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### No. 1 - Legal Systems in Transition

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*Constitutional Court of the Czech Republic*

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*Masaryk University*

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*University of Georgia School of Law*

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*Occasional Papers*  
**Dean Rusk Center**

University of Georgia School of Law

*Number 1*

**Legal Systems in Transition**

**A System of Constitutional Review  
in Post-Communist Europe**

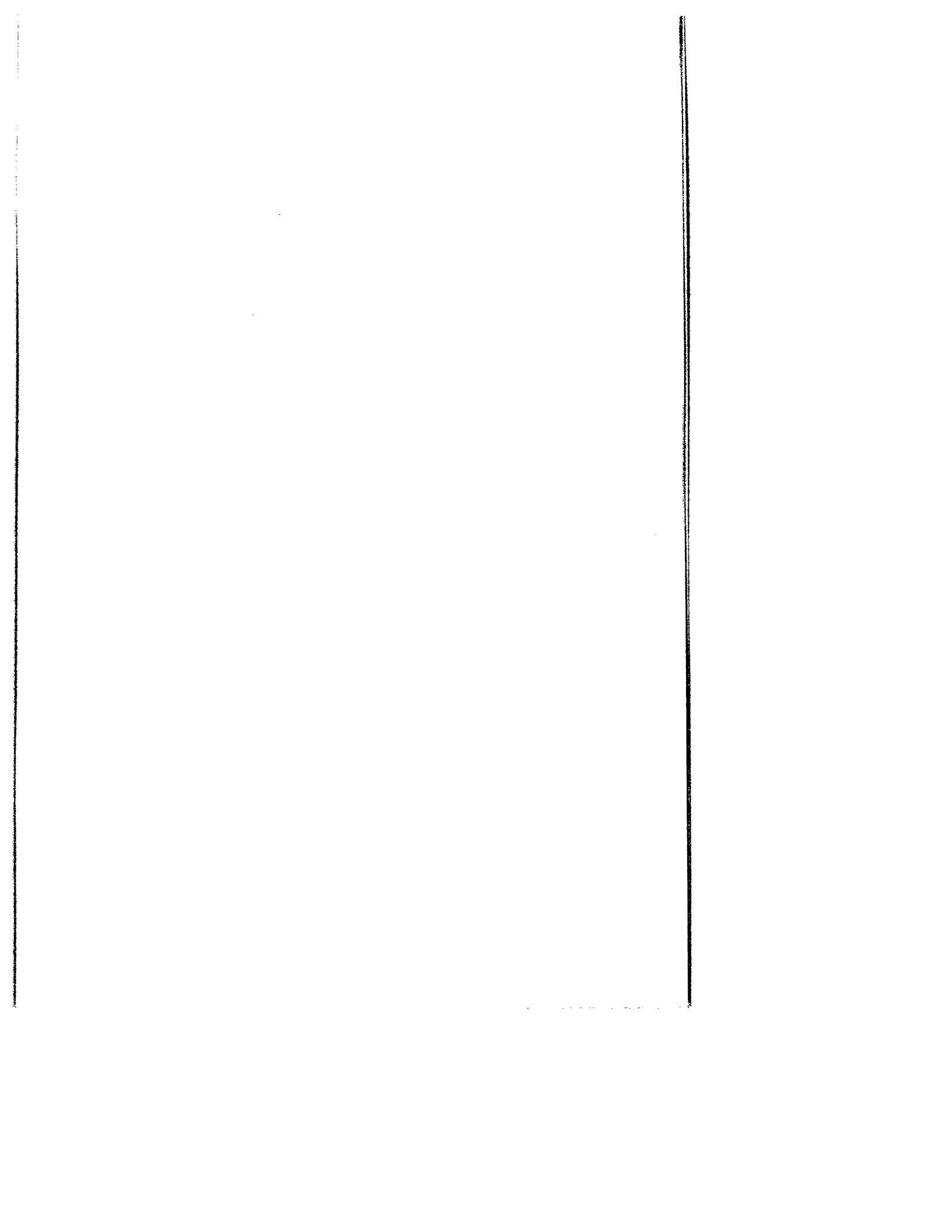
*Justice Ivana Janů*

**Developments in Czech Commercial  
and Constitutional Law**

*Professor Josef Bejcek*

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## PREFACE TO THE OCCASIONAL PAPERS SERIES

A visit by Justice Ivana Janů, Dean Josef Bejček, and some of their Czech colleagues to the Dean Rusk Center and the University of Georgia provided an occasion for the exchange of ideas concerning transition in the legal structure and content in the former Socialist states of central and eastern Europe. Justice Janů and Dean Bejček prepared papers and agreed to their publication.

The availability of these two important papers, one on constitutional courts and the other on transitions in commercial law, rendered to the Rusk Center the necessary impetus for creation of the Occasional Paper Series.

The Dean Rusk Center is pleased to present this publication as the first in a series of papers to be published in connection with the participation of individual scholars in conferences, projects, research, and other activities of the Center. The timing of individual publications will depend on the timing of particular activities in the Center.

— Gabriel M. Wilner, Executive Director

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**A System of Constitutional Review  
in Post-Communist Europe**

**Justice Ivana Janů**

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**A System of Constitutional Review in Post-Communist Europe**  
(Direct Access of Citizens to Constitutional Courts and the  
Importance of the Decisions of the European Court of Human Rights)

**Justice Ivana Janů\***

**Introduction**

This paper proposes to make a brief presentation of the system of constitutional review in post-communist Europe in order to give a general sense of how it functions. To do so, a necessary first step is to point out the significant ways in which constitutional review in European law differs from that in American law. Only then will one be in a position to understand clearly the specific problems connected with constitutional review in post-communist countries. In particular, the difficult task facing a constitutional Justice in implementing the values in the Constitution will be examined. Finally, the role that the European Court of Human Rights plays in this process will be discussed briefly.

**I. Two Models of Constitutional Review**

While there are numerous variations, it is generally accepted that there are two basic models of judicial review – the American and the European. The American model contains an underlying premise and certain basic features distinguishing it from the European model. Its premise is in response to the following query: How is it that, in a democratic state, a court may refuse to follow laws adopted by the legislature? American courts justify their refusal by reference to the need to protect individual rights; if the constitution grants an individual right, the courts must enforce it in preference to what a statute provides. This premise has many important implications for the American system of constitutional review. First and foremost, the American system is an incidental one. This means that issues of constitutionality arise in the course of (or incidental to) ordinary judicial decision making, so that constitutional review is not a special function, but rather is a normal attribute of judicial power. Another feature of the American model follows therefrom: its diffuse nature. All courts are entitled to and required to consider and decide constitutional issues. Since this imperative served as the main justification for constitutional review, it also defines the limits thereof. These limits are found in the case and controversy requirement and the prohibition of abstract review or advisory opinions, essentially requirements that judicial authority is limited to the determination of individual rights.

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\*Vice-Chairwoman, Czech Constitutional Court. Paper prepared on the occasion of a visit to the Dean Rusk Center and the University of Georgia School of Law, January 24-28, 2000.

Further, the decision concerning the constitutionality of the law affects the statute concerned only in relation to the parties to the case. The basic features of the American system can be summarized as follows: In pursuance of their duty to protect individual rights, American courts decide constitutional issues, and, in theory at least, the decision effects the statute concerned only in that specific case, applicable only to the parties to that case.

For more than a century following the establishment of constitutional review in the United States, the European states resisted following the American lead and introducing constitutional review. A differing conception of the judiciary and the separation of powers was primarily responsible for this steadfast refusal. Judges may only apply law; Lawmaking is the province of Parliament; and constitutional review, by calling into question the validity or applicability of a law, is a form of lawmaking, hence not properly a judicial function.<sup>1</sup> Eventually, however, European jurists conceded the need to establish constitutional review (first in Austria and in Czechoslovakia, then, following World War II, in much of Western Europe), as there was no other way to prevent the legislature from disregarding the constitution. Nonetheless, the European model had to be a sort of compromise whereby constitutional review was introduced without, at the same time, offending conceptions of the separation of powers. This aim was accomplished by creating a special, separate body with exclusive competence over constitutional matters. In addition, it was accomplished by making constitutional review almost a final stage in the legislative process (hence, constitutional courts often were referred to as negative legislatures). When the European model (also called Kelsenian after its creator) was first introduced, however, the original underlying premise for creating it was to protect the constitutional structure — the separation of powers — not to enforce individual rights. Kelsen explicitly rejected the possibility of a constitutional court protecting individual basic rights. Hence, cases of individual rights still were decided by ordinary courts strictly in accordance with statutes. The constitutional court's role was to determine the constitutionality of statutes at the request of a state body, such as the president, government, or parliament.

Over time, the two models have diverged considerably from strict adherence to their original underlying premises. As a consequence, the two models which began at opposite

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<sup>1</sup>During the 1920s in the German Weimar Republic, on a few occasions certain federal courts including the Reichsgericht (Federal Supreme Court) declared in dicta that they possessed the power to review the constitutionality of laws, but this experiment was heavily criticized as a usurpation of power not given and did not lay solid roots. See D. Kommers, *The Constitutional Jurisprudence of the Federal Republic of Germany* 6 (2d ed. 1997).



ends of the spectrum have tended to converge in practice. While in theory decisions by American courts exercising constitutional review apply only in the context of that individual case, it is widely acknowledged that, due to the rules of stare decisis and binding precedent, in practice a U.S. Supreme Court decision can lay down a rule which governs an issue generally, so much so as to even make a statute completely inapplicable, hence for all intents and purposes invalidating it. In addition, such developments as the class action<sup>2</sup> and more frequent use of declaratory judgments,<sup>3</sup> have considerably loosened the strict case and controversy requirement and the prohibition of abstract decisions.

