Creating court officials
9	Increasing the number of disclosed criminal acts involving corruption
10	Strengthening the inner audit within the territorial self-government
11	Passing the new constitutional law about conflict of interest
12	Introducing mediation
13	Introducing property return for directors and members of supervisory boards of state companies
14	Passing rules regarding the protection of whistle blowing in labour relations
15	Introducing the obligation of policemen and customs officers to submit property returns
16	Introducing name tags in the police department
17	Commencing operation of the Justice Academy
18	Passing of an Act about work carried out for public well-being

Source:Anti-corruption minimum 2006, Transparency International[17]

Table 2: Number of cases handled by Slovak Courts

Year	Number of cases received by Slovak courts	Number of cases concluded by Slovak Courts	Ratio %
2002	889,000	814,000	91.6
2003	880,000	844,000	95.9
2004	935,000	899,000	96.1
2005	1,057,000	1,012,000	95.7

Source: Statistical Yearbook, the Ministry of Justice of the Sloval Republic[18]

perception of corruption in the justice system is still high, it is important to concentrate on ways to turn this trend.

After the government carried out the anti-corruption measures mentioned above, the system's capacity increased. According to statistics, even though the number of cases in courts is annually increasing, the number of concluded cases is also rising. The ratio of concluded court cases to received cases within a year is growing (see Table 2). This enables the system to conclude court cases that had been backlogged during periods when the capacity of the courts was smaller than the number of incoming cases.

The length of court hearings is thought to be a significant problem by the general public and especially by the enterprise sector. Businessmen consider the low enforceability of the law to be related to the length of time before a hearing. In their view, it is one of the biggest barriers to doing business in the Slovak Republic. It also creates more scope for corruption.[19] The obsolete and often changing procedural regulations, as well as the limited ability of the system to use existing capacities, were all identified as problems.

To speed up decision making in hearings requires the courts to conclude backlogged cases as quickly as possible and to simultaneously start working efficiently on new ones. Monitoring the credibility of the justice system, while increasing the efficiency of the judiciary, pose great challenges for the Slovak Republic. Introducing procedural regulations for deciding civil and commercial disputes, developing measures to increase the ability of the system to use its capacity more efficiently and establishing an appropriate system of human resources management are among these challenges.

Endnotes

1 The author served between 2002 and 2006 as the State Secretary of the Ministry of Justice and the Minister of Justice of the Slovak Republic.

2 This legislation consisted primarily of the following acts: act no. 597/1990 about head offices (courts) and district courts, later replaced by act no. 80/1992 and act no. 335/1991 about courts and judges, act no. 412/1991 about the karma responsibility of judges and act no. 420/1991 about the pay conditions of judges.

3 The Commercial Arbitration Court, an institution which decided commercial cases between state companies, was abolished.

4 Amendment to the Constitution, act no. 185/2002 about the Judicial Council, act no. 385/2000 about judges and associated judges.

5 The Judicial Council has 12 members: the chairman of the Judicial Council is the chairman of the Supreme Court, eight members are elected by judges and three are proposed by the National Council of the Slovak Republic, the government of the Slovak Republic and the President of the Slovak Republic.

6 At first judicial councils were created by regional courts with authority over all courts within the region. Pursuant to a new law, judicial councils now have to be created by every court.

7 The expression efficiency of the justice system is used here to mean the efficient work of courts, court hearings without delays and the efficient usage of resources.

8 Perceived corruption in the judiciary – Conclusion report of the opinion poll for Transparency International, August 2002, www.transparency.sk.

9 The Commercial Register in the Slovak Republic is administered by the district courts. The previous system of work at the Commercial Register was based on the Austrian model. A court investigated proposals not only from the formal side but also the material side. Deadlines at different courts varied from 40 days (the best functioning court doing registrations) to 150 days (the worst functioning court doing registrations).

10 Anti-corruption minimum 2006, www.transparency.sk.

11 Decisions made pursuant to civil and commercial law are currently published and the government plans to start publishing decisions made pursuant to penal and administrative law.

12 The first audiovisual recordings were made in spring 2006 primarily in penal proceedings according to the new penal law.

13 The new government which came into power on 4 July 2006 also declared this as one of its aims.

14 The government proposed abolishing 15 courts (the two smallest regional courts and 13 district courts). However, in the end the parliament passed the abolition of ten district courts.

15 Perceived corruption in Slovakia – Opinion Poll www.transparency.sk.

16 Anti-corruption minimum 2006, www.transparency.sk.

17 Anti-corruption minimum 2006, www.transparency.sk.

18 www.justice.gov.sk.

19 Audit of the business environment, April 2006, a joint publication by RUZ and PAS and ZPS, organisations of entrepreneurs of Slovakia.

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The enforcement of judgments in civil and commercial cases in the new EU member states

This article provides an overview of enforcement procedures and their efficiency in eight new members of the European Union: the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic and Slovenia.

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Introduction

It is widely acknowledged that efficient courts issuing fair judgments play a significant role in establishing the rule of law. Member states of the European Union (EU) and international bodies have been quick to recognise this fact and have adopted international conventions, regulations and recommendations aimed at ensuring court judgments are recognised and enforced.

The Brussels Convention of 1968, which had previously addressed this issue, has been replaced in most EU countries, with some exceptions, by the new Council Regulation No. 44/2001 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters. Regulation No. 44/2001 provides for the recognition of any judgment given in an EU member state by the court of another EU member state without requiring any special procedure.[1]

This regulation has recently been complemented by Regulation (EC) No. 805/2004 of the European Parliament and of the Council which creates a European Enforcement Order for uncontested claims. Regulation (EC) No. 805/2004 simplifies to a large extent the access to enforcement of uncontested claims, improving on the exequatur procedure provided for in Regulation No. 44/2001.[2] The European Enforcement Order should be issued by the court that delivered the judgment, based on requirements set forth in Regulation (EC) No. 805/2004 and is required to be enforced in any other member state without the need for a declaration of enforceability.[3]

The regulations mentioned above, however, limit their ruling to ensuring access to enforcement in other member states, whereas the enforcement procedures are governed by the law of the member state where the enforcement is sought.[4] Most early members of the EU have long-established enforcement procedures which have been historically formed and shaped in line with their development. In contrast, the eight countries which have joined the EU more recently are still in the process of transition and are continuing to develop and perfect their enforcement frameworks.

It was only relatively recently that international bodies began to turn their attention to the importance of efficient enforcement of the law application process, recognising that "...the enforcement of court decisions, in particular within a reasonable time, has to be regarded as an integral part of the right to a fair trial for the purposes of Article 6 of the European Convention on Human Rights"[5] and proper, effective and efficient enforcement of court decisions is of capital importance for member states in order to create, reinforce and develop a strong and respected judicial system."[6]

In line with this new approach, the Committee of Ministers of the Council of Europe adopted on 9 September 2003 Recommendation Rec (2003)17 of the Committee of Ministers to member states on enforcement (the recommendation).[7] The Recommendation sets forth the principles of regulation and the application of enforcement procedures and basic guidelines regarding enforcement agents.

The recommendation encourages:

- the clarity and ease of enforcement procedures
- effective and appropriate means of serving documents
- measures against procedural abuses
- regulations on transparency
- quick procedures.

The recommendation further specifies that the activity and status of enforcement agents should be clearly defined by relevant regulations. In particular, enforcement agents should be adequately trained, remunerated and equipped, they should have attained a specified level of professional qualification and they should be subject to monitoring. The recommendation is accompanied by an explanatory memorandum that provides background information about the principles.

This article provides an overview of enforcement procedures and their efficiency in eight new members of the European Union, namely the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic and Slovenia. Lawyers from each country describe the main features of the enforcement procedures in their country and suggest measures for improving the quality of enforcement.

