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## CONTENTS

CORPORATE GOVERNANCE IN SINGAPORE: EXPLORING THE CONCEPT OF DIRECTOR INDEPENDENCE IN THE LIGHT OF GLOBAL CORPORATE GOVERNANCE PRINCIPLES

**Chen Meng Lam**

ARBITRAL AWARDS UNDER THE SAUDI LAWS: CHALLENGES AND POSSIBLE IMPROVEMENTS

**Ahmed A Altawyan**

A CRITIQUE ON THE HUMAN RIGHTS PROTECTION MECHANISM BEFORE THE EUROPEAN COURT OF HUMAN RIGHTS: THE CROATIAN PERSPECTIVE

**Tunjica Petrusevic**

FASHION FAUX PAS: THE LAW AND ECONOMICS BEHIND THE COPYRIGHT-FREE INDUSTRY

**Drishti Shah**

SHAREHOLDER PRIMACY AND CORPORATE GOVERNANCE: A UK PERSPECTIVE

**Anurag Vijay and Nidhi Singh**

THE JUSTICIABILITY OF ECONOMIC, SOCIAL AND CULTURAL RIGHTS IN NIGERIA: A CALL TO FOLLOW GLOBAL TRENDS

**Philip Ebosetale Oamen**

THE NEW CONCEPT OF SEX-CRIMES IN CROATIAN CRIMINAL LAW

**Igor Vuletić and Davor Šimunić**

ONCE A DEBTOR, ALWAYS A DEBTOR – LESSONS FROM BULGARIAN DEBT COLLECTION PRACTICES

**Kristina Stefanova**

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### **CONTENTS**

- 4 CORPORATE GOVERNANCE IN SINGAPORE: EXPLORING THE CONCEPT OF DIRECTOR INDEPENDENCE IN THE LIGHT OF GLOBAL CORPORATE GOVERNANCE PRINCIPLES  
**Chen Meng Lam**
- 14 ARBITRAL AWARDS UNDER THE SAUDI LAWS: CHALLENGES AND POSSIBLE IMPROVEMENTS  
**Ahmed A Altawyan**
- 25 A CRITIQUE ON THE HUMAN RIGHTS PROTECTION MECHANISM BEFORE THE EUROPEAN COURT OF HUMAN RIGHTS: THE CROATIAN PERSPECTIVE  
**Tunjica Petrusevic**
- 34 FASHION FAUX PAS: THE LAW AND ECONOMICS BEHIND THE COPYRIGHT-FREE INDUSTRY  
**Drishti Shah**
- 42 SHAREHOLDER PRIMACY AND CORPORATE GOVERNANCE: A UK PERSPECTIVE  
**Anurag Vijay and Nidhi Singh**
- 50 THE JUSTICIABILITY OF ECONOMIC, SOCIAL AND CULTURAL RIGHTS IN NIGERIA: A CALL TO FOLLOW GLOBAL TRENDS  
**Philip Ebosetale Oamen**
- 62 THE NEW CONCEPT OF SEX-CRIMES IN CROATIAN CRIMINAL LAW  
**Igor Vuletić and Davor Šimunić**
- 70 ONCE A DEBTOR, ALWAYS A DEBTOR – LESSONS FROM BULGARIAN DEBT COLLECTION PRACTICES  
**Kristina Stefanova**

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## **CORPORATE GOVERNANCE IN SINGAPORE: EXPLORING THE CONCEPT OF DIRECTOR INDEPENDENCE IN THE LIGHT OF GLOBAL CORPORATE GOVERNANCE PRINCIPLES**

MS. CHEN MENG LAM<sup>1</sup>

### **ABSTRACT**

Director independence is a major institutional element of corporate governance. In Singapore, the Code of Corporate Governance 2012 (“Singapore Code”) has introduced several major changes to the concept of independent directors. The expanded definition of independence, which requires independent directors to be independent from both management and shareholders holding 10% of the company’s shares, could affect the availability of independent directors in Singapore. While the definition of independence is well-elaborated, Singapore’s rules do not provide clarity on the role of independent directors; nor do the expectations of the role appear to have changed to take the expanded definition into account. This paper suggests that the Singapore Code should advocate that independent directors exercise vigilance on behalf of minority shareholders and play a proactive role in risk management. Relevant comparisons are made with the requirements in the United States and United Kingdom, and other global corporate governance principles.

**Keywords:** Corporate governance, Independent directors, Code of Corporate Governance

### **INTRODUCTION**

In a recent study analysing corporate governance requirements and degrees of enforceability across 25 global markets, Singapore ranked first in the Asia-Pacific region, and third overall behind the United States and United Kingdom (KPMG and ACCA, 2014). Singapore first implemented the Code of Corporate Governance in 2001. The concept of independent directors was introduced by it as a mechanism to improve board accountability and objectivity, and has since been widely embraced by listed companies in Singapore. In 2012, the corporate governance framework in Singapore underwent extensive review, resulting in key amendments in the revised Code of Corporate Governance 2012 (“Singapore Code”) relating to various aspects including director independence, board composition, directors’ training, remuneration matters, risk management, and shareholders’ rights and responsibilities. The changes to the concept of director independence in the Singapore Code were implemented with the aim of bringing an objective and independent element to board decision-making relating to corporate affairs.

Against the backdrop of Singapore’s reputation for good corporate governance, a recent slew of corporate governance issues arising in Singapore Post Limited, a major listed company providing postal services, is a good reminder that the safeguards against board governance in Singapore may not be sufficient. The director at the centre of Singapore Post Limited’s corporate governance problems was then its lead independent director, who misbehaved under the watch of its then independent board chairman (Tan, 2016). The events stirred up corporate governance concerns in the business community and media, and resulted in the scrutiny of Singapore’s independent directors. This suggests the need to re-examine the concept of director independence in Singapore.

This paper focuses on the definition and role of an independent director in Singapore. It is widely recognised that director independence in the context of corporate governance has

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long been a subjective trait that is not easy to measure. The approach towards director independence depends on several factors, including board structures, company ownership structure, and corporate culture. It is therefore no surprise that the concept of director independence varies from jurisdiction to jurisdiction. Relevant comparisons are made with the corporate governance regime in the United States and United Kingdom, and the possible rationale and consequences of major differences are discussed. The concept of director independence in the G20/OECD Principles of Corporate Governance (“OECD Principles”) and the ICGN Global Governance Principles (“ICGN Principles”) is also examined.

Under the expanded definition of director independence in Singapore, independent directors are required not only to be independent from management, but also to be independent from shareholders with an interest in 10% or more of the total voting shares in the company (Code of Corporate Governance, 2012). The expansion brings the definition of independence closer to that of the United Kingdom, but departs from the definition of independence in the United States. The modification is crucial because it may mean that the independent directors are changing their core function from monitoring management on behalf of dispersed shareholders to monitoring controlling shareholders on behalf of minority shareholders (Puchniak and Lan, 2016). Although the expanded definition of independence purports to improve board objectivity and effectiveness, it poses potential implications and obstacles for listed companies in Singapore. These issues are examined in this paper.

Independent directors in Singapore have generally been seen as acting as overseers, checking and balancing the acts of the board and management of the company. Despite the clarity provided by the expanded definition of independence, the rules in Singapore have yet to prescribe the role of independent directors; nor do expectations of the role appear to have changed to take into account the expanded definition of independence. This paper suggests that, in the light of the expanded definition of independence, as well as the unique corporate culture and the predominance of concentrated ownership structure in local companies, the Singapore Code should advocate that independent directors exercise vigilance on behalf of minority shareholders in contexts such as self-dealing transactions and other conflict-of-interests situations, and play a proactive role in risk management to mitigate the risk of fraud, bribery and corruption.

## **CORPORATE GOVERNANCE CONCERNS**

It is widely recognised that the structure of corporate ownership within an economy is a primary determinant of a country’s corporate governance system (Solomon, 2013). Ownership structures are diverse across countries, with dispersed ownership being more common in listed firms in the United States and the United Kingdom, compared to countries in Asia where concentrated ownership is more prevalent (Hopt, 2011; Stijn et al., 2000; La Porta et al., 1999). The varying governance approaches based on ownership structures across different jurisdictions are expressly acknowledged in the OECD Principles, which state that “[t]he variety of board structures, ownership patterns and practices in different countries will thus require different approaches to the issue of board objectivity” (OECD, 2015, p. 58). Among the various approaches to bolster board objectivity is the use of independent directors, which has become a cornerstone of the modern corporate governance landscape. Generally, independent directors are crucial for enhancing board effectiveness and providing a source of confidence to investors in the strength of the governance of the company (Clarke, 2007). Independent directors have increasingly been crucial in helping to attain a balance of power within the company board and providing an independent view on corporate strategy and affairs (Solomon, 2013).

### **Governance Concerns Arising from a Dispersed Ownership Structure**

The defining characteristic of a dispersed ownership structure is the separation of ownership and control (Berle and Means, 1932). Under the agency theory, managers make the day-to-day business decisions on behalf of the dispersed shareholders as agents, and are responsible for advancing the shareholders' best interests (Jensen and Meckling, 1976). Jensen and Meckling (1976) however assert that the underlying assumption under the agency theory is that in the absence of oversight, management could be tempted to use corporate resources in its own perceived self-interest. The central governance concern in a dispersed ownership structure is therefore the significant agency problems between management and shareholders, arising from the shareholders' lack of incentive to supervise management due to their dispersed ownership (Solomon, 2013). This agency problem presents shareholders with the need to monitor company management.

There are various approaches towards corporate governance which improve accountability, thereby allowing shareholders to monitor management and resolve agency problems in a dispersed ownership structure. Such approaches include the board of directors, disclosure and transparency, internal controls and risk management, audit functions, institutional investors, regulations, and a market for corporate control (Solomon, 2013). The board of directors, in the context of agency concerns, is an intermediary representing shareholder interests vis-à-vis management, curtailing management's ability to extract private benefits or act in a suboptimal way with respect to shareholder interests" (Nili, 2016, p. 6). The board of directors serves as a check on management, and would presumably perform its role more effectively if its members were independent from and not financially beholden in some way to management. The concept of independent directors thus originated in a dispersed ownership structure to strengthen the monitoring role of the board (Gordon, 2007).

#### ***Corporate Governance in the United States***

The American economy has traditionally been dominated by publicly-held companies with widely dispersed shareholders (Hopt, 2011). The principal governance concern is the potential for overreaching by management, and independent directors in a dispersed ownership structure strengthen control over management and address conflicts of interests between managers and shareholders (Solomon, 2013). The concept of independent directors originated from the notion of disinterested directors under common law, whereby directors who have an interest in any transaction or proposed transaction are barred from voting on such matters (Karmel, 2013). In the aftermath of the financial scandals in 2001, the United States Securities and Exchange Commission incorporated the requirements of independent directors into the Sarbanes-Oxley Act of 2002. The subsequent 2008 financial crisis led to further legislative requirements on independent directors in the Dodd-Frank Wall Street Reform and Consumer Protection Act. Under the stock exchange regulations, domestic listed companies, except for controlled companies (i.e. those where a single shareholder or a group of shareholders holds 50% or more of voting shares), are required to have a majority of independent directors (Weil, Gotshal and Manges LLP, 2014; NYSE Listed Company Manual, Section 303A.01; NASDAQ Stock Market, Rule 5605(b)).

#### ***Corporate Governance in the United Kingdom***

The typical ownership structure in the United Kingdom is similarly dispersed (Hopt, 2011). The concept of independent directors was taken first to the United Kingdom via the Cadbury Report in 1992. After the reporting scandals in 2001, the requirements on independent directors were strengthened via the Higgs Report in 2003. Under the UK Corporate Governance Code (2012), the board should include an appropriate combination of executive and non-executive directors (and in particular, independent non-executive directors) such that no individual or small group of individuals can dominate the board's decision-making. Except for smaller companies (i.e. below the FTSE 350 throughout the year immediately prior to the reporting

year), at least half the board, excluding the chairman, should be comprised of non-executive directors determined by the board to be independent (UK Corporate Governance Code, 2012). Pursuant to the UK Corporate Governance Code (2012), a smaller company should have at least two independent non-executive directors.

### **Governance Concerns Arising from a Concentrated Ownership Structure**

In a concentrated ownership structure, the presence of controlling shareholders gives rise to different corporate governance issues (Bebchuk and Hamdani, 2009). Urtiaga and Saez (2012) report that controlling shareholders generally have both the incentives and the power to monitor management, and they usually wield control over the board. As a result of the low level of separation of ownership and control, there can be abuses of power. The problem in a concentrated ownership structure is the potential expropriation of the minority shareholders by the controlling shareholders through self-dealing and related party transactions (Urtiaga and Saez, 2012). Minority shareholders also may not be able to obtain requisite information on the company's operations. Opaque financial transactions and misuse of corporate funds are potential problems in a concentrated ownership structure (Solomon, 2013). The goal of corporate governance is therefore to monitor the corporate behaviour of the controlling shareholders and reduce the potential expropriation of minority shareholders. In a concentrated ownership structure, the independent director could similarly perform a monitoring role, but focusing on the controlling shareholders rather than on the management (Bebchuk and Hamdani, 2009).

### ***Corporate Governance in Singapore***

The landscape in Singapore is vastly different, with concentrated-ownership companies being prevalent among the state's listed companies. Tan (2011, p. 29) reported that "corporate ownership is highly concentrated, and mainly owned by families, groups of families or interest groups and the Singapore government." According to a recent empirical study, up to 60.8% of listed companies in Singapore can be classified as family-controlled (Dieleman et al., 2013). Empirical evidence suggested that family members collectively hold large controlling blocks of shares in family-controlled companies, which results in such companies having extremely concentrated shareholder structures (Dieleman et al., 2013). The highly concentrated-ownership structure among family-controlled companies can give rise to the agency problem of expropriation of minority shareholders by the controlling shareholders.