In Europe, on the other hand, the original concept that constitutional review should be strictly abstract review (negative legislature) over time has given way to a model that allows for consideration of constitutionality in light of specific cases. This development can be illustrated by tracing the three waves of constitutional court creation in Europe. The first wave, after World War I, consisted of the establishment of the Austrian and Czechoslovak courts performing exclusively abstract review. Although the Czechoslovak court ceased functioning in 1939, the Austrian court's jurisdiction was significantly revised in 1929 to allow for ordinary courts (albeit initially only the two highest courts), when so required for the resolution of specific

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<sup>2</sup>Defined as "a lawsuit brought for yourself and other persons in the same situation (the affected class). To bring a class action you must convince the court that there are too many persons in the class to make them all individually a part of the lawsuit and that your interests are the same as theirs, so that you can adequately represent their interests." See 23 **Fed. R. Civ. P.**

Rule 23. Class Actions (a) Prerequisites to a Class Action. One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.

<sup>3</sup>Defined as "a judicial opinion that state[s] the rights of the parties or answers a legal question without awarding any damages or ordering that anything be done. A person may ask a court for a declaratory judgment only if there is a real, not theoretical, problem that involves real legal consequences." See 28 U.S.C. § 2201:

(a) In a case of actual controversy within its jurisdiction, except with respect to [enumerated exceptions] . . . , any court of the United States, upon the filing of an appropriate pleading, may declare the rights and other legal relations of any interested party seeking such declaration, whether or not further relief is or could be sought. Any such declaration shall have the force and effect of a final judgment or decree and shall be reviewable as such.

See also 57 **Fed. R. Civ. P.** on Declaratory Judgments:

The procedure for obtaining a declaratory judgment pursuant to Title 28 U.S.C. 2201, shall be in accordance with these rules. . . . The existence of another adequate remedy does not preclude a judgment for declaratory relief in cases where it is appropriate. The court may order hearing of an action for a declaratory judgment and may advance it on the calendar.

controversies before them, to submit constitutional issues to the constitutional court. The second wave began following World War II, when in the 1950s, constitutional courts were established in Germany, Italy, and France, and continued into the 1980s with the creation of courts in Spain and Portugal.<sup>4</sup> In all countries but France, ordinary courts were permitted to submit constitutional issues to the constitutional court. Of even greater significance was Germany, already in the second wave with Spain following its lead, which departed very significantly from the Kelsenian model, because individuals in those countries were permitted to petition the courts directly to complain of the violation of their basic constitutional rights. It may be recalled that Kelsen did not consider the protection of individual rights appropriate for a constitutional court. Accordingly, constitutional complaint permits that feature of constitutional review which originally was most objectionable to the European jurist — the determination by courts that Acts of Parliament should not be applied in individual cases. This institution has become the staple of both courts' work, making up 95 percent of German case load and the vast majority of Spanish. This revolutionary trend continued into the third wave, the establishment of (or reconstruction of already existing) constitutional courts in the postcommunist countries after 1989, where the constitutional complaints procedure similar to that of the German and Spanish courts was introduced, for example, in the Czech and Slovenian courts.

## II. Specific Powers of Constitutional Courts

Following are some observations about general trends in the relationship of European constitutional courts to other state bodies. As a constitutional court is created for the basic purpose of preventing other state bodies from violating constitutional rules and principles, there is tension built into its relationship with the state bodies it checks. The way these relations develop is a function of the type of procedures over which the constitutional court has jurisdiction. To the extent that the court's jurisdiction consists primarily or exclusively of abstract review of legal norms, it functions mainly as a check on the parliament or government, and it has minimum relations with the ordinary courts (hence no potential for conflict with them). The classic example is the French Conseil constitutionnel, which engages exclusively in abstract

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<sup>4</sup>The fact that constitutional courts were established in Yugoslavia in the early 1960s and in Poland in 1986 is not being overlooked; they are not being considered, as they were not genuine courts in the Kelsenian sense.

review and has no relations at all to ordinary courts; the Hungarian court comes close to the French model in this respect.<sup>5</sup> The Constitutional Court of the Czech Republic (Ústavní soud České Republiky) has abstract review powers, but this constitutes a small (albeit very significant) percentage of its caseload, which will be referred to again later. Other types of constitutional review, which now will be addressed, have implications for relations with the ordinary courts.

#### A. Conditions of Case Referrals by Ordinary Courts to the Constitutional Court

The institution of incidental review involves a procedure where an ordinary court refers to the constitutional court the issue of the constitutionality of a statutory provision which it must apply to decide a case before it. This institution can function as a mechanism of fruitful cooperation between the courts, each in the area of its special expertise, to properly resolve a particular legal dispute. However, it can be the cause of conflict when the constitutional court invokes the principle of the constitutionally conforming interpretation to find an ordinary court's interpretation of a norm constitutionally unacceptable and it may require the ordinary court not to interpret it in that way. In this situation, what a constitutional court sees as its basic function, that of preventing court decisions from being inconsistent with the constitution, conflicts with what ordinary courts see as reserved to their exclusive jurisdiction of interpreting statutory law. This type of situation is exemplified by the Italian constitutional court.<sup>6</sup> Since its jurisdiction

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<sup>5</sup>See § 21(2) of Hungarian Act XXXII of 1989 on the constitutional court, which provides that proceedings in abstract review (repressive) can be initiated by anyone. This is an example of the *actio popularis*. In addition, § 48(1) of the same act gives the court jurisdiction over constitutional complaints, but primarily as a means to initiate a proceeding in abstract review and not as a means to annul ordinary court decisions.

<sup>6</sup>See Italian Constitutional Act No. 1/53 and Ordinary Act No. 87 of 11 March 1953. Sections 23 and 24 of the latter act lay down the general requirements:

Section 23 In the course of a judicial proceeding, any party to the case or the Public Prosecutor may raise the issue of unconstitutionality in the appropriate form, indicating: a) the provisions . . . deemed to be unconstitutional; b) the provisions of the Constitution . . . allegedly infringed thereby.

If the case cannot be tried without first resolving the question of constitutionality, or if the trial court does not consider that the question of constitutionality raised is groundless, it shall issue an order referring the matter immediately to the Constitutional Court, setting out the terms and the reasons for raising the question of constitutionality, and shall suspend trial proceedings.

A court before which a case is being tried may also refer a question of constitutionality *ex officio* by means of a court order. . . .

Section 24 A court order rejecting the claim of unconstitutionality as being manifestly irrelevant or groundless must include adequate reasons. . . .

almost exclusively consists of incidental review, it must exert its influence by applying the principle of constitutionally conforming interpretations. This caused conflict between it and the ordinary courts in the 1960s.

Such procedure exists in the Czech Republic.<sup>7</sup> However, the Czech model differs from the Italian because a Czech ordinary court is required to refer an issue only if it should "come to the conclusion that a statute which should be applied in the resolution of a matter" violates the constitution; that is, if the ordinary court itself concludes that the statute is unconstitutional. This gives courts wide discretion in deciding not to refer statutes for evaluation. As a consequence, in its first five years the Constitutional Court did not receive many references, and therefore has reviewed ordinary court interpretations primarily in the context of constitutional complaint procedures. The number of such referral procedures, however, recently has begun to increase.

### **B. Conditions of Direct Citizen Access to Constitutional Courts**

A constitutional court can most effectively carry out its high duty of protecting fundamental rights if it has a genuine institution of constitutional complaint: genuine meaning one allowing for broad, general access, where any person may turn to the constitutional court when he asserts his fundamental rights have been violated. When a court has such a procedure, as do the German, Spanish, Czech, and Slovenian courts, the great majority of its caseload inevitably is taken up by it. For example, ninety-five percent of the Czech Constitutional Court's caseload is comprised of constitutional complaint proceedings, and the German Court has similar numbers.

Of course, the Czech procedure<sup>8</sup> is not a form of *actio popularis*. There are restrictions on access to the Court (something akin to the case and controversy requirement) which keep submissions within reasonable limits. In addition, the typical jurisdictional requirements

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<sup>7</sup>Article 95(2) of the Constitution of the Czech Republic (Ustava České Republiky) and § 64(4) of the Act on the Constitutional Court permits all ordinary courts to make such a reference.

<sup>8</sup>Article 87(1)(d) of the Czech Constitution and § 72 of the Act on the Constitutional Court exemplify genuine constitutional complaint. This covers a very broad category of cases, namely those where any natural or legal person claims that one of his fundamental rights was violated by the decision or other action by a public authority.

apply: exhaustion of remedies,<sup>9</sup> representation by attorney, and time limit for filing,<sup>10</sup> (although not court fees).<sup>11</sup> Even with these requirements the Czech Constitutional Court receives large numbers of complaints (more than 2,000 annually; 2,500 were submitted in 1999).<sup>12</sup> As most of these cases request review of ordinary court decisions, the Constitutional Court is often criticized for acting as a revisory body of the ordinary courts, and this fact tends to lead to conflict between them. Similarly, as mentioned with incidental review, it is a matter of both courts' most basic functions coming into conflict. The problem of which court's views take precedence touches on the issues of the scope of constitutional court review and the binding powers of its decisions. In this context, it should be pointed out that Article 89, para. 2 of the Constitution provides that "enforceable decisions of the Constitutional Court are binding on all authorities and persons."

### III. Special Problems of Post-Totalitarian Constitutional Justice

In its task of developing constitutionalism as part of the legal order, however, the Justices of a constitutional court in post-totalitarian nations are faced with a special set of challenges. While having virtually no experience to draw upon in their work, they are torn between the urgent need to create very quickly the absent legal culture and the danger of overstepping their bounds, thus stifling the development of society.