Czech Republic

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Legal framework

All court decisions and arbitral awards in civil and commercial matters compliant with Czech legal requirements[8] can be enforced either by the relevant court and its bailiff under the Civil Procedure Code (CPC),[9] as amended, or by a private court executor (the executor)[10] under the Execution Code (EC), as amended.[11]

The CPC, which was adopted in 1963, regulates civil court procedure including execution procedures.[12] There have been almost 30 amendments to the provisions relating to execution including the:

- improvement of execution against a debtor's salary, bank accounts and other financial revenues and, especially, execution by auction sale of movable and immovable property[13]
- creation of the institution of "declaration of property"[14] by the debtor
- establishment of new methods of enforcement[15]
- improvement of existing methods[16]
- improvement of the court mail delivery system.[17]

The most significant change to the enforcement of judgments in the Czech Republic came with the enactment of the EC in 2001. Prior to that, the court and its bailiffs had to deal with a large volume of enforcement requests with only limited resources. In addition, under the CPC, courts and bailiffs are still limited by procedural obstacles and have little motivation to ensure enforcement. The main purpose of the EC was to expedite the enforcement process and to help courts by transferring some of their responsibilities to the executors and, therefore, increase the number of successful executions.[18] To a certain extent this goal has been achieved.

Enforcement bodies

Enforcement based on the CPC should be undertaken by the competent court and its bailiffs.[19] The relevant court and its bailiffs are supervised by the chairman of the court and by the next level of court.

Enforcement based on the EC vests with the executors, who should be members of the Czech Executors' Chamber.[20] Executors are supervised both by the relevant court (for example, in cases relating to general activities, fees) and by the Executors' Chamber (for example, in cases relating to complaints by either the creditor or the debtor in the proceedings against an executor).[21]

The creditor can choose whether to follow the enforcement procedure established by the CPC or the enforcement procedure established by the EC. Reasons for the creditor choosing one procedure over another depend on the complexity of the proceedings and the costs. Some of these are outlined in the section below.

Enforcement procedure

An enforcement procedure under the CPC starts with the submission by the creditor of a petition for execution. Based on the petition, which must comply with legal requirements and indicate the method of execution and whether the supporting decisions have been submitted, the competent court will issue a court execution order.[22] The court execution order will establish the method of enforcement, as well as the obligations of the debtor and other participants. Upon delivery of such an order to the debtor, the property of the debtor as specified in the petition will be seized.

An enforcement procedure under the EC also starts with the submission by the creditor of a petition to court. However, the

creditor is not required to specify in the petition the method of execution. The court will issue an executor execution order within 15 days. Based on the order, the executor is entitled to take all necessary steps to complete the execution. The executor will issue an executor's writ specifying the method of execution decided by the executor.[23]

After the executor execution order and the executor's writ are served on the debtor, the debtor is not allowed to dispose of any of its property except for property necessary for the purposes of ordinary business and the satisfaction of basic living needs and maintenance of its property. Any act undertaken by the debtor in breach of this restriction will be deemed null and void.[24] Should the executor's writ specify certain property, the exemption mentioned above will not apply to this property.[25] Both the creditor and the debtor have the right to appeal the executor execution order, but they do not have the right to appeal the executor's writ.[26]

The EC and the CPC provide for several methods of enforcement of monetary claims and corresponding rights of the enforcement bodies, including:

- requesting the employer or the bank to withhold and transfer the salary, balance of the bank account and other revenues of the debtor (including seizure of the bank account or salary)
- seizure and sale of a receivable (including rights from trademarks, licenses, securities and shareholdings)
- seizure and sale of movables, immovable property and businesses.[27]

Non-monetary claims may be enforced by:

- vacating the property or seizure of property
- the partition of property held in joint ownership
- the provision of works and services.[28]

The cost of enforcement proceedings under the CPC and the EC includes: a court fee; the fee and documented expenses of the executor (under the CPC only one fee is calculated as a percentage of the value of the monetary claim); and the costs of the creditor.[29] All such costs are primarily covered by the proceeds of the seized assets. In the event that the execution is not successful, the court may order the creditor to reimburse enforcement costs.

There is no time limit for the enforcement procedure. It terminates for the reasons stated in the CPC or the EC. For example, a procedure is terminated due to successful enforcement, petition of the creditor or the fact that enforced assets are insufficient to cover the costs of execution. In the event of bankruptcy, ordinary enforcement procedures cease and they are replaced by bankruptcy proceedings.[30]

Improvements

The key issue regarding the regulation of enforcement of judgments in the Czech Republic is whether to keep dual enforcement proceedings or to assign execution solely to executors and to delegate certain types of enforcements such as those related to alimony or custodial issues to courts and bailiffs.[31] There is some pressure from regulatory authorities and lawyers to include separate enforcement procedures in the EC and to exclude enforcement provisions from the CPC. However, such a major change to the existing regime would take some time to implement.

Another controversial issue is the right of the debtor to formally appeal against any court decision and, thereby, delay the proceedings.[32] According to the Minister of Justice, an amendment limiting this right of the debtor may be proposed shortly.[33]

An additional area for improvement is the limited number of executors. This is currently being addressed by increasing the number of executors and their employees. In addition, some methods of enforcement are difficult to perform, including the seizure of shareholdings, the sale of movables in the possession of third persons, and the sale of immovables[34] and/or a business.[35] These issues need to be regulated in a more clear and detailed manner.

The creditor should also have an unlimited right to change the executor due to incompetence and/or inactivity.[36] Setting a time limit on certain executor activities by statute would also help to improve the execution proceedings in the Czech Republic.

Estonia

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Legal framework

In Estonia the enforcement of court judgments in civil cases is regulated by the Code of Civil Procedure,[37] the Code of Enforcement Procedure[38] and the Bailiffs Act.[39] These legislative acts were adopted with a view to improving the coherence of legal provisions in this field.

Major changes to the enforcement framework in Estonia began in 2001 with a reform of the statute governing bailiffs.

This reform, which was aimed principally at streamlining the enforcement procedure and reducing the cost to the state, transformed state employees of the court's enforcement department into freelance bailiffs. Bailiffs are now independent agents who hold an office in public law. More recent changes reduced the number of bailiffs from around 170 to less than half that number as there was insufficient work for so many bailiffs.

New regulations also reflect the principles of European Community law and conform with EU legal acts, as well as other international conventions to which Estonia is a party. Currently, no fundamental modification of Estonian legislative acts concerning enforcement of court judgments is pending.

Enforcement body

The bodies responsible for the enforcement of court decisions in Estonia are called bailiffs (*kohtutäitur*). Since the reform of 2001, bailiffs are self-employed legal persons governed by public law who act in their own name and are responsible for their actions. In order to comply with the requirements for becoming a bailiff, the number of which is limited by law, a person must have an academic degree in law, be a citizen of Estonia or another member state of the EU and have passed the special bailiff's exam.

Bailiffs are supervised by the Minister of Justice. The Minister issues regulations and organises, through his assignees, the examination, evaluation and periodic control of bailiffs. The Minister of Justice has the right to impose a disciplinary sanction on a bailiff. A bailiff can be held liable for wrongful non-performance or inappropriate performance of his or her duties, as well as for any indecent act that undermines the reputation of the bailiff's profession. A bailiff is entitled to lodge an appeal against the imposition of a disciplinary sanction with an administrative court within one month of becoming aware of such an imposition.

Enforcement procedure

A court decision becomes executable when it can no longer be subject to any appeal (except through a special review procedure). Such judgment receives an execution notation, which signals its entry into force and allows the bailiff to proceed with the execution without needing to check the enforceability of the judgment. Additionally, any party to the proceeding can apply for such a notation with the same court that made the decision. The statute of limitations for a claim recognised by a court judgment in force or arising from a settlement agreement approved by a court or from another execution document is 30 years.