In Singapore, the concept of independent directors was introduced in 2001 with the aim of improving board accountability and objectivity, and as a way of preventing corporate mismanagement. Principle 2 of the Singapore Code provides that "[t]here should be a strong and independent element on the board that is able to exercise objective judgement on corporate affairs independently." To demonstrate this, independent directors should make up at least one-third of the board, but this percentage is increased to at least half of the board where the chairman of the board and the chief executive officer is the same person or are immediate family members, or the chairman is part of the management team or not independent (Code of Corporate Governance, 2012, Principle 2; Yip and Tan, 2013). Furthermore, the issuer's board must have at least two non-executive directors who are independent and free from any material business or financial connection with the issuer (SGX Listing Mainboard Rules, Rule 210(5)(c)).

### **DEFINITION OF DIRECTOR INDEPENDENCE**

Different countries define independence differently. The OECD Principles do not provide an exact definition of independence and recognise varying approaches towards defining independence for board members. According to the OECD Principles, "in many instances, objectivity requires that a sufficient number of board members not be employed by the company or its affiliates and not be closely related to the company or its management through

significant economic, family or other ties” (OECD, 2015, p. 58). Under this definition of independence, shareholding would not bar a director from attaining an independent status. The OECD Principles further provide that “in other instances, independence from controlling shareholders will need to be emphasised, in particular if the ex-ante rights of minority shareholders are weak and opportunities to obtain redress are limited” (OECD, 2015, p. 58). This definition would prevent an independent director from having a connection with shareholders. In addition, the ICGN Principles set forth a list of criteria that would compromise the independence of a director (ICGN, 2014). Importantly, a director’s independence is compromised if he is a “significant shareholder of the company, or an officer of, or otherwise associated with, a significant shareholder of the company” (ICGN, 2014, p. 10). No further elaboration is provided on what constitutes a “significant shareholder”.

### **United States**

The definition of independence in the United States requires that the independent directors be independent from the management. Specifically, the definition focuses on the absence of financial and family ties between directors and the company. The rules in the NYSE Listed Company Manual and NASDAQ Stock Market contain specific prerequisites for director independence, explicitly prohibiting directors from being considered independent if they were employees of the company, received compensation over a certain threshold other than as a director fee, had ties to the company’s auditor, or had business or compensation interlocks with the company above a certain threshold. Crucially, the definition of independence does not consider the relationship with controlling and significant shareholders. As the governance concern is independence from management, ownership of even a significant amount of the company’s shares, by itself, is not a bar to a finding of director independence (NYSE Listed Company Manual, Section 303A.01; NASDAQ Stock Market, Rule 5605(b)).

The definition of independence currently does not consider social and professional ties with the company and its management, although those ties may in reality affect the independence of directors. There are, however, case law developments in the United States suggesting that the definition of independence may become broader in future (Khanna and Mathew, 2010). In *re Oracle Corp. Derivative Litigation*,<sup>2</sup> it was held that personal and social relationships are relevant to determining director independence. Although the decision was made within the context of claims of independence for a special litigation committee at issue, it begs the question of whether a workable definition of independence could exist that might capture social and personal relationships (Tung, 2011). Currently, the requirements for independence described in *Oracle* have yet to be incorporated into the stock exchange regulations, which have mainly focused on directors’ financial and family ties to the company. However, in the light of *Oracle*, it remains to be seen whether formal independence without social independence is adequate under the current definition of independence to assure the effectiveness of independent directors.

### **United Kingdom**

The definition of independence in the United Kingdom is more comprehensive than in the United States, as it requires independent directors to be independent from both management and significant shareholders. The 1992 Cadbury Report, which first introduced the notion of independent directors in the United Kingdom, required independence only from management. In the wake of the financial scandals in 2001, the Higgs Report in 2003 recommended the expansion of the definition of independence, and this was reflected in the revised UK Corporate Governance Code. The impetus for the expanded definition of independence was to address the fact that it was “not just relationships or circumstances that would affect the director’s

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<sup>2</sup> (2003) 824 A.2d 917 (Del. Ch.).

objectivity, but also those that could appear to do so” (Higgs Report, 2003, p. 36). The expanded definition of independence also makes clear that “receiving additional remuneration beyond the director’s fee compromises an individual’s independence” (Higgs Report, 2003, p. 36). Non-executive directors should also not allow the objectivity of their judgment be affected by the income derived from their role or shareholding (Higgs Report, 2003).

### **Singapore**

In 2012, the Singapore Code was revised to require,<sup>3</sup> among other changes, independent directors to have independence from shareholders holding 10%<sup>4</sup> or more of the company’s shares, and not just independence from management (as had been the case under the previous definition). Under the expanded definition, a director is deemed to not be independent if he is “a director who is a 10% shareholder or an immediate family member of a 10% shareholder of the company, or a director who is or has been directly associated with a 10% shareholder of the company, in the current or immediate past financial year” (Code of Corporate Governance, 2012, p. 5). A director will be considered “directly associated” with a 10% shareholder only “when the director is accustomed or under an obligation, whether formal or informal, to act in accordance with the directions, instructions or wishes of the 10% shareholder in relation to the corporate affairs of the corporation” (Code of Corporate Governance, 2012, p. 5). The expanded definition of independence appears to be in line with the concentrated ownership structure that predominates listed companies in Singapore, as it now covers relationships with controlling shareholders.

While the expansion brings the definition in Singapore closer to that of the United Kingdom, it poses potential implications and obstacles for listed companies as a result of the requirements linking shareholding and director independence. Firstly, the expanded definition of independence could reduce the availability of independent directors for listed companies in Singapore. Given Singapore’s relatively close-knit business community and the prevalence of family-controlled firms, major shareholders are often disinclined to select directors who would challenge management, albeit constructively, preferring instead to bring in independent directors who would work harmoniously with them. It is therefore common to have friends of the major shareholders sitting on the board of such companies as independent directors, to minimise excessive challenging from outsiders. Under the expanded definition, these individuals may lose their independent status if they are considered directly associated with the major shareholders. Secondly, the requirement of linking “10% shareholders” and director independence could be unduly conservative. It raises the question of whether a shareholder holding 10% of the company’s shares could sufficiently influence the governance of the company concerned.

### **THE ROLE OF INDEPENDENT DIRECTORS**

The OECD Principles provide that “independent directors can contribute significantly to the decision-making of the board and bring an objective view to the evaluation of the performance of the board and management” (OECD, 2015, p. 58). Independent directors can also play an important role in areas “where the interests of management, the company and its shareholders

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<sup>3</sup> The revised Singapore Code took effect in respect of annual reports relating to financial years commencing from 1 November 2012, with the exception of changes needed to comply with the requirement for independent directors to make up at least half of the boards in specified circumstances. Such changes are to be made at the annual general meetings following the end of the financial years commencing on or after 1 May 2016.

<sup>4</sup> An “independent” director is “one who has no relationship with the company, its related corporations, its 10% shareholders or its officers that could interfere, or be reasonably perceived to interfere, with the exercise of the director’s independent business judgement with a view to the best interests of the company”; a “10% shareholder” is defined as “a person who has an interest ... in not less than 10% of the total votes attached to all the voting shares in the company”; and “voting shares” exclude treasury shares (Code of Corporate Governance, 2012, p. 4-5).

may diverge, such as executive remuneration, succession planning, changes of corporate control, take-over defences, large acquisitions and the audit function” (OECD, 2015, p. 58). The OECD Principles also recognise the importance of having independent directors review and monitor related party transactions. For significant transactions, a committee of independent directors should be established to vet and approve the transaction. The committee should review significant related party transactions to ensure fairness and reasonableness (OECD, 2015).

### **United States**

The primary role of independent directors in the United States is to monitor management on behalf of dispersed shareholders who are hindered by collective action problems from monitoring management themselves (Gordon, 2007). This is consistent with the definition of independence that requires an independent director to be independent from management. To facilitate oversight of the management, the independent directors have relevant powers in the audit committee, including the hiring, overseeing and firing of outside auditors (Clarke, 2007). They also have a role in the vetting of conflict-of-interest transactions, which are reviewed by the courts under the heightened standard of the entire fairness test unless the transactions are approved by independent directors (Ferrarini and Filippelli, 2014; Fairfax, 2010). Furthermore, the independent directors have a role regarding shareholders’ derivative actions, since they may prevent shareholders from bringing those actions or may terminate such derivative actions (Fairfax, 2010).

### **United Kingdom**

Similarly, independent directors in the United Kingdom play an important monitoring role in overcoming the agency problems inherent in companies with a dispersed ownership structure. The Walker Review (2009) highlighted the need for independent directors to constructively challenge executives more substantially before strategic decisions are made. Independent directors, particularly in the banking sector, need to challenge executives on issues of risk, risk management and related strategy. They should also play a crucial role in monitoring excess risks taken on by the company.

### **Singapore**

#### ***The Existing Role of Independent Directors***

Theoretically, the role of independent directors in concentrated ownership companies is to a large extent different from that in dispersed ownership companies. In a concentrated ownership structure, independent directors are not needed to monitor management, since the former are already actively monitored by the controlling shareholders. The role of independent directors is therefore to reduce potential expropriation of the minority and address conflicts among controlling and minority shareholders.

Independent directors in Singapore are generally regarded as crucial in providing an oversight and monitoring role for the board and management (SID, 2007). SID (2007) elaborated that the primary role of an independent director is “not to protect the interest of minority shareholders, but to act as a check and balance on the acts of the board and management of the company”. SID (2007) also recognises that “the independent director is not merely the guardian of the minority shareholders, nor is he only to focus on related party transactions involving a listed company, its management or major shareholder.” SID (2007) acknowledges that the indirect role played by the independent director seems to promote the best interest of minority shareholders, but in fact promotes the interest of *all* shareholders. In essence, the primary role of independent directors in Singapore is not to monitor the controlling shareholders but to monitor the board and management. This does not appear to match the governance concerns arising from concentrated-ownership companies predominant in Singapore, nor is it compatible with the expanded definition of independence in the Singapore,

which requires independence from both management and 10% shareholders.

### ***Redefining the Role of Independent Directors***

To address the mismatch outlined above, this paper suggests that, in the light of the expanded definition of independence, the unique corporate culture and the predominance of concentrated ownership structure, the Singapore Code<sup>5</sup> should advocate that independent directors exercise vigilance on behalf of minority shareholders and play a proactive role in risk management.

The Singapore Code should explicitly make clear that independent directors play a role in exercising vigilance on behalf of minority shareholders in contexts such as self-dealing transactions involving the controlling shareholder and the company, as well as other conflict-of-interest situations. One might initially question the need for such enhanced monitoring function. It has been argued that the family-controlled companies in Singapore are indirectly prevented from extracting private benefits of control because the effectiveness of Singapore's corporate regulators and the strong emphasis in Singapore family corporate culture appear to be important substitutes for the monitoring of controlling shareholders by independent directors (Puchniak and Lan, 2016). However, there have been specific local cases of expropriation of minority shareholders in Singapore, including *Raffles Town Club Pte Ltd v Lim Eng Hock Peter*<sup>6</sup> and *Lim Swee Khiong v Borden Co (Pte) Ltd*.<sup>7</sup> An empirical study has shown that self-dealing transactions are in fact common in family-controlled companies (Tan, 2011). These circumstances make clear that enhancing the monitoring role of independent directors to exercise vigilance on behalf of minority shareholders can provide a useful additional check on private benefits of control, and this role ought to be made explicit in the Singapore Code. Moreover, an enhanced monitoring function assigned to independent directors in alignment with the expanded definition of independence in Singapore could boost Singapore's reputation as a beacon of corporate governance.

In particular, the role of independent directors should focus on vetting and approving self-dealing transactions and other conflict-of-interest situations. Currently, Rule 917 of SGX Listing Mainboard Rules requires a statement by the audit committee regarding whether it takes the view that the self-dealing transaction at issue (called an "interested person transaction" under the SGX Listing Mainboard Rules) has been carried out on normal commercial terms, and is not prejudicial to the interests of the issuer and its minority shareholders. Under the Singapore Code, Guideline 12.1, the audit committee should comprise of at least three directors, the majority of whom should be independent. Importantly, the audit committee is able to discharge its obligation by obtaining an opinion from an independent financial adviser and relying on the value assessment made by such an adviser (SGX Listing Mainboard Rules, Rule 917(4)(ii)). It is submitted that these current requirements do not reach a level sufficient for an independent director to effectively monitor controlling shareholders to prevent the potential expropriation of minority shareholders. Tasking independent directors with the vetting of self-dealing and other conflict-of-interest transactions could be effective in deterring the private benefits of control and the expropriation of the minority.

Increasingly, shareholders are also demanding higher expectations of how companies undertake risk management to keep risks at an acceptable level. In this regard, the Singapore Code should explicitly provide that independent directors also play a role in reviewing the risk

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<sup>5</sup> While compliance with the Singapore Code is not mandatory under the "comply-or-explain" regime adopted in Singapore, listed companies are required to disclose in their annual report any deviation from the Singapore Code and

provide an appropriate explanation for such deviation. This effectively provides an impetus for listed companies to redefine the role of their independent directors.

<sup>6</sup> (2010) SGHC 163.

<sup>7</sup> (2006) 4 SLR(R) 745.

management framework put in place by the company to mitigate the risk of fraud, bribery and corruption. They are expected to engage in proactive steps rather than assuming that no corporate misconduct can happen. Such steps can include conducting the necessary due diligence and background checks on entities transacting with the company, stepping up awareness of risk management within the company, and ensuring compliance with the applicable laws. The independent directors are expected to constructively challenge and ask questions, and raise the appropriate red flags at the right time.