First, there is the very serious obstacle that post-totalitarian societies have no reserves of experience upon which constitutional Justices may draw. This is a slight exaggeration to make a point, as all societies have a traditional legal culture drawn from the basic values of the

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<sup>9</sup>See § 75 of the Czech Act on the Constitutional Court.

<sup>10</sup>§ 72(2) of the Czech Act permits sixty days to file. Compare § 48(2) of the Hungarian Act, which also provides for a sixty-day period, § 44(2) of Spanish Organic Law No. 2/1979 on the Constitutional Court, which provides for a twenty-day period, and § 93 of the German Law on the Federal Constitutional Court of 12 March 1953, which provides for a one month period.

<sup>11</sup>In addition, § 74 of the Czech Act also allows individuals to initiate proceedings in abstract norm control; however, they can do so only in conjunction with the submission of a constitutional complaint and where additional conditions are met as well. By contrast, in Hungary the constitutional complaint procedure allows for review of legal norms but not decisions, and in Spain the procedure only allows for the review of decisions but not of legal norms.

<sup>12</sup>In addition, § 43 of the Czech Act provides other devices which help to reduce the total number of complaints which the Court must decide on the merits. For example, it grants an individual Justice or a panel discretion to reject a complaint as "manifestly unfounded."

society. In the inter-war period, Czechoslovakia had a liberal constitution, a well-functioning democracy, and even a constitutional court. However, while a source of inspiration, the First Republic Constitutional Court operated only briefly, made few important decisions, and was a quite different institution than the present Court. Consequently, it cannot offer specific guidance as to the resolution of present constitutional disputes, and there is not wide experience in this field. Hence, lacking are precedents and models upon which to draw in making decisions that will implement constitutional principles as a day-to-day reality of the legal order.

In addition, although the western European societies offer models, few judges have a very thorough knowledge of particular systems and we are unable to draw upon them properly. Judges acting in ignorance tend to choose one of two very flawed approaches. They either assume that the western model is a perfect embodiment of a shared legal culture, which leads to subservient imitation of it (even though they often have little relevance to our situation); or they choose the particularist approach, an arrogant idea that "we know perfectly well what we are doing," which results in the rejection of outside models in toto as having no significance for our "unique" situation and legal culture.

In a very real sense, a constitutional court in a post-totalitarian society of necessity must be quite activist because it is introducing tenets of a legal culture that were not there before and which are fundamental to a rule-of-law, western society. Examples are the requirement that custody in criminal procedure be strictly limited or that ordinary courts and administrative agencies be protective of constitutional rights. Constitutional courts face great resistance in this because it goes against people's desire to do things in a customary and familiar manner and because it amounts to telling them they need to change their behavior (which offends their pride and implies criticism of conduct up until then as having been incorrect). Without this activism and uncompromising insistence on at least certain basic principles, the court would not be helping the nation work toward a law-based state. In carrying out her role, a constitutional Justice must perform a delicate balancing act between the twin hazards of being too obtrusive and too deferential.

At the same time, constitutional courts must be careful not to give in to the temptation to dominate national life by adopting an inflated conception of their roles. It can create expectations concerning guaranteed outcomes which the state may not be able to deliver. Also, in a time of transition when much is in a state of flux, it is not wise to tie down state policy, particularly on economic and social issues, lest the state be unable to adapt and change as necessity

dictates. In addition, by overturning legislative choices, the court can blunt Parliament's chance to mature as an institution (i.e., the people's chance to mature in making democratic choices). Constitutional intervention, rather, should be in very limited and vital areas. Otherwise the court might inflate its own role while at the same devaluing the effect that its decisions have.

#### IV. The Significance of the Constitution in Value Establishment

##### A. The Lawlessness Decision

Having characterized the European model for constitutional review and discussed the various types of powers of European constitutional courts, the heart of the matter — the mission of a constitutional court in post-communist countries — will be addressed. Although there are countless theories and views, I would advance the following proposition: The changes from communist to post-communist regimes consisted not so much in new political structures and rules but in axiological significance of the new regime and its constitution, more specifically the set of values which are characteristic of a democratic, law-based state. (Klokočka, old law, new values: "This means that even while there is continuity of 'old laws' there is a discontinuity in values from the 'old regime'.") The most crucial function of a constitutional court is to ensure that this set of values is brought to life and observed in practice. The constitutional court becomes its guardian, a fact expressed in the Czech Republic, for example, by Article 83 of the Constitution which declares the Constitutional Court to be the "judicial body responsible for the protection of constitutionalism."

From the very beginning, the Czech Constitutional Court made no secret of its view on the matter. In the very first judgment it handed down, on 21 December 1993, in upholding the constitutionality of Act No. 198/1993 Sbirka (Sb.) on the Lawlessness of the Communist Regime and Resistance to It, the Court rejected the view that respect for legality alone (and, in any case, the Communist Regime did not respect legality) suffices to establish legitimacy. In this regard, it said the following:

Our new Constitution is not founded on neutrality with regard to values, it is not simply a mere demarcation of institutions and processes, rather it incorporates into its text also certain governing ideas, expressing the fundamental, inviolable values of a democratic society. The Czech Constitution accepts and respects the principle of legality as a part of the overall basic conception of a law-based state;

positive law does not, however, bind it merely to formal legality, rather the interpretation and application of legal norms are subordinated to their substantive purpose, law is qualified by respect for the basic enacted values of a democratic society and also measures the application of legal norms by these values. This means that even while there is continuity of "old laws" there is a discontinuity in values from the 'old regime'.

... Those principles of the Czech Constitution, such as the sovereignty of the people, representative democracy, and the law-based state, are principles of the political organization of society, which are not entirely normatively definable. Positive law proceeds from them, however normative regulation does not make up the full contents of these principles - something apart from it remains.

... Within the concept of the constitutional state, upon which the Czech Constitution is based, law and justice are not subjects for the unfettered discretion of the legislators, not even subjects for a law, for the legislators are bound by certain basic values which the Constitution declares to be inviolable. For example, the Czech Constitution provides in Article 9, para. 2 that "any changes in the essential requirements for a democratic state governed by the rule of law are impermissible." Thus, in the framework of this Constitution, the constitutive principles of a democratic society are placed beyond the legislative power and are thus *ultra vires* of the Parliament. A constitutional state stands or falls by these principles. To do away with any of these principles, by whatever means carried out, whether by a majority or an entirely unanimous decision of Parliament, could not be otherwise interpreted than as the elimination of this constitutional state as such.

Thus, in no case can the Constitution be characterized as a mere organizational norm which would merely lay down, in a state founded on the separation of powers, who exercises which power, how, and to what extent.

#### **B. Super-Constitutional View of the Constitution**

As can be seen from the above cited passage from the Lawlessness judgment, Article 9, para. 2, since it prohibits "any changes in the essential requirements for a democratic state governed by the rule of law," has a certain super-constitutional character, which means that any amendments to the Constitution directed at modifying these essential requirements would not be valid or effective. As cited above, that view was expressed quite convincingly by the Constitutional Court in its judgment. The Constitution itself does not declare what is meant by "the essential requirements," nor does it refer to any specific articles of the Constitution. By logical analysis, however, it is possible to determine that the intended requirements include at



least the following principles that may be derived from Articles 1, 2, 4, 5, and 6 of the Constitution and Articles 1, 4, 22, and 23 of the Charter<sup>13</sup>:

- The democratic law-based state, founded on respect for individual rights and freedoms (Constitution, Article 1) which are inherent, inalienable, non-prescriptible, and not subject to repeal (Charter, Article 1) and whose meaning and significance may not be limited by legislation (Charter, Article 4, para. 4)
- The sovereignty of the people (Constitution, Article 2, para. 1)
- State authority may be asserted only in cases within the bounds and in the manner provided for by law (Constitution, Article 2, para. 3)
- All citizens may do that which is not prohibited by law; and nobody may be compelled to do that which is not imposed by law (Constitution, Article 2, para. 4)
- The fundamental rights and basic freedoms shall enjoy the protection of judicial bodies (Constitution, Article 4)
- A pluralistic political system based on "free and voluntary formation of and free competition among political parties" [which renounce force] (Charter, Articles 5 and 22) and majority rule (Constitution, Article 6)
- Civil disobedience consisting of the right to resist "any person who would do away with the democratic order of human rights and fundamental freedoms established by this Charter" (Charter, Article 23)

It should be pointed out that although Article 1 of the Charter declares the fundamental rights to be inalienable, non-prescriptible, and not subject to repeal, this does not include the consequence that they are, in American terms, absolutes. In other words, it is permissible to place restrictions upon them. However, such restrictions must be explicitly authorized in the Constitution or Charter and may be introduced only by statute (never by ministerial regulation). Further, the right may be restricted only for the conditions laid down in the exception clause (Charter, Article 4, para. 2) and the restriction must be even handed, that is, apply equally to all situations meeting the conditions (Charter, Article 4, para. 3). If we take as an example the right to form political parties in Article 20, para. 2 of the Charter, Article 20, para. 3 permits

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<sup>13</sup>Charter of Fundamental Rights and Basic Freedoms, 16 December 1992 (Základní listina práv a svobod). The Charter forms a part of the Constitutional Order of the Czech Republic.

restrictions on the exercise of the right of association, included among which is the right to form political parties by means of "measures that are necessary in a democratic society for the security of the state, the protection of public security and public order, the prevention of crime, or the protection of the rights and freedoms of others." In addition, even if not specifically authorized in the Constitution or Charter, there are inherent limits on basic rights in the boundaries they run up against when they come into conflict with one another. In such situations, the Court has recognized the principle that each right should be preserved to the maximum extent possible (Anonymous Witness Case). Finally, restrictions must respect the principle of proportionality (Charter, Article 4, para. 4, providing that in making use of the provisions authorizing limitation upon the basic rights, "the essence and significance of these rights and freedoms must be preserved"). In this respect, Charter Article 4, para. 4 in conjunction with Article 1, is similar to Constitution Article 9, para. 2, in that it makes clear that the fundamental rights, or more precisely the essential core of the fundamental rights, occupy an area in the legal order that is immune to change by law. In that sense, Article 4, para. 4 is superpositive law.