A claimant seeking the execution of a judgment shall submit the judgment to the bailiff who will start execution proceedings on the basis of the execution document and the claimant's application. An execution procedure starts once the bailiff notifies the debtor of the proceeding and of his or her rights. The court or the bailiff should establish a grace period for voluntary execution in order to allow the debtor to satisfy the claim.

Upon expiration of such period, unless all demands are fully satisfied, the bailiff can proceed with coercive enforcement. Bailiffs are invested with the power to seize and sell assets, to freeze the debtor's bank accounts and securities and to withhold the debtor's salary and other monetary income. In addition, the bailiff is empowered to repossess immovable property and evict any occupants in cooperation with the police, if necessary.

Parties to execution proceedings have the right to file a complaint against the decision, action or inaction of the bailiff. Such a complaint should be first filed with the bailiff, who will hear and decide on the complaint. In the event that the parties are dissatisfied with the solution suggested by the bailiff, the decision can then be contested in a county court.

In the event that a claim cannot be settled through execution proceedings within three months, or it becomes evident that the debtor lacks sufficient property to discharge all of his or her obligations, the creditor can file a bankruptcy petition against the debtor. In such a case, execution proceedings shall terminate when the debtor is declared bankrupt.

Bailiffs are entitled to charge a fee for their services, comprising an amount for the initiation of execution proceedings and a main fee, which is a flat rate that is determined by the amount of the monetary claim or by the nature of the execution operation. The bailiff also has the right to receive additional remuneration for an operation that is technically or legally complicated or time consuming. Parties to the enforcement proceedings can file a complaint with the local county court for incorrect fees claimed by the bailiff. If a debtor satisfies the claim within the term of voluntary execution, only half of the determined execution costs are to be paid.

Enforcement costs are usually borne by the debtor and can be recovered from the enforced assets. In certain cases, however, the claimant is required to make an advance payment for costs to ensure that the proceeding goes forward.

In addition to the bailiff's fee, the debtor must bear other costs associated with the execution proceedings including the cost of verifying personal data and assets, the cost of transmitting documents and transportation costs.

Improvements

Due to the fact that the new Code of Enforcement Procedure only entered into force in 2006, it is difficult at this stage to pinpoint any necessary improvements. The new Code of Enforcement Procedure solved several problems contained in the previous code. When elaborating the new Code of Enforcement Procedure, the practice of the Supreme Court of Estonia was taken into consideration and it now conforms with other legal acts and EU law.

Nevertheless, there are a few issues which may arise under the new Code of Enforcement Procedure, although they do not necessarily need to be changed. First, the new Code of Enforcement Procedure entitles the bailiff to cancel the seizure of property that obviously belongs to a third person. There is a risk that the bailiff will adjudge property

relations and that would be against the principle of perfecting the enforcement procedure. Secondly, the new Code of Enforcement Procedure entitles the bailiff in certain instances to seize a debtor's property without the debtor having been sent written notice of the commencement of enforcement proceedings. Extreme caution should be exercised in the application of this provision in order to avoid violating the debtors' rights.

Hungary

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Legal framework

The enforcement of commercial and civil court decisions in Hungary is primarily based on the 1994 act on judicial enforcement (JEA)[40] and on the 2001 decree by the Minister of Justice on the organisation of judicial enforcement.[41] The most substantial amendment to the JEA since its enactment in 2001 was aimed at creating a more efficient judicial enforcement procedure.[42] Specifically, the amendment sought to simplify and accelerate enforcement procedures, to promote the interests of creditors and, in particular, to make it easier for creditors to enforce their claims while, at the same time, protecting the interests of debtors.

One of the main results of the changes is that the enforcing court may now suspend execution upon the debtor's application, subject to certain conditions. Further, a request for enforcement which falls within the competence of independent bailiffs may, in most cases, also be submitted directly to the bailiffs instead of sending it only to the court. The purpose of this is to facilitate the initiation of the enforcement procedure by persons who do not use lawyer's services. The amendment also ensures better and wider access to the various databases from which the assets of a debtor may be identified.

Although these amendments are designed to meet the needs of creditors they have, arguably, not resulted in a quicker or more efficient enforcement procedure.

Enforcement bodies

Judicial enforcement is ordered and/or implemented by the court and certain other officials, such as court bailiffs, independent bailiffs and others.[43] General supervision of the organisation of judicial enforcement is carried out by the Minister of Justice. The activity of independent bailiffs is supervised by the Hungarian Chamber of Court Bailiffs (the Chamber), whereas the supervisory authority for the court bailiffs is the chairman of the competent county court.

There are various legal remedies against court decisions in connection with judicial enforcement, including the withdrawal of the certificate of enforcement, an appeal of the enforcement order and an objection to enforcement and legal remedies by prosecutors.

Enforcement procedure

Pecuniary claims are often enforced through a prompt collection order. This order allows the collection of the debt through the banking system prior to the initiation of a full blown formal judicial enforcement procedure. A so-called "enforceable document" is not required at this preliminary stage. It is only required for the final and binding judgment. However, a formal enforcement procedure must always be based on an enforceable document. Although several types of enforceable documents exist, the usual enforcement document is a certificate of enforcement issued by the competent court upon the request of the creditor, based on a court judgment.

The court issuing the enforceable document provides it to the relevant bailiff. Upon commencement of the enforcement procedure, the bailiff delivers the enforceable document to the debtor and requests immediate performance. If the debtor fails to comply with the enforcement order, the bailiff has the power to collect the creditor's claims out of the debtor's income, including his or her salary and from his or her other assets.

A seizure of assets is performed gradually in order to cause the least possible prejudice to the debtor's interests. At first, collection is attempted from bank accounts and from the earnings of the debtor. Then, if full collection of the claim has still not been fulfilled, movable assets and any real property of the debtor can be seized. There are no statutory time limits for the procedure and they are almost invariably lengthy.

According to the JEA, the costs of enforcement are funded by the creditor and are recoverable from the debtor. These costs include any stamp duty on an *ad valorem* basis, the fees of the creditor's legal representatives, the fees of the bailiff and the costs of recovering any commission. Enforcement costs are recovered first from the proceeds, before the creditor's claims are satisfied.

Improvements

Although the judicial enforcement procedure has developed a lot in recent years, and some of the former constraints have been removed by amendments to the JEA, there are still a

number of issues which can result in lengthy proceedings.

In principle, the JEA contains strict procedural deadlines for all parties involved in the enforcement process but, in practice, bailiffs do not adhere to these deadlines and the failure to meet the deadlines has no legal consequences.

With regards the prompt collection order prior to the formal judicial enforcement procedure, some legal practitioners suggest that its scope should be broadened to include the bank accounts of individuals. In addition, rules for the execution and monitoring of withdrawals should be more precisely defined for financial institutions.

It is also common for bailiffs to be willing to suspend enforcement proceedings where they are unable to detect any asset of a debtor. After enforcement is suspended, bailiffs are no longer obliged to regularly monitor databases in order to identify new assets and, from time to time, the creditor must request the bailiff to proceed. Some statutory deadlines inserted into the JEA would solve this problem.

Access to various databases is established, but the databases still need to be updated more regularly in order for the system to be effective.

It has been suggested that the current system of supervision needs amendment. According to one proposal for revision, the chief judge of the county court would supervise independent bailiffs rather than the Chamber. Even with this change, other measures would need to be taken by the Chamber in order to ensure that enforcement proceedings are more effective and follow the statutory deadlines.

Latvia

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Legal framework

The enforcement of judgments in commercial and civil cases in Latvia is regulated by two main laws, the 1998 Civil Procedure Law and the 2002 Law on Bailiffs.