## CONCLUSION

The concept of independent directors in Singapore is both a challenging and controversial area. While the definition of independence in Singapore is now well-elaborated, listed companies face potential implications and obstacles as a result of the expanded definition. Notwithstanding the clearer definition of independence, the rules in Singapore have yet to prescribe the role of independent directors. Independent directors are generally regarded as crucial as overseers, monitoring the acts of the board and management for the company. But such a role appears not to match the governance concerns arising from concentrated-ownership companies predominant in Singapore, and the expanded definition of independence in the Singapore which requires independence from both management and 10% shareholders. To address the agency problems of expropriation of minority shareholders that could be prevalent in a concentrated ownership structure, the Singapore Code should advocate that independent directors exercise vigilance on behalf of minority shareholders and also play a proactive role in risk management.

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## **ARBITRAL AWARDS UNDER THE SAUDI LAWS: CHALLENGES AND POSSIBLE IMPROVEMENTS**

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### **ABSTRACT**

Arbitrating parties expect that the arbitration process will result in final and binding awards. The Kingdom signed the New York Convention in 1994 to reassure foreign investors to invest in the country. Despite such acceding to a stated convention, Saudi Arabia has been described as hostile toward the recognition of arbitration agreements and enforcing foreign awards, and many international awards have been rejected (Saleem, 2012). The Kingdom has thus tried to reform its arbitration regime. A new Enforcement Law came into effect in 2012 by Royal Decree No. M/53. The new law replaced relevant provisions, and its possible impact on the enforcement of arbitral awards should be examined in the context of domestic and international arbitration. How will the new enforcement law and the new arbitration law impact arbitral awards and avoid the flaws of the previous legislation in practice? This study will address the arbitral award under Saudi law by comparing it with the modern trends in international commercial arbitration practice.

**Key Words:** enforcement law, arbitral award, Saudi court, enforcement, public policy

### **INTRODUCTION**

The Saudi ruler tried to change the past enforcement practice in the Kingdom by reassuring investors through Article 52 of the new Arbitration Law (2012) that the arbitration award issued in accordance with the new law will be authentic, authoritative, and enforceable. The legislation confirmed that arbitral awards would be enforced if they comply with the new Saudi law. In addition, the new law stated that the competent court does not have the authority to examine the facts and subject of dispute, unlike the old law, which was a major obstacle to arbitration in the Kingdom (Saudi Arbitration Law, 2012, Article 50(4)).

### **SUBMISSION TO THE COMPETENT COURT**

The new Arbitration Law requires that, to be executed, the arbitral award be submitted to the competent court after the expiration of the time permitted to challenge the validity of the award (Arbitration Law, 2012, Article 55(1)), with some attachments such as a translation of the arbitration award into Arabic certified by an accredited authority if it was issued in another language (Arbitration Law, 2012, Articles 43, 44, 53). After satisfying these legal requirements, the competent court must verify the following points:

1. The arbitral award does not conflict with an award or decision issued by a court, committee or authority that has jurisdiction over the subject of the dispute in Saudi Arabia (Arbitration Law, 2012, Article 55(2)). This requirement is logical, because it is impossible to enforce an award that conflicts with another award already issued by other judicial bodies in the kingdom.
2. The arbitral award does not include anything that contradicts the provisions of Islamic Sharia and public order in the Kingdom. The law provides more flexibility on this point, because it allows the competent court to enforce those portions of the award that do not violate Islamic Sharia and to dismiss those portions that do violate Islamic Sharia (Arbitration Law, 2012).

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3. The arbitral award as been well and truly notified to the convicted (Arbitration Law, 2012).

These conditions set up by Saudi law to allow enforcement of an arbitral award, whether domestic or international, are similar to those required by the New York Convention, so that they will be explained extensively later in this section. Saudi law does not allow appeal against the order issued to execute the arbitration award, but the order rejecting the execution may be appealed to the competent court within thirty days of the date of issuance of the award (Arbitration Law, 2012, Article 55(3)).

### **SUBMISSION TO THE ENFORCEMENT COURT**

If an arbitral award meets the requirement of the new Arbitration Law as stated above, the arbitral award will be enforced by the competent court, which completes the first stage of enforcing the award in the Kingdom. The second step needs to follow the rules set up in the new enforcement law for taking enforcement to the award.

According to the Royal Decree No M/53, 2012, the Saudi judiciary authority must customize enforcement circuits in the public courts in the main cities and provinces (Saudi Enforcement Law, 2012). These circuits undertake the implementation of decisions or orders of the competent quasi-judicial committee, such as banking dispute committees, according to the system of implementation (Roy, 1994). In addition to judgments, decisions, and orders issued by the courts, the enforcement court is responsible for executing arbitral awards that have obtained an executive order from the competent court in accordance with the arbitration (Enforcement Law, 2012, Article 9(2)).

An arbitral award in the implementation law stage is also at risk if the implementing court reviews the award to ensure that it is not contrary to the provisions of the public order in the Kingdom (Enforcement Law, 2012, Article 11). The arbitral award will therefore be reviewed to make sure that it complies with Islamic Sharia and public order twice, at the competent court level and again at the implementing court level. The enforcement law could be a significant step to ensure that the arbitral award is executed. However, the absence of specifying the meaning of Islamic Sharia as applied in the state and public order of in the Kingdom could make the enforcement of such awards less certain in the country and could subject their enforcement to past practice. Although all decisions of an enforcement judge are final, decisions regarding enforcement disputes and claims of insolvency are subject to appeal, and the determination of the appellate court shall be final (Enforcement Law, 2012, Article 6). This is the last stage of implementing the domestic arbitral award.

The enforcement law requires that international arbitration comply with all previous requirements in arbitration and implementation law, with additional requirements (Enforcement Law, 2012, Article 11, 12). The law also states that the application of this system must not conflict with any international treaties or conventions associated with states, bodies, and organizations (Enforcement Law, 2012, Article 94). As a result, the study should customize a separate section to analyse such requirements through such international conventions and treaties and their practice in the Kingdom.

## **INTERNATIONAL ARBITRATION AND ENFORCEMENT IN THE KINGDOM**

### **Background**

During the 1950s, Saudi courts refused to enforce many international arbitral awards, because they thought that the awards were degrading and disrespectful to Islamic Sharia (the primary system of law in the Kingdom) (Roy, 1994, p. 920–924). However, the Kingdom of Saudi Arabia entered into the New York Convention on 19 April 1994.<sup>2</sup> Upon adoption, Saudi Arabia

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<sup>2</sup> See the list of contracting states at New York Arbitration Convention at <http://www.newyorkconvention.org/list+of+contracting+states>.

became the 94th party to the Convention, which requires all signatories to recognize the arbitration agreements and awards issued by other member nations. As a result, it was supposed that the Kingdom would become more attractive to investment in the modern global community. This study will examine whether the Kingdom's adoption of the New York Convention has advanced the successful application of international commercial arbitration by foreign investors in the state by analysing the following points.

### **Principles Governing Recognition and Enforcement**

According to Article III of the New York Convention, each contracting state must recognize international arbitral awards as binding and enforce them by the rules of procedure of the state through which the award is issued and also under the conditions stated in the articles of the Convention (The New York Convention, 1958). The Convention thus distinguishes between recognizing and enforcing arbitration awards. Recognizing the award means acknowledging that it is valid and binding (Moses, 2012, p. 212–213). The award will thus have an official legal status, as the result of which the award cannot be re-litigated or arbitrated (Moses, 2012). Saudi Arabia recognizes international arbitral awards under the new Arbitration Law and Enforcement Law as long as such awards comply with its rules (Arbitration Law, 2012, Articles 3, 8(2)). To accept the arbitral award, however, Saudi law requires that the arbitral tribunal deposit the original copy of the award or a signed copy in the language in which it was delivered by the competent court within 15 days, with a translation into Arabic certified by an accredited authority if it was performed in a foreign language as stated earlier (Arbitration Law, 2012, Articles 43, 44). The terms of enforcement frequently used for the purpose of execution, which is obtained under the legal process of the authorizing jurisdiction, is explained in the following points.

### **Requirements for Enforcement**

#### ***Scope***

The New York Convention applies to international awards, as provided explicitly in Article I(1) of the Convention, which refers to two types of awards:

- A. Arbitral awards made in the territory of a State other than the State in which the recognition and enforcement of such arbitral awards are sought;
- B. Arbitral awards that are not considered domestic awards in the State in which their recognition and enforcement are sought (The New York Convention, 1958).

The nature of the first type as international awards issued between states is clear, but the definition of a domestic award is not provided in the Convention, which leads to different determinations between states about the second type. Many countries thus enforce only the first type of award, such as Japan and Netherlands. Other states, like the United States, apply this Convention even if the arbitration involves citizens of the United States as non-domestic awards, for example if the relationship involves property located abroad, envisages performance of enforcement abroad, or has some other reasonable relation with one or more foreign states (Moses, 2012, p. 213). Like the United States, Saudi law considers some awards as non-domestic, even if they take place between Saudis. For example:

- A. If the headquarters of both parties to the arbitration lie in more than one country at the time of the arbitration agreement, and if one party has more than one business centre, this depends mainly on the centre that is most relevant to the subject of the dispute, and if one or both arbitrating parties do not have a certain business centre, it depends mainly on their usual residential address.
- B. If the headquarters of both arbitrating parties lie in the same country at the time of the arbitration agreement, and one of the following places lies outside of that country:
  - 1- The venue of the arbitration procedures as assigned in the arbitration agreement or the agreement refers to how to assign the venue;

- 2- The place of executing an essential part of the obligations arising from the trading affairs between both parties; or
  - 3- The place most relevant to the subject of the dispute.
- C. If both parties agree to resort to an organization or a permanent arbitration authority, or an arbitration centre lying outside the Kingdom.
- D. If the arbitration subject included in the arbitration agreement is related to more than one country (Arbitration Law, 2012, Article 3).

The Convention thus applies for one type of international awards that all contracting states are bound to the recognition and enforcement of arbitral awards made in the territory of a State other than the State where the recognition and enforcement of such awards are sought. The arbitral awards that are not considered domestic awards have different determination between laws, which leads to differences in their recognition and enforcement.

In addition to defining its scope, the Convention allows states to make two reservations (New York Convention, 1958, Article I(3)). The first is allowing any contracting state on the basis of the reciprocity principle to declare that applying the Convention to the recognition and enforcement of awards will be only in the territory of another contracting State (New York Convention, 1958, Article I(3)). That reservation is adopted by many contracting states, one of which is the Kingdom of Saudi Arabia, which has declared: ‘On the basis of reciprocity, the Kingdom declares that it shall restrict the application of the Convention to the recognition and enforcement of arbitral awards made in the territory of a Contracting State’.<sup>3</sup> In addition to this reservation, the Saudi Ruler states in the enforcement law that the enforcement judge must not enforce an international award except on the basis of reciprocity (Enforcement Law, 2012, Article 11, 12). The only difference between the new enforcement law and the new rules is that the party seeking enforcement under the old law must show that the jurisdiction that issued the international award will, as a matter of reciprocity, enforce an award of the Kingdom, and the new law states clearly that it is the enforcement judge who must find such reciprocity (Al-Ammari and Martin, 2014, p. 404). For example, in one case, a Saudi court requested a specific example of an enforcement of a Saudi judgment in an American court from a party seeking enforcement of an arbitral award in the Kingdom. The party was unable to provide such an example but instead provided the Saudi court with an opinion from the legal office of the United States Department of State, which confirmed that American courts recognize and enforce Saudi judgments. The Saudi court was not, however, satisfied by such proof and refused to recognize and enforce the international arbitration award issued in the United States (Al-Ammari and Martin, 2014). It is not clear how a Saudi court will handle this matter under the new law, because the new law is a good step toward saving the arbitrating parties time and energy by leaving this responsibility of proving a matter of reciprocity to the court. As a result, according to the limitation of reciprocity that Saudi Arabia has adopted, arbitrating parties who aim to enforce an award in the Kingdom should consider the place of arbitration and where it occurs to avoid encountering obstacles at the enforcement stage.

The second reservation allowed under the New York Convention is that a contracting state may declare that the Convention will apply only to differences arising out of legal relationships, whether contractual or not, that are considered commercial under the national law of the state making such a declaration (New York Convention, 1958, Article I(3)). Saudi Arabia is not among the 44 countries that have accepted this reservation. However, since the term ‘commercial’ is not defined, the practice will be different from country to country, with the result that international arbitration between states will not be uniform in practice. This may cause the Convention to fail in one of its goals (Moses, 2012, p. 214).

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<sup>3</sup> Such reservations are available at New York Convention website at: <http://www.newyorkconvention.org/list+of+contracting+states>.

### ***Requirements for Enforcement***

The New York Convention does not provide specific guidance about the procedure for enforcement, but leaves this matter to the contracting states in accordance with their own rules (New York Convention, 1958, Article III), except for some requirements stated in Article IV:

1. The party applying for recognition and enforcement of the arbitral award must, at the time of the application, provide:
  - a) The duly authenticated original arbitral award or a duly certified copy thereof;
  - b) The original agreement or a duly certified copy thereof.
2. If the arbitral award or agreement is not made in an official language of the state in which the award is relied upon, the arbitrating party applying for recognition and enforcement of the award must produce a translation of these documents into that language. The translation must be certified by an official or sworn translator or by a diplomatic or consular agent (New York Convention, 1958, Article IV).

Article 53 of the new Saudi Arbitration Law gives the same requirements as the Convention, as explained earlier (Arbitration Law, 2012).