### **C. Cases on Issues Related to the Foundations of Democracy**

Certain decisions of the Constitutional Court concerning the right to vote and to stand for election serve as examples of its decision making in this area. In October 1996 in the Senate Registration Cases,<sup>14</sup> the Constitutional Court was presented with an ideal opportunity to elaborate upon the basic significance of political rights, particularly the free competition of political forces. Just prior to the first Senate elections (the upper house of Parliament), the Court granted eight constitutional complaints concerning the right to be registered for election to the Senate. In doing so it overturned decisions of both the Supreme Court and the Central Electoral Committee that prospective candidates for election to the Senate did not meet the registration formalities. It reasoned that the Central Electoral Committee and the Supreme Court had incorrectly interpreted the Electoral Act to exclude the aspiring candidates on the basis of a narrow, formalistic reading of the Electoral Act. The Court overturned their decisions with reference to Article 22 of the Charter, which provides that "statutory provisions relating to

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<sup>14</sup>See the Senate Registration cases, 6 *Sbirka* 103-111, judgments of 15 October 1996, II. ÚS 275/96, IV. ÚS 275/96, IV. ÚS 276/96 (English translations of the latter two decisions are published in the *Reporter*, Vol. 4, No. 1 (1997)); judgments of 22 October 1996, I. ÚS 277/96, II. ÚS 276/96, III. ÚS 276/96, III. ÚS 277/96; judgments of 29 October 1996, III. ÚS 275/96, III. ÚS 283/96.

political rights and freedoms, as well as the interpretation and application of them, shall make possible and protect the free competition among political forces in a democratic society." In the Court's view, this article lays down an imperative rule that those applying the Electoral Act must construe it favorably to persons attempting to exercise electoral rights. Hence, applicants meeting the essential requirements set down in the statute must be admitted to the election. These cases demonstrate that, in respect of certain critical issues, the Court will intervene very forcefully into the decision of individual cases. Electoral rights undoubtedly are included among them, a fact which gives some assurance that in all future elections, a candidate may feel confidence that his electoral rights will be vindicated because the Constitutional Court has ruled that, even in questionable cases, prospective candidates are entitled to the benefit of the doubt.<sup>15</sup>

In 1997 the Court reviewed the Electoral Act's five percent threshold clause which prescribes that only those parties which receive at least five percent of the vote may obtain seats in the Assembly.<sup>16</sup> The Court rejected the argument that such a requirement violates the principle of proportional and direct elections. The Court held that the principle of proportional representation does not require strict, mathematical proportionality (which, in any case, is not possible in a 200-member body) since, in addition to reflecting the will of the electorate, the electoral system also must allow for divergence necessary to ensure a functioning parliament that can adopt legislation and form a government. Citing Europe's unfortunate experience with the institution of proportional representation in this century and the resulting reforms to the institution (including the introduction of threshold clauses typical in other parliamentary democracies in Europe), the Court concluded that the institution of proportional representation now encompasses this needed flexibility within its own terms. Hence, the possibility of a threshold clause could even be considered as contained within the concept of proportional representation itself.

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<sup>15</sup>The Court even stated, in its judgment of 15 October 1996, IV. ÚS 275/1996, 6 *Sbírka*, No. 104, p. 249, the following:

Taking into account the fact that this is the first election to the Senate and, thus, also the first application of a number of provisions of Act No. 247/1995 Sb., the Constitutional Court considers this judgment, first and foremost, as a decision which should assist in the future in interpreting this law in a manner that is correct from the perspective of constitutional law. At the same time, it makes the assumption that the legislature will consider, in the spirit of this judgment, the possible need for modifications and clarifications of the text of the Act on Elections to the Parliament of the Czech Republic.

<sup>16</sup>Judgment of 2 April 1997, Pl. ÚS 25/96, 7 *Sbírka*, No. 37.

Although such a threshold clause is deemed necessary for a functional parliament and government, in fall 1999, the Court held that there is no similar justification for imposing a similar three percent threshold for a party's eligibility for state subsidies.<sup>17</sup> The Court considered the section of the Electoral Act which provides that the state shall subsidize the activity of political parties, but only those which receive at least three percent of the vote. The Court felt that this presented smaller parties with a strong financial incentive not to participate in election, that it set up unequal conditions for election, and, thus, that it violated the principle of the free competition of political forces. Accordingly, it annulled the three percent requirement and suggested that a threshold of no higher than one percent would be acceptable.

#### **V. View of the Constitution from the Protection of Fundamental Rights Perspective**

Now comes the point where the Constitutional Court's overall mission coincides (or clashes) with its competence. Its mission is both to introduce and to safeguard the value system against a blank or competing system (one whose values were hostile to it), and it must do so in the context of decision making on laws and individual complaints. This task is hampered by many handicaps and shortcomings, but the one most crucial in the context of this discussion (which will focus on the protection of basic human rights in the context of constitutional complaints) is the fact that we have no guides, no historic precedents of our own. It is in this regard that the role of the European Court of Human Rights (ECHR) for establishing basic human rights in Europe will be referred to.

##### **Article 3**

The Charter of Fundamental Rights and Basic Freedoms forms a part of the constitutional order of the Czech Republic.

##### **Article 10**

International treaties concerning human rights and fundamental freedoms which have been duly ratified and promulgated and by which the Czech Republic is bound are directly applicable and take precedence over statutes.

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<sup>17</sup>Judgment of the Constitutional Court of 13 October 1999, No. 243/1999 Sb.

Article 3 of the Constitution ascribes a constitutional dimension to basic human rights and Article 9, para. 2, in a certain sense, even has a super-constitutional character, consequently giving the Czech Republic impetus to change the approach to rights and to radical changes in legal thinking. In the hierarchy of values, the individual has attained a position superior to that of the state after a long period where he was denied that status.

Article 10 represents a clear openness of the legal order to the European standards for the protection of human rights and in the way they are conceived in international treaties on human rights, especially the European Convention on Human Rights and its protocols. The European Convention was signed in Rome in 1950 by fifteen European states, establishing the oldest political organization in Europe, the Council of Europe. In 1989 when the Berlin Wall fell, the Council had twenty-three members. In the course of the ensuing ten years this number rose to forty-one, essentially by adding countries from central and eastern Europe whose democratic development had been suspended for a long time. It must be emphasized that all the countries of central and eastern Europe wishing to join the Council have expressed their readiness to sign and ratify the European Convention on Human Rights, including the optional provisions concerning the right of individual petition and the compulsory jurisdiction of the Court. The Council of Europe made immense contributions toward speeding up the democratic metamorphosis in central and eastern Europe through the regular joint meetings of groups of members of the national parliaments from traditional and post-communist countries, the discussion of troubling political and legal problems, the search for solutions, and assistance in drafting constitutions.

Just as the Parliamentary Assembly of the Council of Europe played a key role in instructing legislators from post-communist countries in the field of legislation, an equally important contribution was made to the development of their judiciaries by the European Court of Human Rights.<sup>18</sup> After exhausting all domestic law remedies for the protection of their rights, individuals may submit a matter directly to the Court.

In the course of its more than forty years in operation, the ECHR has created an immense body of case law, which new members use for guidance in seeking difficult solutions in new legal fields, such as the consistent protection of basic rights and the building of a democratic and law-based state. In no case, however, is the Court meant to replace the

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<sup>18</sup>The Court was reorganized by the adoption, on 11 May 1994, of the 11th Protocol to the Convention.

justice systems of the member countries. An annex attached to this paper contains a discussion of certain interesting cases of the ECHR.

In conclusion, I would cite the words of European Court of Human Rights President Luzius Wildhaber during his recent visit to the Czech Republic: "Our Court furthers both continuity and innovation. Although we recognize the significance of precedent for legal certainty, foreseeability and the government of laws, the European Court has never been bound by a strict doctrine of stare decisis. Nonetheless, the Court's precedential judgments create a solid basis upon which the Court may reliably build."

## ANNEX

The first of these cases is a mildly controversial decision against the United Kingdom, and the others concern freedom of the press. The press decisions are very instructive, considering the fact that most of our lives were spent under the watchful eye of the censor (e.g., judgment of 21 January 1999, Fressoz & Roire v. France). Another interesting decision deals with what is, for the West, a typical communist reality (Rekvényi v. Hungary). Finally presented is Matthews v. United Kingdom, related to the unification of Europe within the framework of the European Union and the respect for human rights in this complicated process, a case which the President of the ECHR called the most interesting from among the Court's decisions of the year 2000.

### Discussion of Individual Cases:

#### Fressoz & Roire v. France<sup>19</sup>

This case arose because of a labor dispute over wage increases, and involved the publication in a newspaper of the company director's tax return showing he had enjoyed large salary increases. The newspaper's editor was convicted for receiving information subject to confidentiality and obtained through the violation of official confidentiality. On appeal, the editor unsuccessfully asserted that a journalist cannot be charged with the crime of illegal receipt of information. The matter then came to the ECHR, which found that conviction of the editor constituted an "interference" with his right to free expression and recalled the basic principles derived from its case law on free expression.

Freedom of expression represents one of the most important foundations of democracy and relates not only to "information" and "thoughts" which are accepted as desirable or considered harmless, but also those which injure, shock, or disturb and thereby contribute to plurality of views, tolerance, and the spirit of openness without which there is no democracy (Handyside v. U.K.,<sup>20</sup> 1976, Jersild v. Denmark,<sup>21</sup> 1994).