As part of the improvement of the Latvian legal system, a fundamental reform of the bailiff institution was launched in 2002. As a result of this reform, bailiffs were transferred from the organisational structure of the Ministry of Justice to the judiciary and are performing their activity similar to notaries and sworn advocates The aim of this reform was to make the activities of bailiffs more efficient and to improve the quality of the enforcement of judgments.

There have been differing opinions on the success of this reform. Some officials have expressed the view that the reform was not thoroughly planned and that a number of issues still remain unresolved. In addition, negative publicity has been generated by a number of criminal cases against bailiffs.

Enforcement bodies

Judgments in commercial and civil cases are enforced by sworn bailiffs who form part of the judicial system. Bailiffs are state officials with independent status in their professional activities. The supervision of bailiffs is performed by the courts based on civil procedure. The actions of a bailiff during the enforcement of judgments may be appealed by a creditor or a debtor in the district (city) court. In practice partial supervision of bailiffs is also performed by the Council of Latvian Sworn Bailiffs (hereafter, the Council of Bailiffs), which can initiate disciplinary proceedings against a bailiff.

Enforcement procedure

Enforcement proceedings can only be commenced by a creditor once the judgment has come into effect. In order to refer the judgment to enforcement, the creditor must receive a separate enforcement document, which is usually issued by the same court that passed the underlying judgment. The creditor may submit the judgment to the bailiff for enforcement within a period of 10 years.

Upon commencement of the enforcement process, the bailiff notifies the debtor with a proposal that the debtor fulfil the judgment voluntarily. If the judgment is not fulfilled voluntarily, the bailiff carries out compulsory enforcement by applying certain measures, the most common of which is seizure of the debtor's monetary assets (both income and deposits), selling the debtor's property and removing persons or property from the premises. During the enforcement of judgments, the bailiff's requirements are binding on all persons. The bailiff can also request the assistance of the police.

At the conclusion of the enforcement process, the amounts collected from the debtor are distributed. The costs of enforcement are covered first, followed by the claims of the creditor(s) and any remaining amount is returned to the debtor.

The law does not prescribe a timeframe for enforcement of the judgment. The timeframe depends on the actions of the creditor, the bailiff and the debtor. If the debtor is declared insolvent, then the process of enforcement of the judgment is terminated and the creditor may request repayment of his debt during the ensuing insolvency proceedings.

The costs of enforcing the judgment, including the state fee,

expenses relating to performance of enforcement activities and the remuneration of the bailiff are borne by the debtor. The bailiff's remuneration is determined in accordance with approved rates, which are partly a fixed fee and partly a variable fee, a certain percentage depending on the amount collected.

Improvements

Although efforts have been made to improve the enforcement of judgments, there remain a number of causes for concern for both the creditor and the debtor. The law does not set any time limits for a bailiff to carry out the enforcement of a judgment. Bailiffs may choose when to perform each action of enforcement. Thus, if the bailiff is not motivated he or she may significantly delay the enforcement of the judgment.

As a result, creditors are advised to approach the bailiff repeatedly and encourage more vigorous enforcement of the judgment, or to turn to another bailiff. The creditor may also file a complaint with the Council of Bailiffs about inaction by the bailiff. One possible solution would be to enhance the motivation of bailiffs by increasing their level of remuneration for enforcement activities. At present, they are inadequately compensated for their work.

Bailiffs have received considerable criticism for some of their activities, for example conducting fictitious property auctions and under pricing real property at auction. In response to these criticisms, the Council of Bailiffs has proposed amendments to several laws. These amendments extend the number of persons entitled to participate in auctions organised by bailiffs and involve certified property valuers. In addition, it has been suggested that a police representative should be present at auctions organised by bailiffs.

The transparency of a bailiff's actions is materially affected by the lack of publicly available information. For instance, according to the law, information on property auctions should be published in the official gazette. However, this publication is not widely distributed. Furthermore, there is no legal requirement for auctions of movable property to be published in any mass media.

In an effort to improve the situation, the Council of Bailiffs has set up an electronic database of advertisements for auctions organised by bailiffs with free online access. However, this database does not enjoy official status and the published advertisements are not fully reliable.

Needless to say, bailiffs play a crucial role in the enforcement of judgments. Their professional skills and qualifications are, therefore, of the utmost importance. However, only 53 out of a total 109 bailiffs have currently attained the highest legal qualifications, while others are still in the process of education. The law sets a requirement for bailiffs to have attained the highest legal qualifications. However, this requirement will not be compulsory until 2010. Until then, creditors should take this situation into account and choose a reliable bailiff.

Lithuania

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Legal framework

The enforcement procedure in Lithuania is regulated by:

- the Code of Civil Procedure (effective as of 1 January 2003)
- the Law on Bailiffs (effective as of 1 January 2003)
- the Instructions on Enforcement of Judgments approved by the order of the Minister of Justice (effective as of 4 November 2005)
- the Code of Professional Conduct for Bailiffs (effective as of 1 April 2003).

Following Lithuania's independence in 1990, the necessity to reform enforcement procedure became increasingly apparent. A more effective system for enforcing judgments and ensuring payment of debts was introduced in 2003.

Up until then, the system of enforcement of judgments had been inadequate in a number of areas: the level of professional qualification of court bailiffs was low; property realisation procedures were ineffective; there were few coercive enforcement measures; no system for searching data on debtor's property existed; and, it was possible to lawfully delay the enforcement procedure etc.

Upon the implementation of the enforcement reform, the system of state bailiffs' offices was reorganised and replaced by private bailiffs. It was decided that the expenses of enforcement of judgments in a dispute between private persons were to be borne not by the state, but by the parties to the dispute. The system of private bailiffs was based on the Dutch and French experience.

The current framework for the enforcement of judgments in Lithuania complies in principle with EU legislation, namely Recommendation Rec. (2003) 17 of the European Council Committee of Ministers on enforcement of 9 September 2003. The quality of executions has risen significantly and debtors are now more likely to settle debts and pay fines voluntarily.

Enforcement bodies

The basic functions of the enforcement procedure are carried out by independent private bailiffs. In order to ensure the transparency of procedural actions by bailiffs, persons are granted the right to appeal against procedural actions by bailiffs in court without paying any stamp duty.

The professional activity of bailiffs and their compliance with the requirements established in the Code of Professional Conduct for Bailiffs is regulated by the Bailiffs Chamber of Lithuania and by the Ministry of Justice. Disciplinary proceedings may be brought against bailiffs and their assistants by the Minister of Justice and the Presidium of the Bailiffs Chamber of Lithuania for breaches of the Code of Professional Conduct. Such proceedings are examined by the Bailiffs' Court of Honour.

Enforcement procedure

The enforcement procedure and bailiffs' rights therein depend on whether a judgment for interim measures, a final court judgment or an arbitration award is being enforced. Prior to enforcing a final court judgment or an arbitration award, a creditor will usually receive a writ of execution, although certain court documents are automatically enforceable. For purposes of enforcing a judgment for interim measures, there is no need to issue a separate writ of execution and to send a warning to satisfy the judgment voluntarily. However, the range of coercive enforcement measures is restricted.

The general statute of limitations for serving documents for execution is 10 years from the date when the court judgment became effective.

The enforcement procedure of final court judgement or arbitral award is initiated with a warning sent by the bailiff to pay the debt voluntarily.[44] Upon receipt of such warning, the debtor is usually given a 10 day period in order to satisfy the judgment voluntarily. If the debtor fails to comply, the bailiff starts a search of the debtor's property, the scope of which depends on the size of the debt, specifics of the debtor's activity and other factors.