In addition to the above-stated requirements, the Convention requires that contracting states not impose more onerous terms or higher services fees or charges on the recognition or enforcement of arbitration awards to which this Convention applies than are imposed on the recognition or enforcement of domestic awards (New York Convention, 1958, Article III). The Saudi law does not differentiate between domestic and international awards in the conditions or fees in the course of enforcing arbitration awards, and most of the conditions imposed by Saudi laws are similar to those that stated in the Convention. However, Saudi enforcement law distinguished between local and international awards issued from the Kingdom, and international awards from a foreign state in the enforcement and recognition stage. The international awards that have come from another country do not need to go to the competent court of appeal like other arbitral awards for ratification but can be enforced directly through enforcement courts (Enforcement Law, 2012, Article 9). Hence, enforcement of international awards issued from a foreign state will face only one stage, while other awards will face two stages, one before the competent court and another at an enforcement court, which make them harder to enforce than the first type.

### **Grounds for Non-enforcement Under the Convention**

Grounds for not enforcing an arbitral award under the New York Convention are the same as the grounds set forth in Saudi law and the UNCITRAL Model Law (Enforcement Law, 2012, Article 11; New York Convention Articles V; UNCITRAL Model Law on International Commercial Arbitration, 2006, Article 35, 36; Arbitration Law, 2012, Article 55). The Convention provides specific grounds for not enforcing an arbitral award, which means that the award must be enforced completely, unless there exists one of the stated grounds (New York Convention, 1958, Article V). Such grounds are not based on the merits, so the facts and the law in the case cannot be reviewed under the Convention. However, the grounds for not enforcing an award is based on the arbitrating parties' will as stated in the arbitration agreement and on the integrity of the arbitration process, such as fairness and taking a chance at a reasonable hearing (American Arbitration Association, 2006, p. 157–175; Moses, 2012, p. 217).

### ***Incapacity and Invalidity***

The first defence that an arbitrating party can assert is comprised of the following:

- a. Incapacity of the party or;
- b. The arbitration agreement is not valid.

The determination of incapacity or invalidity will be in accordance with the law that was chosen by the arbitrating parties, or, if no law was chosen, it will be in accordance with the law of the country in which the award was made (New York Convention, 1958, Article V(1)). Under the Saudi Arbitration Law, there is no determined age of legal capacity. However, in returning to other Saudi laws that handle such a matter, such as the Child Protection Law, the study found that 18 years old is deemed to be the age of legal capacity (The Saudi Child Protection Law, 2014; Saudi Labour Law, 2005, Article 2). In legal entities, however, the legal capacity will fall to the person who is authorized to sign the arbitration contract for legal entities according to the type of company. For instance, in the joint stock company, the Chairman of the Board of Directors represents the company before the courts, tribunals and third parties (Saudi Corporate Law, 2015, Article 82(1)). Hence, every legal entity has a different form of legal capacity depending on the Saudi law of companies. Although the Convention refers the rules of incapacity and invalidity to the applicable law, it provides the standard that the arbitration agreement must meet to be valid. In the arbitration agreement, which must be in writing, the arbitrating parties undertake to submit to arbitration all or any differences that arise or that may arise between them with respect to a defined legal relationship, whether contractual or not, concerning a subject matter capable of settlement by arbitration (The New York Convention, 1958, Article II). The Convention also states that the term 'agreement in writing' under the Convention must include an arbitration clause in a contract or an arbitration agreement, and it must be signed by the arbitrating parties or contained in an exchange of letters or telegrams (The New York Convention, 1958).

#### ***Lack of Notice or Fairness***

The second ground for not enforcing an arbitral award under the New York Convention is not giving an arbitrating party full opportunity to present his side of the disputed case (New York Convention, 1958, Article V(1)(b)). This defence can be based on a lack of notice of the appointment of the arbitration tribunal or of the arbitration proceedings or on the basis that the party was unable to present his case (The New York Convention, 1958). One of the famous examples of this ground is *Iran Aircraft Industries v. Avco Corp*<sup>4</sup>. Avco Corporation (Avco) entered into a contract with Iran Aircraft Industries for the repair and replacement of helicopter engines. A dispute between the parties arose, and an arbitral tribunal denied Avco's claims. The United States Court of Appeals for the Second Circuit denied enforcement of the award. In so ruling, it found that the tribunal's award was subject to the defences to enforcement provided in the New York Convention, because Avco had been 'unable to present its case' within the meaning of Article V(b) of the Convention. In other words, Avco did not have the chance to present its case in a meaningful manner. One of the judges had approved a method of proof, proposed by Avco, which was a submission of Avco's audited accounts receivable ledgers. However, another judge later asked for the actual invoices to substantiate Avco's claim. The Court thus concluded on appeal that Avco was misled regarding the evidence that it was required to submit and was thus deprived of the opportunity of presenting its case.

#### ***Arbitrator Acting in Excess of Authority***

The third defence that an arbitrating party can assert is actions by the arbitral tribunal that exceed its authority (The New York Convention, 1958, Article V(1)(c)). This can take different forms, such as that the arbitration award deals with matters not within the scope of the arbitration agreement, or that it contains decisions on issues beyond the framework of the arbitration agreement (The New York Convention, 1958). However, if decisions on matters submitted to arbitration can be separated from those that were not, those parts of the arbitration award that contain decisions on matters submitted to arbitration can be recognized and enforced (The New York Convention, 1958). In international commercial arbitration, the defence based

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<sup>4</sup> (1992) 980 F. 2d 141 - Court of Appeals, 2nd Circuit.

on the ground of exceeding authority non-enforcement has rarely succeeded (Moses, 2012, p. 221), and the study did not find a case in the Saudi courts has addressed this issue.

***The Tribunal or the Procedure Is Not in Accord with the Arbitration Agreement***

Article V(d) of the New York Convention provides that the grounds for not enforcing an arbitration award include the composition of the arbitration tribunal or the arbitration procedure did not comply with the arbitration agreement. Also, the arbitration was not in accordance with the law of the state in which the arbitration took place (New York Convention, 1958). The defence on these grounds is not often successful in international commercial arbitration (Moses, 2012, p. 222).

***The Award Is Not Yet Binding or Has Been Set Aside***

The fifth defence is that the arbitration award is not yet binding on the arbitrating parties, or that it has been set aside or suspended, whether by the competent authority or under the law of the country in which the award was made (The New York Convention, 1958, Article V(1)(e)). The award must thus be binding and unappealable so as to be fully enforceable; this process was explained under Saudi law earlier in the article. The municipal courts, however, have discretion to enforce an arbitral award even if the award was vacated in another jurisdiction, because the Convention uses the word ‘may’ instead of ‘must’ if defences arise that could create a loophole in applying the Convention between contracted states. At the same time it provides an advantage for enforcing the vacated award in the countries that can enforce such awards, such as France, and unlike the Kingdom of Saudi Arabia (Moses, 2012, p. 222–226).

The last two defences under the New York Convention are those that permit the court to refuse recognition and enforcement of an arbitral award by itself without a request from an arbitrating party (The New York Convention, 1958, Article V(2)).

***Subject Matter Not Arbitrable***

Not all subject matters are capable of arbitration, and some matters can be arbitrated in one country but not in another (Moses, 2012, p. 226–228). The New York Convention refers to the law of arbitrability only from the perspective of enforcing the award. It requires the competent court to look to its own rules to determine whether the subject of dispute is arbitrable (New York Convention, 1958, Article V). Determination of the law governing arbitrability is thus significant and crucial.

Under Saudi law, the issue of the arbitrability of the subject matter is vague. The provisions of the Saudi law provide two types of disputes that cannot be arbitrated:

- a. Personal status, and
- b. Issues that cannot be reconciled (Arbitration Law, 2012, Article 2).

The first type is stated, but the second one is not. However, the implementing regulations of the old arbitration law mention the second type by provided three instances of disputes that cannot be reconciled (Implementing Regulations of the Saudi Arbitration Law, 1983, Article 1):

1. Hadd (plural: Hudud), which refers in Islamic Sharia to unchangeable punishments prescribed by primary sources of Islamic Sharia, considered as the right of God (Allah) (Hossain, 2013, p. 7–8). Hudud are specified both in their quantity and quality and as being the right of Allah to prescribe for public and individual interest. In addition, Muslims cannot annul them. According to the majority of the Muslim scholars, Hudud crimes are as follows:
  - a. Zina (unlawful sexual intercourse);
  - b. Theft;
  - c. Qazf (false accusation of Zina);
  - d. Drinking intoxicants;
  - e. Hirabah (highway robbery);
  - f. Baghy (rebellion); and

g. Riddah (apostasy) (Hossain, 2013).

Once the offender is convicted of a Hadd crime, the judge has no choice but to impose the prescribed punishments, neither more nor less, even if the victim consents to mitigation or removal of the offence (Hossain, 2013).

2. Lian

This dispute involves a husband who accuses his wife of adultery without supplying witnesses (Nasir, 1990, p. 159–161).

Such a dispute is explicitly addressed in the Quran, which states that the husband must swear four times that his accusation of the wife is real, followed by a fifth oath in which he invokes the wrath of God (Allah) upon himself if he is lying. The wife may then neutralize the claim by responding to it with four oaths of her own, and a fifth calling upon her the wrath of God (Allah) if her husband is telling the truth. If she refuses to take the oath, she is presumed guilty and subject to the punishment for adultery. However, if she takes the oath, she is declared innocent and permanently divorced from her husband. As a result, her husband forfeits any paternity claims over children born after their sworn oaths (Nasir, 1990, p. 159–161).

3. Any subject related to the public policy

The third instance provides a broad loophole, because ‘public policy’ is a general term in meaning and vague in practice, as will be shown in the last defence of the New York Convention. Because of this, in addition to the generality of the last instance stated in the implementing regulations of the old arbitration law, all previous situations given as examples, which means that there are other subjects, cannot be reconciled and thus cannot be arbitrated, which leads to a kind of risk at the enforcement stage in the Saudi court.

**Public Policy**

Article V(b) of the New York Convention authorizes the competent court to refuse to enforce or recognize the arbitral award if doing so would be contrary to the public policy of that state (New York Convention, 1958). This defence should arise if enforcing such an award would violate the forum country’s most basic notions of morality and justice (Moses, 2012, p. 228–229). The term ‘public policy’ is not defined in the Convention, so that the states apply it differently. Some narrow its scope to achieve the Convention’s goal of enforcing international awards in a uniform way among states. Other countries interpret this defence broadly to protect national political interests (Moses, 2012). For example, the United States Second Circuit Court of Appeals affirmed the enforcement of an arbitral award against an American company:

We conclude, therefore, that the Convention’s public policy defense should be construed narrowly. Enforcement of foreign arbitral awards may be refused on this basis only where enforcement of such an award would violate the forum country’s most basic notions of morality and justice. (*Parsons and Whittmore Overseas Co., Inc. v. Société General de L’industrie du Papier*).<sup>5</sup>

In 1995, however, a Turkish court refused to enforce an ICC award that was based on Turkish substantive law, because the tribunal did not use both Turkish substantive law and Turkish procedural law. This violates Turkish public policy, even though there is no material difference in the procedural law of Turkey and the procedural law that applied (Moses, 2012, p. 228). Hence, the absence of a specific definition of ‘public policy’ in the Convention creates a broad loophole in practice between contracting states, which can lead to unjust and improper results.

The issue of public policy is different under Saudi law. Islamic Sharia as applied in Saudi courts is considered part of the public policy in the Kingdom (Al-Ammari and Martin, 2014, p. 402–405). However, public policy principles cannot be specified in the Saudi courts for two main reasons. First, there are not enough published cases. Saudi Arabia has begun to

<sup>5</sup> (1974), 508 F. 2d 969 - Court of Appeals, 2nd Circuit.

release a few of the cases, but there are still not enough to establish a clear picture of the meaning of public policy in the Kingdom.<sup>6</sup>

Even if the Kingdom had enough published cases, the principle of *stare decisis* is not recognized in the Saudi courts, which makes it hard to predict future decisions even if the facts are the same as or very close to the facts of the previous case (Al-Ammari and Martin, 2014, p. 405). The Ijtihad (Bhala, 2011, p. 334–335)<sup>7</sup> as applied in the Saudi court without binding precedents thus provides the court with the power to refuse any award if the court considers the award to be against public policy or Islamic Sharia, even if the subject is not settled among Muslim jurists. For example, in Case Number: 3375/1 / ق of the year 1424 h,<sup>8</sup> the Saudi court refused to enforce a foreign judgment for the amount of 50.69338 USD. The court based its decision on the fact that the judgment involved singing and music, and the Kingdom of Saudi Arabia derives its authority from the Book of Allah and the Sunnah, which forbid these. The court also confirmed that, although there is a debate between Muslim jurists about whether singing is forbidden, it would not change the decision, because it had arrived at the judgment based on faith. This case provides a clear picture of how the Ijtihad as applied in the Saudi court leads to an unpredictable decision about refusing to recognize and enforce an international award.

Thus, Article V(2)(b) of the New York Convention provides a safe harbour in which the Kingdom can refuse to recognize or enforce an international arbitral award contrary to public policy or Islamic Sharia while maintaining its history and religious beliefs. However, this creates a problem for foreign investors and contractors who choose to do business in the Kingdom. The Kingdom's adoption of the New York Convention was intended to give the international community security in commercial contracts with Saudi Arabia, and to confirm that disputes will be adjudicated fairly. On the contrary, Saudi courts will find it easy to reject international arbitral awards under New York Convention Article V (b), as shown earlier, and it may not be required to enforce any more international arbitral awards than was the case prior to the Kingdom's 1994 accession to the New York Convention (Roy, 1994, p. 953–955).

For a loophole in the Convention, there are different proposals to resolve the public policy matter in the Convention, such as a proposal to establish a new international court, a new convention, a new organization, or even define an international framework of public policy with which all contracting states must comply. Such proposals are explained extensively in the different sources (American Arbitration Association, 2006, p. 50–52). However, this study found that the Kingdom of Saudi Arabia must review its handling of the public policy question to achieve the aim of the New York Convention.