The press has the crucial role of reporting information and disseminating thoughts on all issues of public interest; nonetheless, it may not cross a certain line. It needs to protect the

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<sup>19</sup>Reports of Judgments and Decisions, no. 29183/95 ECHR 21 January 1999-I.

<sup>20</sup>Reports of Judgments and Decisions, no. 5493/72 ECHR 7 December 1976.

<sup>21</sup>Reports of Judgments and Decisions, no. 15890/89 ECHR 23 September 1994.

personal reputation and rights of others, and must not leak confidential or classified information. It is within the competence of domestic bodies to judge whether there exists an "urgent societal need" which would justify the limitation. The role of the ECHR is to consider the case as a whole and determine whether the grounds to justify the limitation cited by the government are both relevant and sufficient. In the Court's view, the purpose of the article was not to damage the reputation of the director, but to contribute to the discussion of an issue of public interest. Reporters, by virtue of the protections offered by Article 10, may not be relieved of criminal responsibility; everybody who enjoys the freedom of expression also bears duties and responsibilities.

Nonetheless, taking into consideration its finding that information on the amount of incomes is not subject to confidentiality (only the actual tax return document is), to convict the editor for the mere fact of publication of the information cannot be justified in light of Article 10. To publish information on issues of public interest in good faith and on the basis of verified facts, while observing the rules of journalistic ethics, is protected activity. The ECHR concluded that the conviction of the journalist did not constitute a proportionate means of attaining a legitimate goal in a democratic society, hence Article 10 had been violated.

#### Rekvényi v. Hungary<sup>22</sup>

The amendment to the Hungarian Constitution, effective 1 January 1994, forbids members of the armed forces, police, and security services to be a member of a political party or to engage in political activities. Rekvényi was a police officer who, after unsuccessfully contesting the amendment in Hungarian courts, submitted a complaint to the ECHR arguing that his rights under Articles 10 and 11 of the Convention (freedom of expression and association, respectively) were violated.

The court took it as evident that political activities come within the ambit of freedom of expression, at least to the extent that political discussion constitutes a specific aspect of freedom of expression. The freedom of political discussion is found at the very core of the concept of a democratic society; even soldiers, administrative officials, and police enjoy its protection. Hence, this amendment constituted an interference with freedom of expression. Nonetheless, the court found that Hungary met the conditions laid down in the Convention which permit it to interfere with the freedom of expression, namely that the limitation was laid down by law and

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<sup>22</sup>Reports of Judgments and Decisions, no. 25390/94 ECHR 20 May 1999-III.



was directed toward a defined goal which is necessary in a democratic society. The court found that the state was pursuing the legitimate goal of protecting national and public security and protecting order, especially when it took into consideration the situation prevailing in Hungary prior to the 1989 democratic changes to the political system. The police had served the governing communist party and had taken active part in implementing its policies. The overwhelming majority of police officers were members of the party. The state's effort to have a politically neutral police force was deemed by the court to be a legitimate goal.

Neither did the court find that there had been a violation of the freedom of association. It did not consider the restriction on that freedom to be arbitrary; rather it was pursuant to law and in conformity with Article II, para. 2, which permits placement of statutory restriction upon the exercise of freedom of assembly and association in relation to members of the armed forces, police, and state administration.

This case demonstrates that, not only does the ECHR provide guidance to newly democratizing nations, but it also is sensitive to their special needs and the difficulties they face in bringing about the needed transformation.

#### Matthews v. United Kingdom<sup>23</sup>

This case concerned a British subject resident in Gibraltar who wished to vote in the 1994 elections to the European parliament but was not permitted to because the U.K. limits the right to vote in those elections to those of its subjects residing in the U.K. proper. Matthews complained of a violation of his right under Article 3 of the First Protocol to the Convention, concerning the right to free elections, which reads as follows: "The High Contracting Parties undertake to hold free elections at reasonable intervals by secret ballot, under conditions which will ensure the free expression of the opinion of the people in the choice of the legislature."

The court dealt first with the issue whether the U.K. had a duty to organize elections to the European Parliament even on Gibraltar. According to Article I of the Convention, the state parties bound themselves "to secure to everyone within their jurisdiction the rights and freedoms" guaranteed by the Convention. In the court's view, there was no doubt that the legislation which results in part from the legislative activities of the European Community (in which the Parliament plays a role) has an equivalent significance for the life of the individual as does legislation adopted by national legislative bodies.

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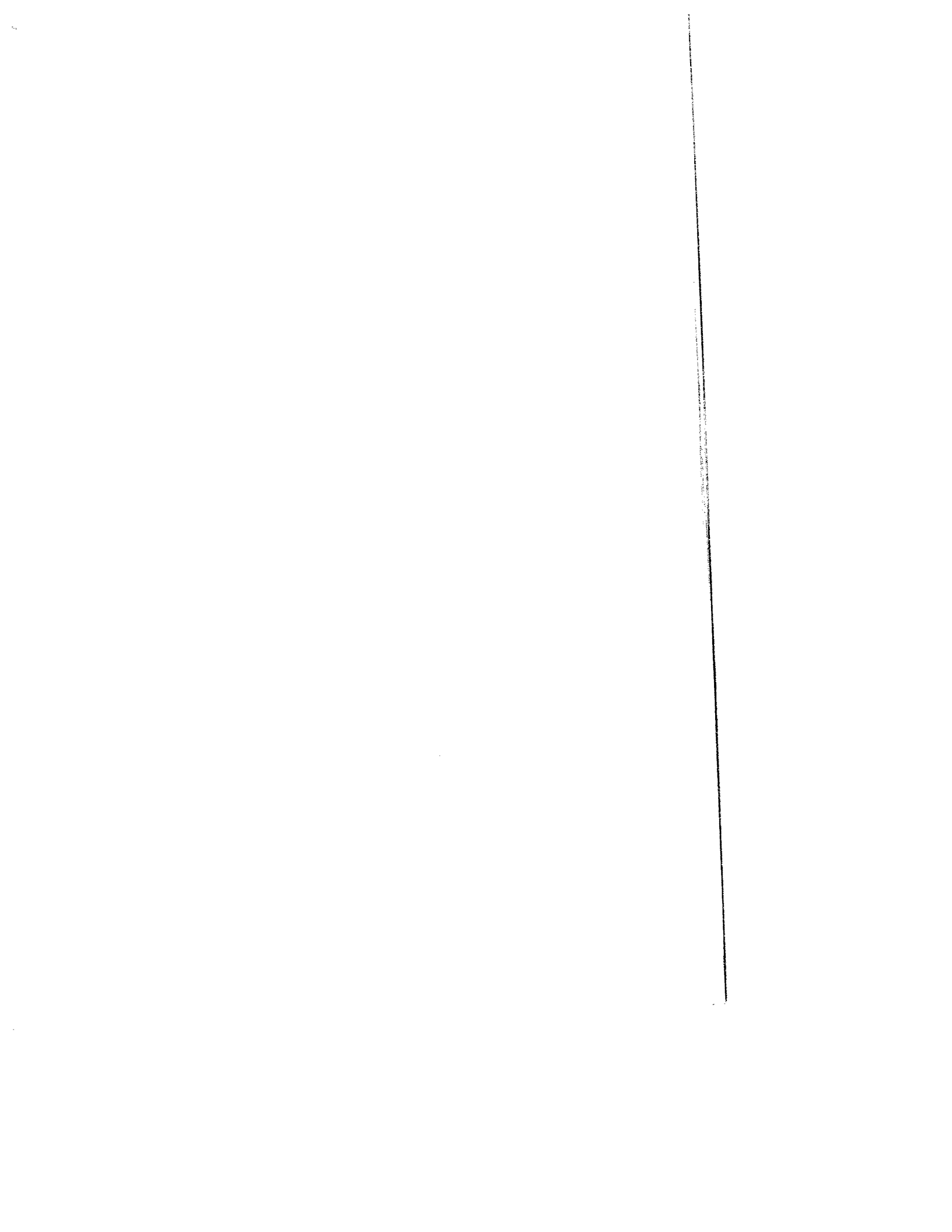
<sup>23</sup>Reports of Judgments and Decisions, no. 24833/9 ECHR 18 February 1999-I.

The court took into consideration the U.K.'s assertion that the European Parliament lacks two of the most fundamental attributes of a legislative body, namely the right of legislative initiative and the power to adopt legislation. The European Community is of a *sui generis* nature which is not in all respects identical to the model of the separation of powers into legislative and executive, but, nonetheless, the court must ensure "an effective political democracy." In the court's view, the European Parliament takes part to a sufficient degree in special legislative processes (under Articles 189b and 189c of the Treaty) that it should be considered a legislature as meant by Article 3 of the First Protocol. Hence, the court came to the conclusion that, under the given circumstances, the very core of the complainant's electoral rights had been denied resulting in a violation of Article 3 of the First Protocol.

# Developments in Czech Commercial and Competition Law in Transition

Josef Bejcek

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## Developments in Czech Commercial and Competition Law in Transition

Josef Bejcek\*

### Introduction

In our transition, as is usually the case, some things were done well, and some things were done poorly. Creating the new Commercial Code<sup>1</sup> belongs among the more successful steps in our legislature despite many new problems caused by this act.

The need for creating new commercial law became apparent after the so-called "Velvet Revolution" of November 1989. It was clear that not even radical amendments to the Economic Code<sup>2</sup> could meet the requirements of the newly born market economy. The new Commercial Code,<sup>3</sup> which came into effect in January 1992, has nearly 800 articles that are grouped into three main parts. The first part deals with general commercial law; the second part concerns legal forms of business. The third part focuses on commercial obligations, "including those arising under specific contracts such as sale, agency or credit contracts and liability for damages."<sup>4</sup> The new Commercial Code was one of the first important steps to launch the Czech business community into a free market economy protected and supported by law.