Should the debtor fail to comply with the judgment voluntarily, he may be subject to following coercive enforcement measures, including the following:

- seizure and realisation of the debtor's funds and property or property rights
- seizure and realisation of the debtor's property and pecuniary amounts held by third parties
- prohibition of third parties from transferring money or property to the debtor or from performing any other obligation for the debtor
- seizure of documents proving the debtor's rights
- attachment of the debtor's wage, pension, scholarship or other income
- seizure from the debtor of property items listed in the court judgment and conveyance thereof to the creditor
- administration of the debtor's property and use of the proceeds to cover the debt
- ordering the debtor to carry out or refrain from specific actions
- set-off of the recoverable amounts in counterclaims.

In order to identify the debtor's property, bailiffs may address enquiries to banks operating in Lithuania, the Real Property Register or the work place of the debtor. The identified property is attached to the extent required for covering the debt and enforcement expenses and an auction of the property will then be announced. (This can be avoided by the debtor if he or she finds a buyer for the attached property and proposes it to the bailiff before the beginning of the auction.)

Auctions are organised by bailiffs. The auction deed of sale of property is certified by the court. Some public criticism has been levelled at the way auctions are conducted. With this in mind, a working group set up by the Minister of Justice to amend certain provisions of the Code of Civil Procedure has also been given the task of preparing amendments to the rules regulating the auction process.

If the debtor has no property or funds, the bailiff will usually perform repeated inspections of the debtor's property every three months. Once bankruptcy proceedings against the debtor have been initiated, the enforcement proceedings are stayed and the document for execution is forwarded to the court that initiated the proceedings.

The issue of enforcement expenses is presently regulated by secondary regulations. The working group set up by the Minister of Justice is drafting a law pursuant to which the issue of the enforcement costs/expenses shall be regulated by law and not secondary regulations.

In Lithuania enforcement expenses can generally be divided into the following three components:

- the general expenses of judgment enforcement payable by the creditor when presenting the document for execution (the amount thereof depends on the recoverable amount)
- expenses related to the performance of separate enforcement actions (whilst in theory these are to be borne by the creditor, in practice the bailiff will usually exempt the creditor from payment of the enforcement expenses and recover them from the debtor)
- remuneration to the bailiff for execution or part thereof (the size of this remuneration depends on the amount recovered and is calculated after the bailiff has recovered the total debt or part thereof. The bailiff's portion of the enforcement expenses may be recovered only from the debtor).

Upon recovery of the debt, all the enforcement expenses incurred by the creditor and the part of the bailiff's remuneration proportional to the size of the amount recovered will be paid first. Then the debt itself will be covered.

Improvements

Apart from the above amendments, creditors' interests would, in the opinion of the Bailiffs Chamber, be better protected if the legal rule allowing recovery of the debt in part from the wages or other periodic income of the debtor were applied not in all cases, but only when the debtor has no other property. One of the provisions of the enforcement procedure to be considered is the rule according to which the recovery of money cannot be levied on a debtor's property if the debtor submits evidence to the bailiff that it is possible to recover the amount of money within six months by making deductions from the debtor's wage, pension, scholarship or other income.

The recent reform of judgment enforcement in Lithuania and its harmonisation with EU legislation means that the rights of both the creditor and the debtor are protected during such procedures. In addition, possibilities to enforce the judgments are now provided and minor deficiencies in the enforcement procedure have been removed in practice, thereby, making the enforcement process more modern and efficient.

Poland

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Legal framework

The enforcement of court decisions in civil and commercial matters in Poland is regulated primarily by the Code of Civil Procedure dated 17 November 1964. The Code has been amended several times, including a recent, major change concerning the rules and procedure for execution proceedings, which became effective last year. The amendments were aimed at simplifying execution proceedings and ensuring better protection for creditors.

Enforcement bodies

The two execution proceeding authorities are the court and the court execution officer. The main authority is the court execution officer who carries out all execution activities except those reserved for courts. He or she is a public officer associated with a district court, with a designated territorial sector for his activity. The creditor, however, has the right, with some exceptions, to select a court execution officer, other than one designated for a certain territorial sector The activity of court execution officers is supervised by a designated court. Actions taken by court execution officers may be appealed. Such appeals are heard by the supervising court.

Enforcement procedure

In order to commence execution proceedings against a debtor, a creditor must have an enforcement document (*tytuł egzekucyjny*), including a court judgment, for which a writ of execution (*klauzula wykonalności*) has been granted by a competent court.[45]

A writ of execution is a confirmation by a court enabling the creditor to commence execution proceedings against the debtor on the basis of an enforcement document. The creditor must submit to the court the request for enforcement together with the enforcement document, in order for it to issue the writ of execution. The court must issue the writ of execution within three days of the filing of the request. However, this usually takes much longer in practice.

Once the court has issued a writ of execution, the debtor against whom the writ of execution has been issued has a right to oppose the writ. The writ can be opposed if the debtor does not agree with the court's decision and denies the facts on which the writ of execution was based, or an event occurred, as a result of which the obligation was discharged or cannot be enforced.

The application for the commencement of the execution proceedings is filed by the creditor with a court execution officer. It should specify the claim to be satisfied by the debtor and the manner of execution. The law lists a number of possible methods of execution for enforcement of pecuniary claims against real property, movable property, a salary, bank accounts, other receivables and other property rights, sea vessels or by means of establishment of mandatory administration upon the enterprise.

The statute of limitations for claims resulting from a final and unconditional decision of a court, other authorised body or a settlement expires after 10 years.[46]

The costs of execution proceeding vary depending on the value of the claim and the value - up to 15 per cent - of the amount enforced, including interest. However, the costs may not be less than 10 per cent or higher than 3,000 per cent of the average monthly wage, which is approximately €600. As a rule, proceeding costs are calculated and enforced after the claim itself has been enforced, except for advance payments charged by the court execution officer before the commencement of the proceedings.

The bankruptcy of the debtor affects execution proceedings. Generally, if the debtor is declared bankrupt, the execution proceedings concerning the receivables of the debtor are suspended or terminated by law. The creditor may enforce its claims on the basis of an extract from a list of claims only.

Improvements

The most significant obstacle to effective claim enforcement in Poland is the time involved. Execution proceedings may take years due to court inefficiency, legal measures available to the debtor enabling him to effectively delay proceedings and, in some cases, insufficient protection of the creditor's interests. Any changes to the execution procedure should focus first and foremost on their further simplification, improving the creditor's position and introducing time frames for completing proceedings.

Slovak Republic

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Legal framework

The main legislative acts relevant to the enforcement of judgments in the Slovak Republic are the Code of Execution Procedure (CEP) and the Code of Civil Procedure (CCP). While the CCP partially regulates execution procedures, the primary regulation is set out in the CEP which is the main focus of this section.

The establishment of the profession of executor in December 1995 introduced two different regimes for execution proceedings:

- enforcement of a judgment before a court in accordance with the CCP
- execution proceedings by an executor under the CEP.

The creditor was free to choose between judicial enforcement of a judgment and enforcement by independent executors.

Recent amendments to the system have harmonised the substantive, procedural and institutional aspects of enforcement and essentially eliminated the dual track enforcement system. However, judgments may still be enforced by both executors and, in very limited cases, by the courts.

Enforcement bodies

Enforcement of commercial court decisions is carried out exclusively by executors, whereas civil court decisions may be enforced by executors and, in limited cases, by the courts. Fundamental decisions and steps in execution proceedings are still made by the court or require the approval of the court. For example, only a court may issue authorisations for execution and decide on the suspension and termination of execution proceedings.

Executors are appointed by the Minister of Justice and must be members of the Chamber of Executors, which is a self-regulating body. Complaints regarding the conduct of executors and the Chamber of Executors may be made to the Ministry of Justice.

Enforcement procedure

Execution proceedings are initiated upon application by a creditor to an executor, who then submits an application to the court requesting authorisation to commence execution. The court will either authorise the execution or reject the request if it finds any incompatibility between the request, the application or the execution title and the law.