The Kingdom can give the New York Convention greater effect if it chooses to give Article V(b) a narrow reading. For example, American courts have held that all New York Convention defences should be given a narrow reading so that they are effective only when enforcement of an award would violate the most fundamental notions of justice (Roy, 1994, p. 953–955). The Kingdom of Saudi Arabia, with its need to gain the confidence of the international commercial community, may choose to give the public policy defence set forth in Article V(2)(b) of the New York Convention a narrow reading, which will undoubtedly require a review of the Ijtihad as it is applied in Saudi courts and which could conflict with the predictability of decisions and obstruct efforts to bring the Kingdom into step with the rest of the international community.

<sup>6</sup> The Saudi courts have begun to publish some of cases at its website at <http://www.bog.gov.sa/ScientificContent/JudicialBlogs>.

<sup>7</sup> The process of legal reasoning through which the jurist derives the law from the Quran and the Sunnah of the Prophet Muhammad by independent reasoning.

<sup>8</sup> ق is the Arabic letter and 1424 h is the Muslim calendar. The case is available at the Diwan Almazalim website at: <http://www.bog.gov.sa/ScientificContent/JudicialBlogs/1430/Documents/>.

## CONCLUSION

The new Saudi Enforcement Law is a significant step toward harmonizing Saudi law with the international community and its standards. This new law also facilitates enforcement of international and domestic arbitral awards with the creation of a specific authority and specific procedures applicable to such enforcement, which was absent in the past. In theory, the enforcement court will not review the merit of the dispute. In practice, however, the public policy addressed by the new Enforcement Law could be obstructive, especially towards awards issued by foreign arbitrators who are not versed in Saudi law or Islamic Sharia as applied in the Saudi courts.

The meaning of ‘public policy’ is not clear in the Saudi courts, and Islamic Sharia applies it through the Ijtihad, which is not bound by any precedent decisions. This makes an arbitral award that violates Saudi public policy undefined. However, enforcement judges may refuse to enforce only that part of the award that conflicts with public policy instead of the entire award, unless that part is not severable from the rest of the arbitral award. The new Saudi Enforcement Law remains a significant step toward international legal principles, but it needs to review public policy matters to be more predictable at the enforcement stage of the arbitration process.

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## **A CRITIQUE ON THE HUMAN RIGHTS PROTECTION MECHANISM BEFORE THE EUROPEAN COURT OF HUMAN RIGHTS: THE CROATIAN PERSPECTIVE**

MR. TUNJICA PETRASEVIC<sup>1</sup>

The paper gives a critical review of the working methods of the European Court of Human Rights (hereinafter: ECtHR), primarily the filtering mechanism. The first part provides an overview of the development of the human rights protection mechanism before the ECtHR with special reference to Protocols No. 11 and 14. Protocol No. 14 saw the introduction of new offices: a single judge, and so-called rapporteurs who assist the single judge. Many have criticized the work of single judges and non-judicial rapporteurs. The critiques come mostly from attorneys. Such criticism is the subject of analysis in the second, central part of the paper. Does the ECtHR itself violate some of the rights guaranteed by the Convention? The third part of the paper tries to answer this question by analyzing the viewpoints of researchers, but also of legal practitioners, principally Croatian attorneys. The fourth part discusses whether there are further legal means following an inadmissibility decision, after which concluding remarks and recommendations are made on how to resolve complaints and remedy shortcomings of the mechanisms of human rights protection as guaranteed by the Convention.

**Keywords:** European Court of Human Rights, Protocol No. 14, filtering mechanism, individual application

### **INTRODUCTION**

This paper is inspired by the more and more frequent criticism of the mechanisms of human rights protection before the European Court of Human Rights (hereinafter ECtHR, or Court). The criticism comes mainly from the professional community, namely prominent Croatian attorneys with years of experience prior to and following the institution of the filtering mechanism introduced by Protocol No. 14 (2010). Several Croatian independent journalists recognized this problem by organizing a round table on May 29, 2013 entitled "A Critique of the Practices of the European Court in Strasbourg", held May 29, 2013 in Novinarski dom, Zagreb). Serious objections and "charges" against the Court were presented on this occasion. There was certainly no lack of criticism for the ECtHR's work from the scientific community (Gerards, 2014) or the UN Human Rights Committee either.

The aim of this paper is to give a critical review of the working methods of the ECtHR, primarily the filtering mechanism.

The Convention for the Protection of Human Rights and Fundamental Freedoms (hereinafter: ECHR or Convention) was opened for signature in Rome on November 4, 1950 and took effect in 1953. Ratification of the Convention by the Member States of Council of Europe (hereinafter: CoE) is overseen by the ECtHR, which was established in 1959. The mechanism for the protection of human rights before the ECtHR was significantly changed by Protocol No. 11, which entered into force in 1998. Protocol No. 11 enabled the direct access of individuals to the Court, which resulted in a substantial increase in the number of applications. The accession of transitional countries in eastern and southeastern Europe further led to the Court's overload. It was necessary to make modifications in the mechanism to prevent the collapse of the entire system. To this end, the CoE adopted Protocol No. 14, which entered

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into force in 2010. Among other things, Protocol No. 14 saw the introduction of certain new offices: firstly, a single judge who may declare inadmissible or strike out of the Court's list of cases an application submitted under Article 34, which decision can be taken without further examination and is considered to be final. The second office involves the so-called rapporteurs who assist the single judge (Convention, Art. 25). Both offices have been established with a view to filtering cases before they reach the Court. Many have criticized the work of single judges and non-judicial rapporteurs. The criticism comes mostly from attorneys, and will be the subject of analysis in this paper.

The paper is structured into four parts. The first will provide an overview of the development of the human rights protection mechanism before the ECtHR, with special reference to Protocol No. 11, which enabled the direct access of individuals to the Court and resulted in a substantial increase in the number of applications. The second, central part of the paper will deal with the filtering mechanism as established by Protocol No. 14. The third part of the paper will try to answer the question of whether the ECtHR itself is in breach of the Convention by analyzing the viewpoints of both researchers and legal practitioners (principally Croatian attorneys). The fourth part will discuss whether there are further legal means following an inadmissibility decision, after which concluding remarks and recommendations will be made on how to resolve complaints and remedy shortcomings of the mechanism of human rights protection as guaranteed by the Convention.

### **THE DEVELOPMENT OF THE MECHANISM FOR THE PROTECTION OF HUMAN RIGHTS BEFORE THE ECtHR**

The European Convention for the Protection of Human Rights and Fundamental Freedoms (hereinafter: the Convention) was one of the first fruits of the European integration following World War II. The Convention was adopted under the auspices of the Council of Europe, at the time a newly established international organization seated in Strasbourg. It was created as a result of efforts to regulate the protection of human rights and fundamental freedoms at the European level, and to establish a system of shared values as a basis for future European unity. When it came to adopting the text of the Convention, a battle was fought over its contents. The resulting compromise consisted of ten fundamental rights and freedoms, which were the acceptable minimum to all signatory states. From the start, there was also the idea of establishing a supranational court that would oversee the compliance of Member States (MSs) of the Council of Europe with the Convention. The problem was the question of what powers that body would have and whether individual applications should be allowed or not. Compromise was reached by giving the MSs the option to choose whether they want to accept the jurisdiction of the ECtHR for individual applications or not. However, if the states opted to allow individual applications, individuals were not allowed immediate access to the Court, but given the option to address the European Commission of Human Rights, which would then review the application and forward the cases they deemed to be well founded. The immediate right to institute proceedings before the ECtHR was thus assigned to the European Commission of Human Rights and MSs. The Commission began its work in 1954 and the ECHR in 1959 (Omejec, 2010).

The Convention is amended by way of protocols. There are two types of protocols: substantive and procedural (Omejec, 2010). Substantive protocols are used for supplementing the catalog of fundamental rights and freedoms, and procedural protocols are used for changing the very mechanism for the protection of rights guaranteed by the Convention. The protocols that are relevant for this paper are procedural, Protocols No. 11 and No. 14, which will be analyzed in detail. The precondition for their entry into force is general ratification from all MSs of the Council of Europe.

Protocol No. 11 was adopted in 1994 and entered into force in 1998. It substantially altered the human rights protection mechanism (Omejec, 2010). The key, but not the only, changes that the Protocol introduced included the possibility of submitting individual applications and the abolition of the Commission of Human Rights. By allowing individuals direct access to the Court, the number of applications increased year after year. The statistical data is interesting. Between 1954 and 1998 there were a total of 121,161 individual applications, and in the years between 1998 and 2003 there were 175,397. It is also interesting that between 1959 and 1997 the Court issued 33,012 decisions, compared to 62,475 between 1998 and 2003 (Annual Report, 2004). In other words, within just five years, both the number of applications and the number of cases on which the Court issued a decision increased significantly.

In the meantime, after 1998, a number of eastern and southeastern European countries acceded to the Convention. Individuals from those countries “flooded” the Court with numerous applications. A large portion of the applications from said countries were a consequence of an unregulated judiciary and frequent human rights violations.

The Court became overburdened and the effectiveness of its work was brought into question. To avoid the collapse of the entire system, it was necessary to make certain changes in the Court’s procedure. To this end, the CoE adopted Protocol No. 14, which took effect in 2010 and which, among other things, introduced new offices that are relevant for the topic of this paper. The first was the single judge. The second office were the (non-judicial) rapporteurs who prepare the case for the single judge. The two offices were introduced with the aim of filtering out the inadmissible cases from the mass.

A new admissibility criterion was introduced that referred to the degree of the disadvantage suffered by the applicant, aiming to dissuade those who did not suffer significant disadvantage from applying (Convention, Art. 35(3)b). The introduction of this criterion was deemed necessary due to a growing number of cases before the Court. It serves as an additional tool for focusing on cases for which an examination of the merits is required. In other words, it allows the Court to reject cases that are considered “lighter” based on the principle that judges should not have to decide such cases (*de minimis non curat praetor*). Although there are two related protective provisions, this new admissibility criterion is subject to numerous criticisms. The debate thereon would go beyond the scope of this paper and will therefore be omitted. The filtering mechanism and the role of the single judge is examined below.

## **THE FILTERING MECHANISM FOR INDIVIDUAL APPLICATIONS**

As previously mentioned, due to a large number of cases and the threat of congestion of the entire mechanism of protection before the ECtHR, it was necessary to implement certain reforms. Protocol No. 14 was adopted to that end, but its entry into force was stalled by Russia until 2010. The Protocol introduced a mechanism for filtering individual applications by the single judge (Convention, Art. 27), assisted by so-called (non-judicial) rapporteurs.

While the inadmissibility of individual applications used to be decided by a Committee of three judges, nowadays it is decided by the single judge.

The Court may thus examine applications that have been referred to it as a single judge, as a Committee of three judges, as a Chamber of seven judges or a Grand Chamber of seventeen judges (Convention, Art. 26(1)). When sitting as a single judge, the specific judge cannot examine the cases coming from the state on whose behalf he was elected (Convention, Art. 26(3)).

The single judge decides on the admissibility or inadmissibility of individual applications. The decision of the judge on inadmissibility is final and has the effect of striking out cases from the Court’s case list. However, even if the single judge declares a case

admissible, all other instances, i.e. councils, are also authorized to declare a case inadmissible at any later stage if inadmissibility is established during the proceedings (Convention, Art. 27).

Based on the conclusions of the 2010 Interlaken Conference, the Court set up a Filtering Section at the Court's Registry (Interlaken Declaration, 2010). The Section oversees the filtering of cases coming from Russia, Turkey, Romania, Ukraine and Poland, the countries accounting for 50% of the total number of cases before the Court. The Section began its work in 2011 and has proved to be very successful.

The Court itself confirms that the measures introduced by Protocol No. 14 have been successful in dealing with the backlog. On September 1, 2011, the backlog consisted of over 100,000 cases, whereas on October 1, 2013, the backlog was 38,200 what is evident from the Press release issued by the Registrar of the Court (2013). This means that 61,850 cases were resolved in two years. Assuming that a month has 22 working days, if multiplied by 24 months, the number of working days in two years is 528. If we divide 61,850 cases with 528, it may be construed that the Court dealt with 117 cases every day. At that time, there were 36 appointed single judges. It follows that each judge examined an average of 3.25 cases per day. This begs the question: is this realistic, and were certain standards adhered to?

Certain countries support the existing filtering mechanism and even advocate more stringent criteria. In our opinion, this proves that the countries that are far ahead in terms of the protection of fundamental human rights and freedoms do not comprehend the problems faced by countries in transition. These countries mostly advocate very stringent filtering criteria without considering why there are so many applications from certain countries in the first place. We will give an interesting example. In 2011, the Dutch Justice Minister proposed three bizarre solutions to prevent the submission of ill-prepared and *manifestly unfounded applications*. The first measure he proposed involved fines for submitting multiple manifestly unfounded applications; the second called for disciplinary measures against an attorney if the application could be considered an abuse of rights; and thirdly, he advocated the introduction of fees for submitting an application. The Dutch "Adviesraad Internationale Vraagstukken" (AIV) strongly criticized these proposals. The AIV is an independent body consisting of experts who advise the Dutch government and parliament on foreign policy. The first proposal of AIV posed a serious threat to the submitting of individual applications in general, as it is very hard for an individual, if not impossible, to estimate whether their application is founded or not. After submitting the application, the individual cannot influence the outcome of the proceedings and the only way to safely avoid the fine is not to submit the application at all. The second measure could discourage attorneys from representing parties, even when there is high confidence that rights have been violated. The AIV believed that Dutch law already provided for disciplinary measures against attorneys and that new sanctions were not necessary. Lastly, the third measure would hit the most vulnerable categories of citizens the hardest (Advisory letter, 2011).