However, it is important to remember that contemporary business practices in the Czech Republic sometimes rest, at least in part, on the legacy of legal regulations or concepts applicable to contracts in earlier times. In short, anyone seeking to understand the commercial law and practices of the Czech Republic today must have some understanding of a certain kind of 'path dependency' – the law and practices of the past.

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<sup>1</sup> Act No. 513/1991 Collection of Acts [hereinafter Coll.] (Czech Rep.).

<sup>2</sup> Act No. 109/1964 Coll., later amended by Act No. 82/1966 Coll., Legal Measure No. 13/1967 Coll., Act No. 69/1967 Coll., Act No. 72/1970 Coll., Act No. 138/1970 Coll., Act No. 144/1975 Coll., Act No. 165/1982 Coll., Act No. 98/1988 Coll., and Act No. 103/1990 Coll.

<sup>3</sup> Amended during the past decade by Act No. 264/1992 Coll., Act No. 591/1992 Coll., Act No. 286/1993 Coll., Act No. 156/1994 Coll., Act No. 84/1995 Coll., Act No. 94/1996 Coll., Act No. 142/1996 Coll., Act No. 77/1997 Coll., Act No. 15/1998 Coll., Act No. 165/1998 Coll., Act No. 356/1999 Coll., Act No. 27/2000 Coll., Acts No. 29-30/2000 Coll., Act No. 105/2000 Coll., and Act No. 367/2000 Coll. Another great amendment of this Code aiming at full harmonization with European Community law was adopted in Act No. 370/2000 Coll.

<sup>4</sup> S. Denyer et al., *Legal Aspects of Doing Business in the Czech and Slovak Republics* 17 (1993).

### I. Short Historical Overview

Before World War I, the Austrian Commercial Code of 1863 governed business and economic relations in the region that is now the Czech Republic. That code was in force until 1950, when it was amended by the Act No. 141/1950 Coll. To govern the Czechoslovak economy, gradually socialized after 1948, the laws regulating property and relationships involving obligations were divided into three codes: the Civil Code, the Economic Code, and the Code of International Trade.

The Civil Code, with respect to property, applied only to relations between citizens and 'socialist organizations.' The 'socialist' status of an organization was an ideological and often arbitrary determination. Yet, the determination of status as a socialist organization was very important because it affected the organization's relations with others. Thus, if an organization was not deemed a socialist organization, the Civil Code did not apply to it — not even in the unusual case when socialist organizations had an urgent need to deal with either the few private entrepreneurs or with domestic 'non-socialist organizations.' In those cases, legal relationships were, at best, ambiguous.<sup>5</sup>

The Economic Code regulated the management and operation of socialist organizations. The Economic Code preferred vertical regulation, or public law, over regulation reached as a result of the parties' contractual freedom. Indeed, the Economic Code actually suppressed contractual freedom and distorted the relative equality of bargaining power in exchange for attempts to promote economic growth and fulfillment of the Central Plan. This intent was effectuated by broadly legislating contractual duties. In addition, the Economic Code made it possible to change or to cancel obligatory and existing contracts if they happened to be at variance with the "national economy's need for proportional development."

Under the Economic Code, socialist organizations enjoyed many advantages over other entities (including entrepreneurs and non-socialist organizations), such as better access to resources (which was very important in the socialist 'economy of shortage') or more favorable tax rates. Socialist organizations also enjoyed a superior legal status. Many nominally socialist

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<sup>5</sup>E.g., the contract for the sale of goods concerning the same type of goods was governed by different rules if both parties were socialist organizations. Consequences were different guarantee terms or a different approach to dispute resolution between such organizations (arbitrating by special state bodies in accordance with "principles of state economic policy" standing outside the law and not judging by independent courts).

organizations (e.g., big state enterprises operating in the 'red') actually harmed the economy, while non-socialist organizations or entrepreneurs (e.g., hardworking private country farmers) often were useful socially despite their inferior legal status. In effect, the Economic Code was the tool of a *dirigist* economy which rejected the market approach in favor of the socialist approach.

Both the Economic Code and the Civil Code blurred the longstanding distinctions between public law and private law. The Economic Code allowed both the State and the supervising bodies of the socialist organizations to intervene in the internal corporate management of socialist organizations. There was no adequate legal redress for the mistakes dictated by this intervention because the State never acknowledged any harm to the economy brought about by its attempts at supervision. Ultimately, the Economic Code did not regulate any forms of private business and it guaranteed the socialist organizations a relatively privileged status.

The Economic Code contributed in this way to the destruction of the unitary property system. The Economic Code, with the support of the allegedly consumer-oriented aspects of the Civil Code, deepened the theoretical and actual differences among the several forms of property ownership. This destroyed what was perceived to be an essential element of a market economy in pre-war Czechoslovakia: a unitary system of property ownership formally subjecting everyone to the same economic conditions and legal regulation.

The destruction of the unitary system of property ownership had several important results, all of which affected the prosperity of the economy. One of them was curbing the freedom to contract: the contract, in theoretical terms an expression of the parties' free will, often had to be made against the will of parties but in accordance with the so-called general social interest. Another result was that the relative positions of those entering into contract were no longer equal and independent. The third result was abandonment of traditional legal principles in favor of narrowing the scope of legal regulations governing corporations, forms of security, many special contracts, antimonopoly measures, unfair trading practices, and bankruptcy.

Even the limited number of laws regulating economic activity had to adapt to certain public law concepts such as central planning, the fulfillment of contractual obligations, the arbitration of economic disputes, and the organization of economic management. Yet, in an economy known as 'real socialism,' the meanings of some of these terms became empty or illusory.

For example, 'economic competition' was often a meaningless term in the *dirigist* and monopolistic economy. Terms like 'economic contracts' disguised inadequate contractual subject matter in that the contracts did not really cover the subject matter intended. In short, the meanings of economic competition and economic contracts were very different from the meanings those terms would have had in a private law system.<sup>6</sup>

Because the Czechoslovakian Economic Code was designed for a centrally-planned economy in which the state could often intervene, foreign business partners did not have assurance that they would be able to contract freely with Czech businesses. Furthermore, the structure of the Economic Code prevented foreign parties from determining their legal rights and obligations with any degree of certainty. In market economies, such assurances would be regarded as 'givens' and considered necessary to the conduct of a successful business transaction. To foreign investors, this lack of certainty was a risk inherent in any business dealing in any socialist country. In light of this environment, Czechoslovakia adopted a Code of International Trade. Specifically, the Code of International Trade was to increase the legal certainty for foreign business partners, regulate relations with foreign business partners, and finally, to develop international economic cooperation.<sup>7</sup>

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<sup>6</sup>The following example from the mid-1980s unfortunately is not a bitter joke but a bitter reality, and it illustrates well the absurdity of the economic system at the time. The disproportion between the material resources and the demand for them used to be centrally solved by so-called "material balancing and investigating the supply-demand relations." A truck producer in need of steel complained that the amount of centrally allocated steel was not sufficient for the centrally planned number of trucks to be produced by this producer. A prompt solution was promised and, indeed, in a few days the number of trucks to be produced was increased by the Central State Planning Commission, while at the same time, the amount of steel allocated to the producer was substantially lowered.

Another sad and ridiculous case involved a Czech inventor, Dr. Backovský, one of the first in the world to develop a transistor. In the early 1950s, he asked for a financial support for developing semiconductors. He was refused by an official of the same state planning body with the explanation that only full conductors are good enough for a socialist economy.

It is obvious that life in our country did not necessarily have to be only gray and dry. If this reminds one of some pieces of absurd drama, it is nothing extraordinary in the land of Kafka and Havel.

<sup>7</sup>As the presence of a socialist regime was an inherent deterrent when foreign businesses faced dealings with their Czech counterparts, the Code of International Trade sought to remedy this obstacle despite its still apparent socialist structure.



## II. Legal Transitions

Socialist law limited free and fair competition, a key factor in any economic reform. In order to create a functional and operating environment for participants in a free market, it was necessary to remove the socialist system and restore the dual system of public and private law. This required both the destruction of the monolithic vertical control that facilitated state intervention in the economy and the creation of a plurality of mutually-independent and autonomous subjects of business ownership.

Within this context, a vital condition to developing a market economy was the development of a strict definition of business ownership. Private ownership implied the ability to control the business entity and to respond to market forces. On many levels, individuals became responsible for the consequences of their own decisions in the market. Private ownership thus became the basic concept behind 'privatization.'<sup>8</sup>

Czech privatization was not solely a success story as had been pronounced in the past. The worst thing about this process was the lack of any legal frame of privatization. Many shady entrepreneurs became rich through fraud by depriving small shareholders of their shares gained during privatization.<sup>9</sup>

Some similarities to the Miloš Forman movie "Horí, má panenka" (translated as "Fire, My Dear" or "The Firemen's Ball") come to mind. The situation is as follows: There is a pile of things in front of the stage in a village hall where a firemen's ball is being held. The items are to be distributed among the happy winners of the ball raffle. Just before the raffle tickets are drawn, the organizers of the ball find out that one of the prizes, a piece of sausage, has been stolen. They want to give the unknown thief a chance to put the sausage back honestly without being identified, so they agree to switch off the light in the hall, hoping that the thief will act honestly and return the prize. But what a surprise! After switching on the light in the hall again, they find out that more prizes have disappeared. Another attempt to restore morality in the same way fails as well, and the pile of prizes to be drawn diminishes again. An old honest fireman, who finds out that the thief was his wife and wants to put the sausage back on the pile on

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<sup>8</sup>In 1994, for example, the Czech Republic completed a coupon privatization program during which approximately one-third of formerly-state-owned enterprises were sold to more than six million individuals. See R. L. Holman, *Czech Sell-Off Round Ends*, Wall St. J., 28 November 1994, at A 14.