After the executor receives court authorisation he or she will notify both the debtor and the creditor that execution proceedings have been commenced, provide an estimate of the execution costs and, where applicable, state how the execution will be carried out. The executor will demand that the debtor perform the judgment or raise any objections within 14 days of receipt of the execution notice and forbid him from disposing of his assets which are to be subject to execution.

If any objections are raised, the court must rule on them within 60 days. Prior to such a ruling being issued, execution proceedings will be suspended. The executor must suspend execution if the debtor voluntarily performs the judgment or if the debtor partially performs the judgment and the creditor agrees to such a suspension. Following the expiry of the notice period and ruling on objections, if any, the executor will issue an execution order. No remedy is admissible against an execution order.

Upon the debtor's motion, the court may grant a stay of execution for reasons stipulated by law. A stay of execution prevents the seizure and sale of the debtor's property. It does not, however, affect any security on the property. A declaration of bankruptcy generally has the effect of discontinuing execution proceedings.

Execution may be performed only in the manner set out in the CEP. A monetary judgment may be executed by the seizure of wages and other income, the seizure or destruction of property at the expense of the debtor, the sale of movable property, the sale of securities, the sale of immovables, or the sale of a business. It is for the executor to determine the method(s) – he or she is permitted to use more than one

method of execution at a time – of execution of a monetary judgment. The creditor may only recommend using certain execution methods. In cases where the performance of an in-kind obligation is concerned, the execution method depends on the character of the obligation that was imposed. Execution may, thus, be by eviction, seizure of property, partition of a jointly owned property or performance of works and services.

A change in the collection of claims was introduced by a governmental decree in April 2006 which stipulated the scope of permissible seizure of wages during the enforcement of a judgment. This decree also laid down a basic non-seizable amount and an amount over which unlimited seizures are allowed from remaining wages.

The costs of execution proceedings comprise the executor's fees, reimbursement of out of pocket expenses and an amount pursuant to the time spent in the performance of the execution. These costs are covered, as a rule, by the debtor, except where the creditor covers the costs incurred due to their own fault or when they pay execution-related costs on behalf of an impecunious debtor. The executor may require that the creditor pay a reasonable advance payment towards his or her fees and out of pocket expenses. Certain costs incurred by the creditor (such as an authorisation fee and the costs of legal representation) are also recoverable as costs of execution proceedings.

Executors' fees are regulated by a decree of the Ministry of Justice. The fee for enforcement of a monetary judgment is determined based on a formula and is calculated as an amount from the enforced claim. Alternatively, an executor and a creditor may agree on the amount of the executor's fees but, in this case, the fees cannot be recovered from the debtor.

Improvements

As the latest amendments to the legislation governing enforcement procedures in the Slovak Republic are still quite recent, it is too early to comment extensively on their shortcomings. Nevertheless, executors have already noted certain defects in the wording of the newly introduced provisions. These defects may have an impact on the practical conduct of executions.

For instance, some interpretational problems arise from a provision under which the executor prohibits the debtor from disposing of assets which are to be the subject of the execution. It is unclear whether the debtor is prohibited from disposing of any property and rights which may be seized under law, irrespective of the amount of the claim or whether some proportionality between the value of the claim and the property must be kept.

Further, the new provision of the CEP under which a court must discontinue execution proceedings after the sale of pledged assets when the pledge was extinguished and the creditor was the pledgee, gives rise to a lack of clarity and a number of practical problems. This provision would be justified for cases in which the execution proceedings relate to the sale of pledged assets owned by a pledgor who is a different person than the debtor. However, where the legislator introduces the sale of pledged assets owned by a third party within the execution procedure, such a major change to the principles of enforcement law would require an express provision. Generally, the enforcement of a pledge does not necessarily lead to the full satisfaction of the claim or changes in the debtor's title over the pledged asset or they may be unrelated to the specific enforcement of a particular judgment.[47]

Experience gained in applying recent amendments to the legislation governing enforcement procedures in the Slovak Republic and the development of such procedures in other countries can be expected to inspire further improvements in execution proceedings in the country.

Slovenia

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Legal framework

The framework for the enforcement of court judgments in civil and commercial matters in Slovenia comprises the following legislative acts: Execution of Judgments in Civil Matters and Insurance of Claims Act (the Execution Act),[48] adopted in 1998 and last amended in 2006; and the Private International Law and Procedure Act.[49] The most recent amendments to the Execution Act were closely linked to EU regulations and international conventions.[50]

The Ministry of Justice is currently drafting a new amendment to the Execution Act based on the Constitutional Court decision dated 9 March 2006.[51] No other legislative changes to the enforcement procedure are currently under way.[52]

Since its adoption in 1998, there have been three amendments to the Execution Act. The 2002 amendment brought the enforcement system into line with legislative changes in the field of payment transactions and property law.[53] It aimed at improving the effectiveness of the enforcement system by strengthening the status of the creditor. At the same time, it imposed more stringent conditions on debtors regarding their legal means in the procedure. Enforcement officers were also given greater powers to operate independently.

Furthermore, the power to decide on a debtor's unfounded appeals was transferred from the courts of appeal to the courts of first instance in order to shorten the procedure.[54] The 2006 amendment brought the Execution Act into line with several Constitutional Court decisions, provisions of EU legislation and, finally, with international conventions.

These changes to the legislation have not, however, entirely acheived their goal and the enforcement system in Slovenia is still not as efficient as it could be.

Enforcement bodies

The bodies responsible for the enforcement of commercial and civil court decisions are the local courts (courts of first instance) and private enforcement officers, who are responsible for direct acts of enforcement and insurance.[55] Enforcement officers are subject to the control of the Minister of Justice, the Chamber of Enforcement Officers and the President of the local court. In case some irregularities are committed while enforcing a writ of execution, a party is entitled to file a complaint to the court, requesting that the irregularity be eliminated. It should be noted that the private enforcement officers, established in 1998, have not really contributed to a faster enforcement procedure.[56]

Enforcement procedure

The Execution Act provides for two procedures, depending on whether the execution is based on an executable title (for example, final judgment) or on an authentic document such as an invoice, bill or cheque.[57] The basis for enforcement is, therefore, either an executable title or an authentic document. A judgment is executable provided two conditions are met: (i) the judgment is final; and (ii) the performance period is due. It should be emphasised that before starting with the acts of enforcement, an execution order has to be issued by the court.

The main stages of the procedure are as follows:

- a creditor's petition for enforcement is submitted to the court
- an execution order is issued by the court
- acts of direct enforcement (depending on the object of enforcement)[58] are performed by the enforcement officer, including the seizure of assets, the sale of assets (movables, real estate), the transfer of claims on money, the realisation of other ownership rights such as securities, the sale of a business share and the transfer of assets in bank accounts

The Execution Act does not specify any time frame for the enforcement procedure to be concluded.

Costs and fees with respect to the enforcement procedure have to be paid in advance by the creditor. If so required, a creditor also has to ensure proper security to the enforcement officer for proceeding with enforcement acts. However, all the costs and fees can be recovered from the enforced assets. The enforcement fees are defined in the Court Fees Act and are linked to the value of the claim.

Improvements

By far the most important area for concern is court backlogs.[59] According to the court statistics of 2004, execution departments had the biggest share of unsolved matters, namely 42 per cent of all the court backlogs.[60] Therefore, fundamental changes will have to be made to the organisation of courts. Some of them are already being carried out as part of the Lukenda Project, a government strategy aimed at addressing this issue.

The whole enforcement procedure would be improved considerably by introducing an appropriate system that enables creditors to file petitions electronically. This would shorten the procedure on the whole. A second issue which needs to be addressed is the notorious inefficiency of the enforcement officers. In 2002 only 50 per cent of enforcement officers' cases were resolved.[61] In addition, only 20 per cent of all petitions for enforcement are based on a final court decision, the majority of which are based on authentic documents.[62] However, an enforcement procedure based on authentic documents can be easily contested and stopped should any of the parties file a court action. Once financial discipline is improved, the enforcement system should improve as well.