The above proposals of the Dutch Justice Minister were contrary to the Court's decision in the case *Airey v. Ireland* (1979)<sup>2</sup>, wherein the Court defined the right of access and said that the purpose of the Convention is to guarantee rights that are practical and effective, not theoretical or illusory.

## **ON THE POTENTIAL VIOLATION OF CERTAIN RIGHTS GUARANTEED BY THE CONVENTION BY THE ECTHR ITSELF**

The first question is whether the filtering of applications by the single judge represents a step back to the old "dual track" system. Has the single judge assumed the earlier role of the Commission for Human Rights, which was abolished in 1998?

In terms of the number of rejected applications from countries in transition, the statistics are alarming. Around 90% of applications are rejected. This raises the question of whether

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<sup>2</sup> [1979] 2 E.H.R.R. 305.

there are two categories of citizens: those from regulated countries (e.g. Switzerland), who submit up to five applications a year, all of which are examined, and those from countries in transition, whose applications are rejected in 90% of cases (Grčar, 2014). Should the citizens suffer the consequences of unregulated judicial systems?

Representatives of the MSs of the Council of Europe met in 2010 in Interlaken (Switzerland) to discuss the future of the Court and the large case backlog it had amassed due to the large number of inadmissible applications. In a solemn declaration, they reaffirmed the central role of the Court in the European system of protection of fundamental rights and freedoms and undertook to increase its effectiveness while preserving the principle of individual applications.

Emphasis was thus put on the importance of preserving individual applications. An agreement was reached under which applicants were given comprehensive and objective information on the application process and the admissibility criteria. For this purpose, the Court published the so-called *Practical Guide on Admissibility Criteria* (2011).

The Court thereby demanded that countries refrain from impeding access to the Court in any way. But could it be that the Court had done this itself? Does the Court enjoy too much discretion in assessing admissibility of applications? Are the admissibility criteria objective and transparent? Are the criteria the same for everyone? All these questions are open for discussion.

Furthermore, when the single judge rules on inadmissibility, the applicant is notified thereof in the form of a “letter”. The letter states the following:

*Having taken into account the submitted documents and to the extent that the said documents fall under the jurisdiction of this Court, the Court has found that admissibility requirements pursuant to Articles 34 and 35 to the Convention have not been met* (Grčar, 2014, p. 9).

There is no formal, reasoned court decision. The letter only states that formal admissibility requirements have not been met in accordance with Articles 34 and 35 to the Convention, but it does not specify the exact requirement(s). We are of the opinion that including the reasoning behind the decision would serve as an additional guideline for cases in which applications need not be submitted simply because they will be rejected as inadmissible. This would prevent the submitting of unfounded applications.

In this regard, it should be noted that Article 45 to the Convention expressly provides the following: “*Reasons shall be given for judgments as well as for decisions declaring applications admissible or inadmissible.*” The Court thus delivers judgments on merit, and issues decisions on the admissibility or inadmissibility of an application. Both instruments should be reasoned. The absence of reasons represents a potential violation of Article 45.

Next, some Croatian attorneys claim that, in practice, the “filtering” process is carried out by non-judicial rapporteurs who are not judges and who do not have the legitimacy to decide admissibility, which in turn directly violates Article 6 to the Convention. Article 6 guarantees that “[...] *everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law [...]*”. This “fairness” is a standard that has been imposed on the MSs, and is one that definitely applies to the Court itself (Uzelac, 2010). It is indisputable. However, the above claim of the Croatian attorneys is incorrect. Non-judicial rapporteurs only prepare the basis for the decision of the single judge and do not issue decisions themselves.

Certain attorneys go as far as to claim that the admissibility of an application is decided upon by officials who were sent by the Croatian Government, which calls their independence and impartiality into question. So, Prodanović said:

*I believe that it is contradictory that the officials sent to Strasbourg by the Croatian state arbitrarily examine complaints of Croatian citizens who were violated by the Croatian*

*state. Guided by these regulations as well as by simple logic, the officials will represent the interests of those who provided them with good employment in Strasbourg and not of those whom they should be pro forma protecting.* (Grčar, 2014, p. 54)

The author cannot agree with these allegations because it is necessary to be familiar with the method of appointing of non-judicial rapporteurs. They are appointed by the President of the Court on the proposal of the Court Registrar and they form part of the Court's Registry. They are appointed from among the most experienced Registry lawyers, who are in turn appointed and employed by the Court itself, and not the MSs. This hypothesis should hence be dismissed. Furthermore, certain attorneys remind us of the need to distinguish between formal and substantive preconditions of access to the Court. Legal doctrine teaches us that applications are dismissed for formal deficiencies and rejected for substantive ones. When a single judge decides that an application is inadmissible for being manifestly unfounded, it *de facto* implies a substantive deficiency. Even though the decision on inadmissibility and the decision that there is no violation has the same effect on an individual, they are very different from a legal point of view. Review by the Grand Chamber is possible only for Court judgments and not for inadmissibility decisions. Although it is not probable that the Grand Chamber will accept a request for review, the possibility exists in case of decisions on the merits. Here we can agree that dismissal on grounds of substantive deficiency is disputable.

Certain applicants also claim that the Court did not allow access to the case file. That was the situation in case *Bačoka v. Croatia* (2013)<sup>3</sup>. If this is true, we believe that it violates Article 40 to the Convention, which guarantees that hearings will be public and documents accessible.

Lastly, the attorneys see much controversy in the fact that the letter delivered to the applicant is not even signed by the single judge, but rather the advisor, i.e. the non-judicial rapporteur (Grčar, 2014).

Considering all the above, the question is does the ECtHR itself seriously violate the rights under the Convention? This argument was presented at the previously mentioned Roundtable held on May 29, 2013 at Novinarski dom in Zagreb.

We believe that certain attorneys' arguments are justified and reasonable and others exaggerated, and that there is no gross violation of the Court to speak of. Despite certain justified arguments, we are of the opinion that such a conclusion is overblown.

## **FURTHER REMEDIES FOLLOWING AN INADMISSIBILITY DECISION**

As already pointed out, the decision of the single judge on the inadmissibility of an individual application is final and has the effect of deleting the application from the case list. A request for review by the Grand Chamber is not possible. As far as Strasbourg goes, individuals thus have no other options. The question is: can the individual seek "justice" before a different international court or body?

The individual may address the United Nations Human Rights Committee (HRC). The HRC is a body of 18 experts who are elected for a term of four years and who oversee the implementation of the International Covenant on Civil and Political Rights by the signatory states. The Republic of Croatia is a signatory of the Covenant, as well as of the First Optional Protocol to the Covenant of 1976. The signatory states must submit periodic reports on the implementation of the Covenant, and the HRC examines the reports and adopts recommendations in the form of concluding observations. The HRC meets in Geneva three times a year. The HRC may consider inter-State complaints, and the First Protocol provides for the possibility of submitting individual complaints as well. Without going into the details of

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<sup>3</sup> Case No. 68449/13, as cited in Grčar, 2014, p. 16

the proceeding before the HRC, we shall focus on the opinion/decision of the HRC in the case *Achabal Puertas v. Spain* (2013)<sup>4</sup> which is relevant for this paper.

In *Achabal*, the HRC concluded that the case that the ECtHR declared inadmissible for being manifestly unfounded was in fact (or should have been declared) both admissible and founded. The decision of the HRC was a big “slap” to the Court. This is the first case in which the HRC examined the working method of the Court by reviewing the reasoning of its decisions on the inadmissibility of individual applications when the reasoning had not been given in the first place. Even though this case was rejected by the Committee of three judges before the entry into force of Protocol No. 14, it is of relevance to us. All other critiques given by the HRC are also applicable in relation to the single judge.

We have pointed out earlier that we find the absence of reasons for the decision to reject applications disputable, and believe making such reasons public would be very useful in the sense of serving as additional guidance to applicants for when not to submit applications. Reasons for decisions on inadmissibility are important for both the internal and the external control of Court decisions; they are the only assurance that the decision has not been issued “illegally” and arbitrarily and that all facts have been taken into account. Reasons are also very important from the viewpoint of fairness for both parties.

The opinion of the HRC is important in terms of criticism of the Court’s case law. In *Achabal*, the HRC said that the reasons for the Court’s decision were insufficient and scant. Furthermore, the HRC harshly criticized the application of the “manifestly ill-founded” standard. Most criteria for rejection are largely formal or procedural in nature. The problem is the condition set out in Article 35(3)(b), which is not a formal but a substantive criterion requiring prima facie engagement in the assessment of facts, i.e. merits. From the efficiency viewpoint, this criterion is very important. The implementation is very useful when, for instance, an individual submits an application concerning facts, which have already been established as not constituting a violation by the ECtHR. When there is previous practice of the Court, therefore, it is not disputed. However, in item no. 370 of the Practical Guide on Admissibility Criteria, the Court itself states: “The reasons given for the inadmissibility decision in such a case will be identical or similar to those which the Court would adopt in a judgment on the merits concluding that there had been no violation (*Mentzen v. Latvia* (2004)<sup>5</sup>). The Guide does not elaborate on this criterion, but rather the Court itself openly admitted that the single judge is guided by the same criteria as the Council of judges in terms of a decision on merits. It would be good to know in what situations the Court applies Article 35(3)(b), and which standards it is guided by.

What we too find debatable is the fact that the single judge may enter into the merits and dismiss an application as manifestly ill-founded without having to provide reasons. The application of this criterion by the single judge is an enigma.

## CONCLUSION

The aim of this paper was to give a critical overview of the working methods of the ECtHR, with special reference to the filtering mechanism of individual complaints.

Regardless of the facts and problems presented herein, we believe that to claim that the Court is intentionally violating human rights under the Convention is an exaggeration. We do not wish to criticize individual judges either. We are of the opinion that these posts are held by highly competent people who are independent in their work.

We have agreed with certain justified criticism from attorney circles and dismissed other arguments. What we do see as problematic is the absence of reasons for the decision to reject an application. The citizens must have an independent and supranational body impartially

<sup>4</sup> Communication No. 1945/2010, U.N. Doc. CCPR/C/107/D/1945/2010 (2013).

<sup>5</sup> Application No. 71074/01, Judgment of 7 December 2004.

examining whether there is indeed a violation or not. We do not wish to assert that the rejected applications should have been accepted and ultimately resolved in favour of the applicant. We did not have access to the records of those cases and it would be frivolous to draw such a conclusion. However, even if we assume that all decisions of single judges were correct, the very *modus operandi* is a concern that in turn raises doubts, especially in those who feel violated. This unfortunately creates a negative image of the Court as a violator of human rights. We personally believe that such a conclusion is overstated, but, due to the high rate of rejection of requests coming from countries in transition, citizens might lose confidence in “Strasbourg”.

We believe that by submitting applications, individuals have contributed to raising the level of human rights protection in certain MSs. This is the case in the Republic of Croatia. Since acceding to the Convention, the level of protection has rapidly increased, but it is safe to say it has not yet reached the level of some more advanced democratic countries. Excessively limiting the access of the individual to the Court does not contribute to the strengthening of human rights protection. It might be that the filtering mechanism is too strict. Had this mechanism existed before, some important cases against Croatia might never have come before the Court.

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## **FASHION FAUX PAS: THE LAW AND ECONOMICS BEHIND THE COPYRIGHT-FREE INDUSTRY**

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### **ABSTRACT**

Apart from being one of the largest and most innovative industries, fashion also acts as a connective tissue between individuals and society. It provides a coherent platform for manifesting identities through its self-expressive nature. With billions of dollars at stake, it is imperative to ruminate over the legal, economic and political integrands of such a tremendously contributive industry. This paper firstly analyses the culture and cyclic nature of fashion as a social locus along with the industry structure. Secondly, it explores the Intellectual Property Protection currently governing key fashion markets, and examines how they instigate commerce and consumer behaviour in these regions. Thirdly, it revisits the highly debated position of IPR in fashion, and conclusively indicates a legal framework that harmonises the fragmented laws to collectively benefit the global fashion scene.

**Keywords:** Fashion, Intellectual Property Protection, Innovation, Clothing Culture

### **INTRODUCTION**

Fashion is an industry that is most visible yet most overlooked. It acts as an illustrator of an individual's self-identity, while visibly marking a social collectiveness. In the constantly changing scene of fashion and style, the only thing that is permanent is the obvious need for fresh designs and trends. One might think that fashion trends are affected by cultural, traditional or other circumstantial factors such as weather. For example, one would need more breathable outfits for summer like skirts or shorts, and warmer clothes such as cardigans and coats for winter. However, we see people in cold countries pairing their denim shorts with stockings and tights and residents of warm nations wearing their cosy baggy sweaters as a single outfit. The application of fashion may have begun due to circumstantial factors, but it no longer is confined to them. Individuals put their own spin on predetermined styles to participate in specific trends (Hemphill and Suk, 2009, p.1155).

This industry is full of puzzling patterns that set it apart from its counterparts. One function of fashion's paradoxical behaviour is its intellectual property (IP) law. While the film, literature and music industries have heavy IP protection under the current legal regime, their combined sales are lower than those of fashion, which has minimal and almost non-effectual protection (Lessons from Fashion's Free Culture, 2010). This puzzling fact is the primary motivator behind this paper. The laws backing the clothing and apparel industry dictate its economics, which are directly governed by its culture and politics. The first part of the paper will provide an insight into the culture of clothing and its sociological aspect as it dictates consumer behaviour through the fashion pyramid. It will clear misunderstandings about the industry's structure, then move onto the legal frameworks of the key fashion markets in the USA, Europe and China, as well as examining the nascent market in India for our second part. It will discuss the effects of existing laws on the commerce of global fashion and suggest a solution by harmonising the fragmented laws in a way that could collectively benefit the global fashion industry.