<sup>9</sup>One of the indisputable contributions of Czech privatization is the widely-known term 'tunneling' — a way of destroying the economic substance of a company at the expense of small shareholders who are only very poorly protected (if at all) by the law.

behalf of his cowardly wife, does not make it on time because the light is switched on surprisingly soon. As a presumed thief, he dies of a heart attack in undeserved shame.

There is an analogy to our privatization. Its often-used method was to switch off the light, privatize in the dark, and then either not switch the light on at all or only a little bit (and by no means prematurely), while protecting the new owners because private ownership is inviolable. Unfortunately, privatization generated not only real owners, but also to a large extent 'easy riders' who acted in accordance with the hit-and-run method.

Nevertheless, a lot of good things have been done. For example, new conditions for setting up and running a business by foreigners have been introduced so that foreign entrepreneurs would be put on an equal footing with domestic ones. At the same time, it was necessary to reorganize the applicable laws for the benefit of both domestic business organizations and potential foreign business partners and investors.

Consequently, when the new Commercial Code became effective on January 1, 1992, it repealed the Code of International Trade, the Economic Code, and a section of the Civil Code. The new Commercial Code also repealed certain other laws in their entirety, including such relatively recent enactments as the Joint Venture Act,<sup>10</sup> the Act on National Economic Planning,<sup>11</sup> and the Joint Stock Companies Act,<sup>12</sup> as well as parts of the Act on Economic Relations with Foreign Countries.<sup>13</sup> Finally, the new Commercial Code repealed several ministerial decrees, federal government orders, and highly specific ordinances. The magnitude of the changes brought on by the promulgation of the new Commercial Code is indisputable. The Commercial Code offers an effort to bring stability to the legal climate of the Czech economy. It remains to discuss in some detail the new legal framework of the development of private competition and a market economy.

### III. Economic Competition and Privatization

After a long intermission in the development of antitrust law and the difficult development worldwide of this field of law, this specialized instrument of economic policy started from zero and began to operate in gradually rising market conditions in the then Czech and Slovak Federative Republic.

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<sup>10</sup>Act No. 173/1988 Coll., as amended by Act No. 112/1990 Coll.

<sup>11</sup>Act No. 67/1989 Coll.

<sup>12</sup>Act No. 104/1990 Coll.

<sup>13</sup>Act No. 42/1980 Coll., as amended by Act No. 102/1988 Coll. and Act No. 113/1990 Coll.

Apart from the advantage of awareness of antitrust law from the short historical period of pre-war experience and of the 'real-socialistic' mutation of competition law, we could seek guidance in theoretical conclusions reached abroad and in usable foreign judicial decisions. However, it is evident that antimonopoly and antitrust law first are determined by the state of a particular economy and the resultant order of economic policy priorities. That is why the criterion of a standard and stabilized market economy (including antitrust decisions) can be used only to a limited extent in the Czech economy in transformation.

The requirement of harmonization of Czech competition law with European Community law, resulting from the Association Agreement, creates pressure for legislative changes while providing a basis for interpretation. However, harmonization cannot change the economic conditions in which our law operates. These conditions include, among others, a particular system of institutions, capacity limitations, and various interests of economic subjects.

The main priorities of Czech economic policy seem to be currency stability, privatization, gaining the amount of capital absorbable by our economy, and maintaining high employment and social stability. Creating and protecting an environment for competition as a presumption of a functional market economy does not seem to be a priority, at least not in the practical economic policy.

Apparently, the most important thing for an environment of competition is not antitrust law but rather the competitiveness of markets: liberalized foreign trade, open frontiers, minimum of special branch policies, minimal barriers to the market access, etc. Antitrust law is a technical means for achieving these desirable elements of a thriving market.

The priority of privatization has often led, paradoxically, to confirming the prior monopolization, with the difference being that a private monopoly is not so closely connected with the state by different interests as is a state monopoly. The objective of privatization in general does not replace state enterprises with a monopoly or dominant position by enterprises with the same market power. But, in fact, this is often the result, only executed here by private owners.<sup>14</sup>

A prospective buyer is willing to pay more for a monopoly enterprise, so a future pro-competition structure often is sacrificed on the altar of privatization, which conserves the

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<sup>14</sup>See F. A. Hayek, *Cesta do otroctvi*, 152 (Academia 1990); K. Hansen, *Wettbewerbsschutz in Mitteleuropa*, *Wirtschaft und Wettbewerb*, 12/1994, at 1000-02.

present monopolization of the economy. The buyers of privatized enterprises frequently gain an unlimited position in the market, the access to which can be made impossible for other competitors for decades. In this context, there is an unflattering opinion that "the Czechs achieved their goals to a great extent by privatizing the state monopoly."<sup>15</sup>

Difficult balancing between short-term advantages from selling the monopoly enterprises to a domestic or a foreign buyer (who often requires a monopoly) and long-term interests in the existence of an environment of competition just confirms the universal rule about more frequent preference of a more immediate interest, even on the state level.

Apart from that, the government must be circumspect and critical to numerous opinions and primarily well-intentioned advice from abroad about the unconditional necessity of splitting up the great industrial complexes in the process of privatization. Such a radical act could weaken the national economy by confronting fragmented domestic enterprises, which are not really able to compete, with concentrated foreign and multinational enterprises, which often operate as legally supported export trusts.

Even admitting foreign capital into joint enterprises with a monopoly position on the domestic market can be two-edged. With regard to the foreign partner's background, it can block a natural change of the market structure.

Privatization is only an operational aim which should create the conditions for the functioning of a market economy. Along with other aims, it should provide for the existence of competition once privatization is over. Privatization, at the same time, is a unique and unrepeatable chance (unfortunately often not very well used) to form new pro-competition structures such as those already in existence for decades or that, due to rapid monopolization, never existed and probably never will exist.

The state can artificially split up economic, technical, commercial, and other structures and connections and, thus, put an end to monopolies. However, it also can support the rise of real competition by privatizing deliberately with pro-competition intentions, thus supporting the rise of new entrepreneurial subjects, the restructuring of which is stimulated by the market. The endeavor to split up monopolies naturally cannot be a call for the last and final intervention of state power in the economy, after which everything should be all right.<sup>16</sup>

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<sup>15</sup>Hospodářské noviny, 21 October 1993 (referring to Wall St. J., 12 October 1993).

<sup>16</sup>See S. Estrin & L. Takla, *Competition Policy in the Czech and Slovak Republic*, Seminar on Competition Policy in the Transforming Economies, The World Bank Economic Institute, Trešt, 27 June -2 July 1993; see also M. Fassman & J. Rusnok, *Konkurencni zpusobilost ceské ekonomiky zaostává*, Hospodářské noviny, 12 December 1995, at 11.

Another controversial point is the maintenance of state or privatized monopolies in so-called 'net branches,' formerly regarded as 'natural monopolies' (transport gas, water and heat industries, postal services, and others). The far-reaching influence of their monopolistic behavior on living standards, if a consistent antimonopoly policy does not strive to eliminate it, can endanger social and currency stability.

Theoretically, the process of privatization can bring about an inverse adjustment of a negative market structure (replacing a state monopoly with a private one) or a negative development of the market structure (a new private monopoly or private oligopolies can originate from a lot of formerly independent enterprises). This is why law can establish rules whose purpose is to eliminate negative development as efficiently as possible.

The decision-making practice of the Czech Antitrust Authority (hereinafter Authority) presently is taking place within the difficult condition of transformation and the uncertainty connected with it. In this situation, it would not be advisable to apply a law that would prohibit or go as far as criminalizing anticompetitive activities. Legal certainty, which prefers explicit prohibitions with a few explicit exceptions, in the context of economic policy, is not a value that should be asserted at all costs. An economic mind necessarily compares it with possible loss of certain economic advantages, which is connected with its unconditional preference.

The decision-making practice of the Authority cannot be (and in my view it is not) narrow-minded and it cannot be guided by the paranoid idea that everyone wants to endanger the competition. Monopolists may be the enemies of competition, but any potential danger to competition can come only through those capable of initiating and perpetuating it. Competitors are starting to adopt decent market manners and they often respect the recommendation of the Authority voluntarily. This acquiescence means that the Authority will not need to undertake frequent administrative action against would-be monopolists.

A certain amount of tolerance towards the monopolizing behavior of smaller competitors is necessary, if only for reasons of size, and it is common even in standard market economies. Such an approach is based on tolerating certain behavior (trusts, mergers) up to the limit of dominance and on taking steps against the abuse of market power only after this limit is exceeded. This approach takes into account that, with regard to deformation of the market structure, evidence becomes more difficult to collect by the time abuse of market power occurs.

#### IV. National Competition Policy and a Broader Competition Context

"The unity in variety" prevailing in the world says that private restrictions, exclusions, and distortions of competition by means of cartels, in principle, are harmful to the very essence of market economy and, in a way, to the freedom of citizens. It is, therefore, necessary to face them unless the restriction of competition in a value consideration would be less important than the economic, social, and other advantages connected with impairing the competitive environment. Quite naturally, there is no such unity in the easing of restrictions and in the endangerment or exclusions of competition which the state itself initiates, supports, or carries out.

Due to the preference of a state's own economic interests (or the national egotism), this attitude is strengthened on the level of international economic competition. It is difficult even for the European Community member states with compatible economies and values to find common grounds, for example on an approach to mergers, because of their diverse political ideas about competition and different ways of rating concentration. However, particular economic interests and advantages are even stronger than doctrinal ideas and are very hard to abandon for the sake of general principles.