Conclusion

Each of the eight countries reviewed in this article have reformed their enforcement framework during the past five years in pursuit of a more efficient system. Nonetheless, the major concerns remain, namely:

- court inefficiency
- executors' inefficiency
- delays in enforcement procedures
- the lack of clarity regarding newly introduced provisions.

In countries where courts are heavily involved in the enforcement process, there is a backlog of cases, due to a lack resources and equipment for dealing with all of the enforcement requests. However, even where enforcement duties lie primarily with bailiffs or private enforcement agents, courts still have an important role to play in the enforcement process, such as authorising the execution process by issuing the enforcement writ. Therefore, efficient courts remain an essential ingredient for the efficiency of the enforcement process.

The status of enforcement officers varies among the countries discussed. While some countries retain a system of court bailiffs who are public servants and are organised within the courts or relevant public authority such as the Ministry of Justice, others have opted for private executors, leaving courts almost entirely aside in the enforcement process, except for the authorisation and supervision of proceedings. In addition, there are countries with a dual system that combines both types of enforcement procedures, namely through the use of courts and through private executors. Lithuania and Estonia, two countries which have decided in favour of private enforcement agents, find the outcome satisfactory and beneficial to the enforcement process.

Among the principal shortcomings in the efficiency of the court or private executors is a lack of motivation on the part of some executors (which results in delays in the enforcements

proceedings) and the limited use by bailiffs of the available enforcement tools. Basically, two solutions were suggested by the contributors: (i) improving the remuneration scheme for the executors; and (ii) raising the level of supervision and transparency. The Estonian enforcement framework seems to allow a wider flexibility to executors, including the terms of payments for their services. However, the dangers of such flexibility of powers and actions are also mentioned. Transparency can be improved by means of wider publicity for the acts of the executors, where the availability of such information does not require specific knowledge or professional skills. In addition, the lack of deadlines for enforcement proceedings contributes to reported delays.

Countries that have recently changed their relevant legal framework point to the need for comprehensive interpretation of the new provisions. Also highlighted is the need to enhance the professional skills of executors and raise their admission standards.

Endnotes

1 Council Regulation No. 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, Article 33 (1) can be found online at: http://europa.eu/eur-lex/pri/en/oj/dat/2001/l_012/l_01220010116en00010023.pdf .

2 Regulation (EC) No. 805/2004 of the European Parliament and of the Council of 21 April 2004 creating a European Enforcement Order for uncontested claims, Article 3 can be found online at: http://europa.eu.int/eur-lex/pri/en/oj/dat/2004/l_143/l_14320040430en00150039.pdf.

3 Id., Articles 5, 6.

4 Regulation (EC) No. 805/2004 of the European Parliament and of the Council of 21 April 2004 creating a European Enforcement Order for uncontested claims, Article 20.

5 Council of Europe, Legal Affairs, http://www.coe.int/T/E/Legal_Affairs/Legal_co-operation/Operation_of_justice/Enforcement_of_judgments/.

6 Prof. Dr. Alan Uzelac, University of Zagreb, Establishing common European standards of enforcement: recent work of the Council of Europe as regards enforcement procedures and bailiffs, Paris, Sorbonne, 15 November 2002, p. 4, http://alanuzelac.from.hr/Pdf/Radovi/rencontres.pdf.

7 Available online at http://www.coe.int/t/e/legal_affairs/legal_co-operation/operation_of_justice/enforcement_of_judgments/2003r17.pdf.

8 Such a decision must be in legal force (generally, delivered to the parties of the dispute and no appeal may be lodged against it) and enforceable (the time limit for the fulfilment of the duty of the debtor given by the court has passed).

9 Act No. 99/1963 Coll.

10 The official name of the executor under the Execution Code is the "court executor". On the one hand, the court executor has the status of a governmental agent who possesses certain state powers but, on the other hand, he/she is a private individual performing activities in order to make profit. See Sections 1.3, 2.2 and 3.2 thereof.

11 Act No. 120/2001 Coll. A third possible way of enforcing executable claims being secured by mortgage, pledge, lien or limitation of the transfer of immovable property is a non-voluntary public auction pursuant to Sections 36 et seq. of Act No. 26/2000 Coll., Public Auction Act.

12 Part 6 of the Civil Procedure Code, Sections 252 to 351a, governs executions under the Civil Procedure Code and, with regards to the methods of enforcement, executions under the Execution Code as well.

13 Act No. 519/1991 Coll.

14 J. Bureš, L. Drápal, M. Mazanec (2001), Civil Procedure Code – Commentary, p. XII. (5th ed). Declaration of property is an instrument which assists a creditor with a monetary claim with discovering the debtor's property through a court order before the execution is ordered.

15 Id. Execution can now be performed by means of the seizure and sale of the debtor's share in a company and the debtor's enterprise.

16 Act No. 30/2000 Coll.

17 Act. No. 555/2005 Coll. According to the explanatory report of the submitter of this act, it is strict and clear and gives a party to any court proceedings less margin to avoid delivery of court mail (Parliament documents, Print No. 580/0, www.psp.cz).

18 Pursuant to the procedure under the Civil Procedure Code, some cases took years before they officially started after the submission of respective petitions for the issuance of the execution order due to the high number of petitions.

19 The competent court of first instance, that is the court to which the claimant submits its petition for the order of the execution, is generally, both under the Civil Procedure Code and the Execution Code, the district court where the debtor has its residency, for individuals, or registered office, for legal entities.

20 The number of executors per district is decided by the Minister of Justice and is related to the number of its residents.

21 Pursuant to Sections 116 et seq. of the Execution Code, the executor is responsible for disciplinary offences, including substantial or repeated breach of statutory obligations or dignity of the executor's profession, with such possible results as monition, penalty or revocation from the executor's office.

22 However, contrary to proceedings under the Execution Code, the court does not have a set time limit under which to order the execution. Because the procedure under the Civil Procedure Code takes longer and because the claimant has to choose the method of enforcement, the Civil Procedure Code procedure is used in only a few cases – usually when the debtor has, for example, immovable assets which can be easily seized by the court and, therefore, no charge for the executor is required to be paid by the claimant in the event that the costs are not covered by proceeds from the execution.

23 The executor is also entitled to request information from various state bodies, banks, insurance companies, notaries, advocates, the Securities Centre and other individuals and legal entities regarding the debtor's bank accounts, business activity, tax issues and property.

24 The main court activity under the Execution Code procedure is the issuance of an execution order. Afterwards, the executor is responsible for the performance of execution, however, the decision on the use of the execution proceeds is, in most cases, a duty of the court.

25 However, the execution may be realised (for example, by sale of movables, debiting the balance of bank accounts, salary, and so on) after the execution order is in legal force, that is when the order is delivered to the debtor and the debtor does not appeal against it within 15 days of its receipt.

26 The effects of the delivery of the court execution order and the executor's writ are not affected by the appeal (see also footnote 25). Generally, the right to appeal, due to its wide scope, is often abused by debtors in order to delay the performance of the execution, for instance, of immovable property, shareholdings, and so on.

27 It is necessary to emphasise that, for the purpose of execution under the Execution Code, the stipulations of the Civil Procedure Code's execution procedures has subsidiary application, for instance, with regards to the methods of execution and their particular procedures.

28 Besides these methods of enforcement, the claimant has a right to ask a court (under the Civil Procedure Code) or the executor (under the Execution Code) to request the debtor to issue a declaration of property. The court (under the Civil Procedure Code) and the executor (under the Execution Code) may also request the debtor to voluntary fulfil the relevant judgment.