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## THE FUNCTION OF FASHION

### Birth of Fashion and Its Semiotics

Most of what we know about modern fashion comes from the European Renaissance (Rublack, 2011). Up until this point in time, clothing was just a functional necessity and did not really change. The kind of garments people wore in the Classical era or in Ancient Greece and Rome remained more or less consistent until the Renaissance, when modern fashion came into play (*The Birth of Fashion, 2015*). This period saw an immense diffusion of objects and artefacts, including textiles and apparels. These objects were traded across seas by a huge number of merchants and at such a rapid pace that innovation and differentiation became key for survival and success. Tailoring saw an influx of complex cuts, fabrics and patterns and accessories such as handbags and hats. With the renewal of culture came a consistent change in clothing that we today term as fashion. People during the Renaissance become much more conscious about their appearance for two major reasons: the popularisation of mirrors and an increase in artist's renditions of their subjects. As art rebirthed, art became a form of media and artists' depictions and portrayals became precedents that common men tried to follow. An example of this phenomenon is the *Kleidungsbüchlein* (Book of Clothes), which started as nothing but a collection of 135 watercolour paintings of Matthäus Schwarz as he donned various garments from his twenties to his old age. He specified his waist measurements in all his portraits to appear fashionably slim as he associated weight gain with ageing and a lower appeal (Rublack, 2011). This brings us to the semiotics of fashion and how it communicates individuality to a society. Fashion and clothing not only dictate social ranks; they also communicate ethnicity, religion, political affiliation, marital status and even suggest gender roles. In modern times, clothing also suggests music tastes, for example through grunge attire, and often carries religious connotations through veils and hijabs.

### Power Dressing and the Politics of Fashion

As fashion caused constant change in the "look of the day", the elite tried to maintain their higher social rank through finer clothing. The sumptuary laws of medieval times monitored social hierarchy through clothes. They regulated the expense that a certain class could incur on clothing and extended it to the type of materials used or patterns made. This created a structure of class-wise clothing due to the restrictive options that the law provided. This is what came to be known as Power Dressing. Velvets, laces and expensive furs like marten skins were reserved for the upper classes, while the lower classes could only use the remaining scraps and cheaper materials (Rublack, 2011).

Considering how art was a form of media during the Renaissance, with artists depicting the aristocracy in paintings and portraits, the poorer classes tried to emulate their style in their own way while striving for social acknowledgment. As these social climbers borrowed elements from the fashionably forward, the latter immediately looked for a newer trend to set themselves apart all over again. This is essentially the crux of fashion politics: a constant cycle of innovation and diffusion (Hemphill and Suk, 2009, p. 1164-1166). Fashion is a very different concept from clothing. Clothing is to a large degree motivated by the need to cover one's body to stay warm or for other bodily needs, whereas fashion is more 'positional' as a symbol of self-expression and status. As a designer or a stylist put up a look together, there will be early movers who want to stay ahead in the fashion game and quickly adopt the new style. Likewise, there will be many who want to follow their style but cannot afford the lavish designer version, so the lower end brands recreate those looks for mass consumption. As these styles trickle down the hierarchy and become mainstream, the elites again look for the next new thing to differentiate themselves and create a demand for a new innovation. This is where the conventional idea of IP protection backfires. IP protection is meant to provide an incentive to innovate; and yet, if fashion had such protection, styles would never trickle down the market,

create trends and stimulate the need to innovate. This is what is known as the Piracy Paradox. This phenomenon has been beautifully explained by Raustiala and Sprigman (2006, p. 33-34). People are looking to be distinctive while following a certain trend, so they flock towards a fad while adding an individualistic spin to it in an attempt to stand out. This pull between being a part of a collective craze and yet leaping out of a crowd is what fashion thrives on.

### **Consumer Behaviour**

When a consumer is looking to partake in a trend, they are not necessarily doing it with an imitative motive. It is mostly due to their desire to be “in fashion”. Who decides what is “in fashion”? It is dictated by the people in power in terms of wealth and aesthetic influence. Designers show their collections at the catwalk not with the intention to sell them but to make a statement. Most of the outfits we see in fashion shows are not functionally wearable; they are more art than clothing. It is a PR move to attain prestige and a certain status. Once these pieces are showcased, they form what is inherently “fashion”. What happens next is that lower end designers and brands take the popular elements from these works of art and make them more functional. Over time, as these concepts make their way to the bottom of the clothing hierarchy, the bizarre elements disappear, while retaining a significant similarity between the clothes on sale and the costumes on the catwalk. This is what fast fashion is all about. The success of brands like H&M, Zara, Topshop and others is based on their ability to take these trends and convert them into a more everyday outfit at a lower cost. Forever 21, another fast fashion retailer, has been the focal point of numerous lawsuits for violating the IP protection of high-end designers and fashion houses. What these designers and houses do not realise is that consumers further down the supply chain would not even recognise their designs if it were not for these fast fashion giants. They help in diffusing the styles created by the designers to the lowest end of the pyramid by recreating them, and therefore play a major role in setting trends. This in turn drives sales for the fashion show designers too, considering how the elite would not buy from a lower end brand and want to differentiate themselves from the masses. The elite will demand a new style quotient because the previous one is no longer exclusive. Fast fashion actually helps the high-end brands. The trends actually reduce the search cost of style. The lack of IP protection in the industry is what allows this quick diffusion of trends and gives an incentive to innovate. If the laws were more stringent, trends wouldn't develop and they would not die out, which – contrary to popular belief – would halt innovation and not promote it.

## **IP LEGISLATION GOVERNING KEY FASHION MARKETS**

### **The European Union**

Europe has always been the creative capital of the world. As the birthplace of fashion and a cradle of ideas, the EU decided some time ago that fashion was no less important than any other art form and needed protection. They implemented a blanket law across the EU for design protection. Since 2002, the EU has provided a dual protection system: registering for up to 25 years in 5 year blocks at a cost of 350 Euros per block, and an unregistered, 3-year protective term (Woods and Monroe, 2015). The law protects designs that are “novel” and have an “individual character”, which is defined by whether the overall impression of the piece is different from other available pieces to an informed user. The key term here is “informed user”. A dress in a particular fabric with a scooped neckline, and another in the same fabric with a V-neck, may be similar to an uninformed user, but to a fashion enthusiast or aesthete they are entirely different garments and hence applicable for protection. What this does is lower the threshold required to be distinctive enough to obtain design protection. This renders the entire point of copyright futile, because with the minutest changes in the design one can patent something as their own (*Lessons from Fashion's Free Culture*, 2010). The unregistered design protection is also granted to designers. As soon as a design is showcased, the design automatically has a 3-year protection at zero cost. Why would one spend large sums on lawyers

and registration when one is clearly able to acquire immunity against dead copies? Yes, unregistered community designs only protect one against “line-by-line copies” and not slightly similar or influenced copies. Majority of fashion designers believe that a fashion season lasts only a couple months. In an industry as ephemeral as fashion, you cannot protect something that is going to die anyway. Registered protection takes up a lot of time, which fashion does not have to begin with. This involves spending money that would be better spent on designs for the next season.

Europe’s IP law has two sides: copyright protection and *sui generis* design rights protection (Monseau, 2011, p. 61-63). Designers have a choice to obtain either or both under the cumulative protection. However, the lines between the two concepts are not very clear, and often the courts of the member states fail to recognise the difference between copyright’s “originality” requirement and design’s “novelty” and “individual character” requirement. A prime example of this is *SAS Chaussures v. SARL Menfort (Fr.)*, 3 June 2011.

### **The United States of America**

To date, the United States has no particular copyright protection for fashion. This is due to its perception of fashion as “utilitarian” and “functional” rather than as a work of art (Shirwaikar, 2009, p. 115). This does not mean there is no protection whatsoever; the USA has one of the strongest IP systems in the world. It just means that the threshold for obtaining a copyright is too high. One would have to prove that nothing like their design has ever existed in human history to get legal protection.

However, designers have found ways around this. It is difficult to get protection for the functional aspects of a garment, like sleeve or a collar, but the pictorial or sculptural aspects of it that affect functionality can be protected. For example, Burberry plaid has been granted copyright. This concept is called conceptual separability: a design that demonstrates an idea separate from the clothing’s function, or an addition that is not meant to enhance the functionality of the clothing (Woods and Monroe, 2015).

Congress proposed the Design Piracy Prohibition Act (DPPA) in 2009 and the Innovative Design Protection and Piracy Prevention Act (IDPPPA) in 2010 to amend the Copyright Act and create a *sui generis* protection law for fashion designs. It is important to dwell on how these bills will help the industry. The IDPPPA proposes amendments to the earlier DPPA that may prove helpful for the American apparel industry (Ellis, 2010, p. 195-198). The very beginning of fashion in America started with imitations and knock-offs of Parisian couture. When an industry’s roots are in the culture of copying international fashion, it seems hypocritical to demand copyright protection to secure the interests of domestic designers. In 1932, the Fashion Originators Guild was established in the US to combat design piracy among American designers, but copying from French designers was permitted. The guild became defunct after the Supreme Court decided that the guild was violating the Sherman and Clayton Acts. Diane Von Furstenberg and other elite designers running the Council of Fashion Designers of America (CFDA) are asking for a more widespread copyright protection along the lines of France and the EU (Shirwaikar, 2009, p. 115). However, there is enough evidence that this is not what the entire American fashion industry wants. The California Fashion Association has made it clear that they do not want legal protection for fashion, and the American Association of Footwear and Apparel (AAFA) took a vote on the subject but could not reach a unanimous decision (Raustiala and Sprigman, 2009, p. 1123). A low-IP regime has a few downsides for the industry, but not without considerable benefit.

### **China**

China is the prime manufacturing hub of the highly globalised fashion industry, while also being a cradle for counterfeit clothing. It thus becomes a key market whose legal framework in terms of IPR needs to be studied. We know how the EU and the US have strong and efficient

trademark laws in place. China, however, has a very different approach to trademarks (Lin, 2013). China has a first-to-file rule, meaning that the first person to apply for the trademark gets it. If a Chinese brand or company files for a trademark belonging to some international brand, therefore, it will be impossible for the latter to retrieve their trademark in China. A common problem this creates is trademark squatting. Individuals in China target known foreign brands and register them as trademarks in China, so that when international companies want to sell their product in China, they either have to pay huge sums of money to buy it back or indulge in long legal battles. Michael Jordan has been a victim of trademark squatting; a Chinese company called Qiaodan Sports Co. used a similar name, as the literal translation of Qiaodan is Jordan, pronounced in a similar way. It also used an identical logo to Michael Jordan's Nike-produced brand, Air Jordan, depicting a jumping basketball player. Jordan's claims were dismissed by the Chinese courts, which argued that "Jordan" is a popular western surname, "Jordan" is not the only interpretation of Qiaodan, and the logo did not possess any distinctive features that could be linked to Michael Jordan. These laws have been beautifully detailed by Bayntun-Lees (2015). Design patent laws in China differ from the ones in Europe, as China only provides registered protection that takes around a whole year to acquire and lasts for a maximum of 10 years. A design that enjoys unregistered protection in Europe also cannot receive a design patent in China if the design has already been made public. Copyright is fairly easy to obtain, considering how China is a part of the Berne Convention. Hence, the creator will automatically enjoy copyright protection in 164 member countries. The design registration will only add a proof of ownership and help in case of conflicts that may arise due to China's formal approach towards IP. The cost of paying for a trademark seems small when compared to the losses one may have to incur without one.

### **India**

India has a very rich art and textile heritage due to its diverse cultural influences, and has a lot to offer the global fashion industry. However, in terms of copyright protection, India is still at a nascent stage. Shishir Tiwari (n.d.) has done impressive research over IPR protection of fashion design in India. Protection was initially confined to production houses like Satya Paul and Kimaya, but now individual designers like Ritu Kumar, JJ Valaya and Manish Malhotra are recognising the importance of copyrighting their works. Most of them realised the value of IP after being targets of counterfeiting at the hands of their distributors or collaborators. Ritu Kumar sued Pramod Kanodia for commercially distributing her fabric designs like "Kulah", "Ambi Bandhini" and "Sangmarmar". The Fashion Foundation of India (FFI) is a body formed of leading fashion houses that work along the same lines as the Fashion Originator's Guild of USA (Shirwaikar, 2009, p. 119). The Indian fashion industry is deeply rooted in the country's heritage. Most designers take inspiration from traditional motifs and crafts and create contemporary outfits to keep the "Indianness" of the clothing prominent. When a significant number of creators are influenced by ancient techniques and craftsmanship like dyeing, block printing and other indigenous methods like *chikan kari* or *phulkari*, one can notice significant similarities even if one does not do it with the motive of copying. Even though artwork and handicraft do not come under the purview of IPR, India has a decent IPR regime. It provides protection under the Designs Act 2000 and the Copyright Act, 1957 along similar lines as in the EU, but only for the non-functional aspects of clothing, as in the US. Another interesting protection it offers is under the Geographical Indications of Goods Act 1999, which protects indigenous art forms like the Kasuti Embroidery of Karnataka or the Kutch embroidery of Gujarat due to their regional significance (Shirwaikar, 2009, p. 120). This protection not only includes the apparel aspect, but also the artistic value of the product. Indian designers are only now realising the value that these protections can bring. Indian fashion houses are often more poorly valued than they deserve, because they usually never acknowledge the potential of protected products in terms of their extensions, licensing, or endorsements.

## WHAT NEEDS TO BE FIXED?

We have gone over the culture of fashion, how it is legally protected in various markets and how it drives the economics of the regional industry. We can now move on to the most important part of the paper, where we interrelate the various aspects discussed and examine what exactly is going wrong and what needs to be fixed in terms of the legal regime.