It is clear that only extensive deregulations and liberal policies can enable companies to take part in international competition. The opinion that free competition should be encouraged only among countries of the same economic and cultural standard denies the existence of comparative advantages and runs counter to the interests of both developed and less-developed countries.<sup>17</sup>

Artificial advantages (not earned by a competitive performance) for domestic enterprises and artificial barriers for foreign enterprises, in fact, are being created. The vicious circle of justifying certain steps as responses to the steps of another state is hard to break. However, globalization and internalization of economy leads inevitably to globalization of competition.<sup>18</sup>

Internal regulations (including Czech) generally focus only on the competition environment in their own national economy and have no extraterritorial effects. Export cartels, for example, commonly are exempted from the prohibition of trust agreements, which can create artificial advantages for domestic enterprises and disadvantages for their foreign competitors doing business with a country with no such exemption.

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<sup>17</sup>See P. Sutherland, *Protekcjonismus versus politika voľného obchodu*, *Ekonom.* 45/1995, at 20.

<sup>18</sup>See A.M. Van den Bossche, *Liberalization, Globalization, and Competition Law and Policy*, *Y.B. Eur. L.* 19-8, 1998, at 67-69.

The restrictions of competition which reach beyond country borders generate a struggle among different competition policies of individual countries, while the states suffer and overlook it if an enterprise with a domestic seat acts anticompetitively abroad. However, strict recourse would be taken against such an enterprise in its home country. At other times, the states hope to gain economic advantages from such behavior of their enterprises.<sup>19</sup>

If states want their competition policies to better reflect the rules of international competition, they also must consider the effect of their national antitrust laws on the international level. That means that an inland regulation of competition must be applied to the restriction of competition caused abroad. The Czech law does not make this possible.

Competition policy is not only about law. Economic competition as a covert conflict of interests takes place in a broad moral, social, and governmental context in which a legal regulation is assigned a certain limited role. The political power of competitors, direct or indirect, is a more effective instrument for influencing the competition environment than their market power, because it precedes the creation of a legal frame for development and protection of competition.

However precise a legal regulation protecting competition may be, anticompetitive pressures may prevail by means of politics. The government is not a mere 'organizer of industry' but also the main instrument used by corporations for forming and maintaining the concentration of economy and for creating oligopolies and monopolies.<sup>20</sup> Thanks to the use of political means, economic subjects can achieve various effects traditionally ascribed to the concentration of economic power. Political power of intervention, in turn, often is the source of economic power, and these two powers can be correlated but do not necessarily have to correlate.

Governmental competition policy in a broader sense means not only improving antitrust laws but also taking actions against attempts by economic entities to gain political power by, inter alia, financing political parties, enacting laws about conflict of interests, and introducing a system of control into the society including the information right of the mass media.

Any measures which potentially or factually limit the attainment of political power by economic subjects, at least, can be comparable to the normative instruments of antitrust law. Otherwise, political power might well be used for diverting the neutrality of self-regulating and

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<sup>19</sup>See B. Duijm & H. Winter, *Internationale Wettbewerbsordnung — Alternativen und ihre Probleme*, *Wirtschaft und Wettbewerb*, 6/1993, at 466.

<sup>20</sup>See A. Etzioni, *Morální dimenze ekonomiky* 185 (Victoria Publishing 1995).

self-controlling economic competition for the benefit of one or more participants against others, for example, by supporting big enterprises against small ones or vice versa.

The practice of political intervention in the competition environment by other than normative (legal) means cannot be considered to be out of the question. The mere fact that small- and medium-sized enterprises would be excluded from the possibility of defensively asserting their interests for structural reasons can morally legitimate their political lobbying. This is likely because big industry usually cooperates with the state in ways that influence the competition environment. National self-serving reasons for political influence, particularly in the process of economic concentration, are probably traditional as well.<sup>21</sup>

Hardly any government will be capable of preferring a general pro-competitive structural policy — one not encouraging anyone in particular but the competition — to a particularly- and directly-aimed industrial policy. A fatal consequence of a one-sided industrial policy can be to permanently subsidize certain industrial sectors, which means that the ability to compete then can be increased only artificially. In accordance with the ordo-liberal theory, the state should first split up or at least limit the power and interest groupings and create forms of economic order, or institutions, rather than concentrate on directing particular economic processes.<sup>22</sup>

If a decision about concrete support and intervention is made on the basis of political power, extensive help should be directed, at least partly, toward a sector or a sub-sector, not toward selected individual enterprises. Supporting the weakest production units leads to the artificial survival of the subjects least able to compete. This policy, apart from direct economic costs, brings about a deteriorated parametricity of the competition environment.<sup>23</sup>

In a number of cases, however, support is addressed to particular competitors, and it does not result from political lobbying but from an effort to get on an equal footing with concentrated foreign competitors at a national level. A typical target conflict takes place, for example, in Czech banks: Despite considerable concentration and interrelations within the domestic banking sector, another process of merging and mega-merging, seeking strategic partners and increasing capital, is presumed in view of the fact that the capital of all our banks together is equal to that of any one major German bank. At the same time, German banks seek foreign partners to be able to stand up to the giant competition of the unified market.

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<sup>21</sup>See M. Šumbera & V. Stankov, Antidumping slouží domácím firmám k lobbistickým tlakům proti konkurenci, Hospodářské noviny, 12 September 1995.

<sup>22</sup>See V. Kluson, Ordoliberalismus a transformace ekonomiky, Ekonom, 31/1995, at 14-15.

<sup>23</sup>See S. Czesaný, Cíle i nástroje průmyslové politiky se mení, Hospodářské noviny, 12 September 1995.



Antagonistic trends in competition policy and in competition law (due to a number of vague concepts, exemptions, and rules of reason) and the controversial character of target conflicts often are confusing and demotivating. The application of competition law increasingly resembles a quasi-judge-made law which, apart from the subsumption of a case under very generally worded legal norms, is based particularly on value judgments.

The political approach to competition, restricted only by a general legal regulation, makes it possible to react more flexibly to inevitable value conflicts than an approach limited by rigorously compulsory and apodictic regulation. Decision making in these questions will always be a kind of extrapolation — an endless seeking of indefinite and ever-changing limits — which should be characterized by a readiness to experiment and to go back, and by cognitive humility.<sup>24</sup>

#### **V. Conclusion: Further Important Legal Developments in Commercial Law**

In 1991, the Czech Republic rejected the concept of a uniform commercialized civil code such as, for example, that of Switzerland. Instead, as is the case in some European countries like Germany or Austria, some business relations fall into the sphere of the more specialized Commercial Code, while others fall into the sphere of the more general Civil Code.<sup>25</sup>

As a particular kind of business may be regulated sometimes by the Commercial Code and sometimes by the Civil Code, questions arise concerning the interrelationship of the provisions of these two codes.<sup>26</sup> Since the two codes themselves do not solve satisfactorily the more complex issues of their mutual relationship,<sup>27</sup> scholars using methods of statutory analysis have tried to make suggested interpretations of the codes to solve these issues.<sup>28</sup> Authoritative judicial decisions interpreting the provisions have not yet led to stable practice.

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<sup>24</sup>Etzioni, *supra* note 20, at 205.

<sup>25</sup>Commercial Code § 261 (Czech Rep.).

<sup>26</sup>See generally Denyer et al., *supra* note 4, at 16.

<sup>27</sup>See J. Bejcek, Nad traumatizujícími záhadou působnosti § 261 a § 262 Obchodního zákoníku, *Právní rozhledy*, 10/1999.

<sup>28</sup>Denyer et al., *supra* note 4, at 19.

Anticipated amendments to the Civil Code will affect this issue because the government intends to create a unified private law code in the Czech Republic.<sup>29</sup> This approach has great support in both academic and political circles, and the legislative process leading to the new Civil Code already has been started.

Since the creation of the Czech Securities Commission,<sup>30</sup> the protection of the capital market has been strengthened. The last amendment to the Commercial Code, coming into effect on January 1, 2001, will operate in the same vein and will harmonize our company law with European Community directives. It will enhance the protection of the Czech capital market and of small shareholders, who otherwise could easily be deprived of their position and of their influence in joint-stock companies.

The task of getting rid of the remnants of the so-called 'banking socialism,' the legacy of pseudoprivatization from the early '90s, still remains. Many Czech banks gained shares in industrial companies at that time, and they gave these companies much insufficiently secured credit to help them overcome their bad economic results. This resulted in frequent failures to pay off credits, and in the instability of the entire banking system. Many banks have lost their banking licenses and thousands of common people have suffered substantial financial damage. In addition, the loss of the small savers' money deposited in commercial banks has led to a general loss of trust in the banks and to an increased dissatisfaction with the economic system as such.<sup>31</sup> Due to their substantial shares in the property of debtor companies, of course, the banks often were not prepared to initiate bankruptcy proceedings. The potential possibility to re-order the structure of the national economy through bankruptcy thus was reduced or eliminated.

The importance of the institutional framework of the economic transition has been undervalued and neglected. It is said half jokingly in our country that "the economists took to flight and the lawyers had no real chance to catch them." Nevertheless, we lawyers are striving to establish a standard legal environment of a market economy, which still has a long way to go. The question is, which of the groups will run out of breath sooner.

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<sup>29</sup>That would mean creating a big 'commercialized' Civil Code and repealing the Commercial Code

<sup>30</sup>Komise pro cenné papíry; see Act No. 15/1998 Coll

<sup>31</sup>No exact figures are available, but one can learn in Czech newspapers that over 100 billion Czech koruny (CZK) (about 3 billion U.S. dollars, approximately 1/5 of the Czech state budget) were granted from the state budget in order to stabilize the endangered banking system and keep it in operation.

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