29 This is strictly set in the Notice of the Ministry of Justice No. 330/2001 Coll., as amended. However, the executor is entitled to arrange a contractual fee with the entitled person which is usually the same amount as the statutory fee. The reason this contractual fee is common is that, unfortunately, it "motivates" the executor to fulfil its statutory obligations.

30 Z. Prudilová Koníčková (2003), "Concurrence of the execution and bankruptcy proceedings", *Legal Advisor*, vol. 12, pp. 19-20. In the case of a bankruptcy order, the respective judgment cannot be executed (Sec. 14 e/ of the Act No. 328/1991 Coll., Act on Bankruptcy and Settlement) and the claimant must claim its receivable in the bankruptcy proceedings. After the end of the bankruptcy proceedings, the execution shall continue, provided the debtor did not cease to exist due to bankruptcy proceedings and the entitled person was not fully satisfied with the procedure.

31 It should also be considered whether the executor should be given the authority to decide on the use of the proceeds and whether the court should only make decisions with respect to objections and appeals against executors.

32 Although no appeal is allowed against an executor's writ, the right of the debtor to appeal a court decision or a court order (for example, in the execution of immovable property on the use of revenues from the sale of the immovable or company) or to make an objection regarding the executor's prejudice is often abused.

33 The record of the interview with the Minister of Justice, Pavel Němec, from 29 May 2005, can be found at: www.vlada.cz. With regards to recent parliamentary elections, the amendment is not likely to be adopted within the next few months and, therefore, there is no public information regarding the content and timing of the amendment.

34 See "Few pillars for the amendment of the Execution Code" on www.exekuceonline.cz; M. Kasíková (2003), "Execution at the Court of the First Instance", *Legal Advisor*, vol. 6, p. 17.

35 The solution for this issue is partially proposed in footnotes 31 and 33. The matter of business shares, movables in the possession of third persons and businesses may be solved by extending the executor's authority over companies and third persons in order to reduce the right to appeal of the latter two and the consequences of an appeal of the execution. Complementary to the above, it may be an option have an unlimited number of executors and, therefore, have the executors expedite the proceedings.

36 At present, this right is limited – the court revokes the executor if there are "reasons of special respect". If the executor simply does not act adequately, it is very difficult to have him or her revoked, notwithstanding the fact that a basic fee and documented costs are still being paid.

37 Adopted on 20 April 2005, in force from 1 January 2006.

38 Adopted on 20 April 2005, in force from 1 January 2006.

39 Adopted on 17 January 2001, in force from 1 March 2001.

40 Act LIII as of 1994, effective from 1 September 1994.

41 Decree No. 16 as of 2001, effective from 3 September 2001.

42 Act CXXXVI as of 2000, effective from 1 September 2001.

43 Others include, for example, deputy independent bailiffs, deputy court bailiffs, trainee bailiffs, trainee court bailiffs and court administrators.

44 There is no need to send a warning in several types of cases, including cases for the enforcement of court orders, cases in which the enforcement term is set in the enforceable instrument, in expeditious enforcement proceedings and in cases in which periodic payments must be made. These exceptions are often criticised and, therefore, an amendment to the Code of Civil Procedure is currently being prepared according to which warnings would be sent during enforcement in all cases.

45 Enforcement documents can be: 1) a final and unconditional court judgment or a decision of a junior judge, or a settlement made before a court; 2) an arbitration tribunal award or a settlement made before such a tribunal; 3) a settlement made before a mediator; 4) a notarial deed in which a debtor has voluntarily accepted execution and which provides for the obligation of payment of a certain amount of money or delivery of other assets; or 5) a notarial deed in which the owner of real property has accepted enforcement against the collateralised property. Additionally, banks can issue banking enforcement documents in accordance with the principles set out in the banking law based on banking books or other banking documents.

46 The limitation period shall be suspended by any action before a court or other authority, which is filed in order to assert, satisfy or secure a claim, such as filing a request for initiating execution proceedings.

47 P. Molnár (2005), "Novoty v slovenskom exekučnom práve" (*Novelties in the Slovak Enforcement Law*), *Justičná revue*, Vol. 57, No. 10, p. 1,214-1,228.

48 Official Journal of the Republic of Slovenia (hereinafter referred to as: OJ RS), 51/1998, 72/1998 Constitutional Court Decision (hereinafter referred to as: CCD): U-I-339/98, 11/1999 CCD: U-I-339/98, 89/1999, 11/2001-ZRacS-1, 75/2002, 87/2002-SPZ, 70/2003 CCD: U-I-331/02-12, 132/2004 CCD: U-I-93/03-26, 46/2005 CCD: U-I-110/03-16, Up-631/03-13, 96/2005 CCD: Up-357/03-23, U-I-351/04, 17/2006, 30/2006 CCD: Up-724/04-18, U-I-322/05.

49 OJ RS, No. 56/1999.

50 This includes: Council Regulation (EC) No. 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters; Official Journal of the European Communities (hereinafter referred to as: OJ EC), No. L 12, 16 January 2001; Council Regulation (EC) No 2201/2003 of 27 November 2003 concerning jurisdiction and the recognition and enforcement of judgments in matrimonial matters and the matters of parental responsibility, repealing Regulation (EC) No. 1347/2000; OJ EC, No. L 338 of 23 December 2003; Regulation (EC) No. 805/2004 of the European Parliament and of the Council of 21 April 2004 creating a European Enforcement Order for uncontested claims; OJ EC, No. L 143 of 29 April 2004.

51 Draft amendment of the Execution of Judgments in Civil Matters and Insurance of Claims Act, EVA-2006-2011-0049 – urgency procedure, http://www.mp.gov.si/fileadmin/mp.gov.si/pageuploads/2005/PDF/zakonodaja/12.06.06-ZIZ-D.pdf.

52 http://www.mp.gov.si/index.php?id=753.

53 Draft amendment to the Execution of Judgments in Civil Matters and Insurance of Claims Act – ZIZ-C-EVA 2005-2011-0008-first reading.

54 Ibid.

55 In some cases, the court can delegate the direct enforcement acts to bailiffs, who are responsible directly to the court.

56 Human Rights Ombudsman of the Republic of Slovenia, Annual Report 2002, http://www.varuh-rs.si/index.php?id=221.

57 According to the Execution Act, the executory titles are as follows: executable judgment, court settlement, executable notarial deed and other executable decision or deed, defined as such by law or a ratified and published international treaty or a legal act of the European Union, subject to direct application in Slovenia.

58 If a debtor files a grounded appeal against the execution order within eight days, the court issues a court order on the appeal. If the court, while deciding upon the debtor's appeal, considered the facts being disputed between the parties and these facts relate to the receivable itself, the debtor has the right to file a complaint within 30 days in order to establish that the enforcement should not be permitted. However, such a complaint does not influence the course of enforcement. In cases in which the petition for enforcement is based on an authentic document and the debtor files an appeal, the court can either: (i) revoke its execution and cede the trial of the matter to the competent court; or (ii) carry on with the procedure as a procedure in case of appeal against an execution order based on an executable title. During the course of the enforcement procedure, the debtor has a right to request a delay of the enforcement procedure and to have a third person state that he or she owns an object of enforcement.

59 In 2003 execution courts recorded 50 per cent of all court backlogs in Slovenia. See K. Erjavec (2004), "Enforcement arrears", *Pravna praksa,* Vol. 8, p. 12. In 2004 they represented 42 per cent of all court backlogs. See Court statistics (2004).

60 A total of 275,184 matters out of 487,541, which represent all the unsolved matters at the local courts.

61 K. Krapež (2003), "How to make an enforcement more efficient?", *Pravna praksa,* Vol. 17, p. 34.

62 K. Erjavec (2004), "Enforcement arrears", *Pravna praksa,* Vol. 8, p. 12.

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