### Counterfeiting vs Copying

Most “stronger IP for fashion” crusaders claim that the reason behind their demand is the huge losses the industry incurs due to counterfeiting. Counterfeiting is defined by the Legal Dictionary as a copy or imitation of something that is intended to be taken as authentic and genuine to deceive another. We have already seen how each country has an efficient law regarding trademark protection in fashion. Trademark protection is fairly easy to obtain and lasts as long as used commercially and defended against infringement. The counterfeit losses that we are talking about can thus be fought against with or without stronger copyright and design protection.

Knock-offs or copies are the next concern for pro-IP propagators. Knock-offs, as per the legal dictionary, are an unauthorised copy or imitation. They are a cheaper version of an expensive or known product. This is something that is not protected efficiently in any of the markets. While the US demands IP legislation similar to that of the EU or Japan, what they fail to realise is that, even if the European laws protect a wider range of fashion designs, they are not really effectual. This is because the unregistered design protection offered by the EU decreases the stringency threshold for novelty and only protects the design against dead copies. One can thus make the most miniscule of changes to an already registered design and get another registration. This minimal novelty requirement renders the entire point of obtaining a copyright or design patent useless, and makes it similar to the law in the US, considering the very high novelty threshold (*Lessons from Fashion's Free Culture*, 2010). Even the registered community design of the EU is not that effective, considering only about 8% of the total registrations are for clothing. If designers truly thought that the registration of designs is helping them, there would be a higher number of applicants and registered designs. The reason behind this low registry is timing.

### Time Constraints and Fast Expansion

The fashion industry is fast moving by nature. Before a trend can take root, it is washed away by a new one. In an industry as transitory as fashion, the very idea of copyright seems futile. Fashion is born with an expiry date. According to the IP WatchDog, on average, design registration can take up to 25 months. Registration of designs under the current legal umbrella in China not only takes up an entire year, but the design also needs to be undisclosed (*Understanding and Using China's Design Patent*, n.d.). A designer creates an original design to create a new trend, applies for registration, and does not get one till two fashion cycles have gone by. By the time the registration is approved, it is too late, and the designer is left with a copyright for the coming ten years only to realise that the trend has already passed. Protection of designs in Europe and Australia last up to 25 and 10 years respectively, with renewal possible every 5 years (Monseau, 2011, p. 57). Such long protection regimes make it difficult for fashion to evolve, because no other designer can now try to recreate or take up elements of the design and re-launch it; nor has this protection helped the designer in any way. The fast fashion chains, through their immediate influx of the latest trends, further the cycle of fashion. They inject new ideas into the market at a blinding pace, causing consumers to demand newer designs at a faster rate. This proves just how momentary the designs are and how there needs to be a fast-track process for obtaining design rights, for a term that takes the trend cycle into consideration. Furthermore, China's first-to-file policy and trademark squatting represents a major hindrance to companies wishing to expand into the Asian market.

### Who is IP Actually Helping?

Even if we do end up getting stronger, more stringent IP protection, who is it truly helping? Pro-IP propagators claim that the low level of protection is hampering new and upcoming designers. Yes, forthcoming designers need to scramble for a market place in the industry, but that is a trait observed across all industries and has nothing to do with fashion's loose IP. On the contrary, stronger laws will put them at a disadvantage, considering how the newcomers are poorly-funded. They do not have the money and power that large fashion houses do and can often be exploited by large corporations. This does not mean the lesser-known designers are always victims. They can be plaintiffs as well as defendants, but stronger IP laws will not benefit either party; it will benefit the lawyers alone. When talking about a stricter legal regime for fashion, it is always the designers whose interests are taken into consideration. Consumers, distributors, and retailers drive the industry as much as the designers do, and their interests should be factored in. The CFDA is largely made up of designers, and their opinion cannot be interpreted as the opinion of an entire industry (Raustiala and Sprigman, 2009, p. 1123). The elite designers and fashion houses are looking at monopolising the industry. They have now begun to cater to different income-groups through their diffusion line. For example, Giorgio Armani's signature line is now accompanied by Armani Collezioni, Emporio Armani and Armani Exchange. The fashion industry, unlike its counterparts is very decentralised. We need to acknowledge the fact that the terms "new" and "original" don't adhere to their conventional meanings when it comes to fashion. As David Wolfe suggested, "It is impossible to create a new textile, a new print, but a new design is almost impossible because all we are doing in creating a new one is putting together existing elements in a different way." There exists a highly symbiotic relationship among the contributors to the fashion industry. Designers are inspired by vintage designs, recreate the works of older designers, interpret or reference a contemporary's work, or collaborate with design chains. Balmain x HandM is a classic example of a collaboration. A luxury French fashion house teamed up with an alleged knock-off chain and created an accessibly-priced collection to reach a wider audience. The benefit for a fast fashion giant and a luxury label through such an alliance is mutual. The belief that fast fashion chains are eating away at the sales of high-end brands is baseless, considering a consumer who could afford Versace would not be shopping at Zara for a knockoff. We need to emphasise that both are targeting a different clientele, and that collaborations are a neat way of entering each other's markets. Repurposing and refurbishing are at the core of the industry.

### CONCLUSION

The primary idea behind IP law was to enhance creativity and innovation, not reduce copying. That requires stronger jurisprudence. The industry has thrived without IP for years and will continue to do just as well, and maybe even better, without it, as demonstrated by Raustiala and Sprigman (2007). Scholars like Hemphill and Suk (2009) have argued in favour of copyright laws but have failed to realise the very alternative approach that is required to make such laws a reality. Fast-track procedures, shorter time periods, cheaper fees and, most of all, harmonisation across international borders needs to be achieved. To fill in the negative space of IPL that surrounds fashion, lawyers and policy makers need to start with a blank slate, erasing all previously applied knowledge of IPR in other creative industries and formulating laws specific to fashion, if they truly wish to advance the industry. The crucial question that this paper raises in terms of IPR is: can one size really fit all?

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## SHAREHOLDER PRIMACY AND CORPORATE GOVERNANCE: A UK PERSPECTIVE

MR. ANURAG VIJAY<sup>1</sup> AND NIDHI SINGH<sup>2</sup>

### ABSTRACT

Corporate governance is the system by which companies are directed and controlled. Broadly, corporate governance can be categorised into two major systems: (a) the Anglo-American “outsider” system represented by the United Kingdom and America, and the Continental “insider” system exemplified by Germany and Japan. The recent decade has seen advancements in technology, production and growth in trade. With the increase in international trade, a need has been felt for better corporate governance. In the 1990s, Europe witnessed a greater rhetoric of Anglo-American shareholder primacy as a result of the superiority of the Anglo-American regime. This in turn also affirmed the belief of many scholars that the Anglo-American corporate governance system featuring shareholder primacy would become the formulation of best corporate governance practices. This belief was challenged after a series of scandals in the new millennium revived the “stakeholder” argument.

The stakeholderism perspective is palpable in the growing shareholding concentration and stakeholder-related information disclosure under the Anglo-American corporate governance practice. However, there has been a persistent debate in the UK over whether shareholder primacy should continue to take precedence. It appears the UK has taken a *third way that merges elements of the shareholder and stakeholder approaches*. For example, many stakeholder proponents have considered the Enlightened Shareholder Value (ESV) principle under the UK legislation as a sign that the UK is departing from the shareholder-orientated pattern.

Interestingly, many also believe that the financial crisis was attributable to the overriding shareholder primacy paradigm. In light of the recent developments in the field of global corporate governance practices, the paper seeks to contribute to the recurring theme of the objective of the corporation by exploring the origins, recent changes and future developments of the corporate objective (more specifically, shareholder primacy) in the UK context. In doing so, we will conduct a study of the characteristics of UK shareholder-orientated rules and recent changes in the field that have impacted the governance structure of companies. The paper aims to give a critical account of the practices reflecting shareholder primacy in the UK in the wake of the financial crisis. The paper also explores the factors that have motivated the UK’s corporate governance regime to move in a stakeholder direction.

The reason for the uniqueness of the UK’s corporate governance is that it is on the boundary of the two models. A drift from the Anglo-American shareholder-orientated regime calls for an examination of UK corporate governance, which is one of the underlying objectives of this paper.

**Key Words:** Shareholder primacy, UK corporate governance, financial crisis, Anglo-American system, corporate governance.

### INTRODUCTION

“Corporate Governance has only recently emerged as a discipline in its own right although the strands of political economy it embraces stretch back through centuries” (World Bank, 1999).

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The term “corporate governance” emerged in the late 1970s in the United States of America after the Watergate scandal to describe the objective of controlling the corrupt overseas behaviour of big companies. Corporate governance has emerged as an independent discipline owing to the surge in hostile takeovers and corporate collapses (Tricker, 2012). There are two models of corporate governance: the Anglo-American model (the United States and the United Kingdom) and the continental model (Germany and Japan). Both models are characterised by their distinct ownership patterns, managerial strategies and structural elements (Aguilera, 2007). While distinguishing between these models, it is important to look into the diverse understandings of the purposes of a corporation. Corporations that operate in Anglo-American countries generally apply the shareholder value paradigm and recognise the maximisation of shareholders’ wealth as their fundamental corporate objective, whereas countries that have adopted the continental approach tend to focus more on the stakeholders, including employees, creditors, suppliers, customers, local communities and the environment (Wen, 2015). Corporate governance norms are critical for realising the macro-economic and social goals in an economy, and usually embrace both the internal governing structures of a corporation and the external forces affecting corporate practice (Cadbury, 2000). If we examine the concept of corporate governance from the perspective of the purpose of a corporation, the shareholder value orientation principle honoured by Anglo-American jurisdiction requires a company to maximise the interests of its shareholders ahead of any other interested party who might have claims against the company (Keay, 2004). As Shuangge Wen writes, corporate governance in the countries led by the United Kingdom is arranged to focus on “dealing with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment” (Shleifer and Vishny, 1997). In contrast, the principal objective of corporate governance in continental systems, exemplified by countries like Germany, is “to ensure the continued existence of the enterprise and its sustainable creation of value in conformity with the principles of the social market economy (interest of the enterprise)” (German Government Commission, 2010). The evolution of corporate governance in the United Kingdom has been premised on the shareholder-orientated pattern. The Cadbury Report, mentioned above, emphasised the shareholder primacy principle. The 1998 Hampel Report followed a similar line of thought and clarified that the single overriding objective shared by all listed companies, whatever their size or type of business, is the preservation and the greatest practicable enhancement over time of their shareholders’ investment (Wen, 2015). The interests of non-shareholder constituencies are incorporated in the UK company law regime, but only as a means of achieving the maximisation of shareholder wealth.

### **WHAT IS SHAREHOLDER PRIMACY?**

The shareholder primacy perspective states that the overriding goal of the corporation is to maximise shareholder value. To understand this idea that a corporation’s sole reason for existence is to make money for its shareholders, it will be relevant to look at the debate between two eminent academics published in the Harvard Law Review in 1932. Professor Berle argued that all powers granted to a corporation or to the management of a corporation are at all times exercisable only for the rateable benefit of all the shareholders as their interest appears (Berle, 1931). This view was supported by Professor Milton Friedman, who argued that “there is one and only one social responsibility of business: to use its resources and engage in activities designed to increase its profits” (Friedman, 1970).

Professor Merrick Dodd challenged Berle’s shareholder primacy thesis. He argued for “a view of the business corporation as an economic institution which has a social service as well as a profit-making function” (Dodd, 1932). Economists usually favour shareholder primacy, viewing it as the key to the capital system, and this view is deeply entrenched in markets worldwide, including in the United Kingdom (Governance Institute, 2014).

## THE UK SHAREHOLDER-ORIENTATED CORPORATE GOVERNANCE MECHANISM

Certain essential components exist within the UK corporate governance framework, which can be said to be premised on the shareholder-orientated pattern. The UK follows the Anglo-American model and has a well-developed market-based system linked to the shareholder value paradigm. Some of the notable characteristics of the market-based economy in the UK include diffused shareholdings, liquidity equity trade, mature equity and security markets and stringent disclosure rules to efficiently inform the market (Hall and Soskice, 2001). It is very obvious to measure the corporate performance under the parameter of maximisation of shareholders' profits: earnings per share and returns on equity capital. As Shuangge Wen also writes, market control via equity is regarded as a fundamental governance means in the UK that facilitates its shareholder-orientated corporate governance practice.

A dispersed share ownership structure has been observed in the UK, with shares widely distributed between among individuals and investment institutions. The average of large shareholdings in the Anglo-American countries is also significantly lower than in continental-based countries. The UK has a significantly lower average shareholding than Germany. This diffused ownership has rendered shareholders passive in corporate governance; they tend to exercise their power via the "exit" choice and leave market forces. To ensure the interests of the shareholders, the ideology of shareholder value orientation has been established, given the relatively weaker shareholder control in the UK.

### THE PREDOMINANCE OF SHAREHOLDER PRIMACY IN THE UK

Prior to the introduction of the Enlightened Shareholder Value (ESV) principle in 2006, UK corporate law comprised both common law and statutory provisions and was significantly characterised by the principle of shareholder value orientation, manifested in a variety of ways. The common law exhibited the paramount significance of shareholders' interests, palpable in the common law construction of directors' duty and the confined regard for the interests of non-shareholder constituencies within the realisation of shareholder primacy in the company law context (Wen, 2015).

#### Directors' fiduciary duty

As discussed by Shuangge Wen in her book on shareholder primacy, the common law is broadly understood to be shareholder-orientated, particularly in the formulation of the loyalty duty of directors (Davies, 2008). The principle of *cestui que trust* states that, although in principle a director only owes his duty to the company, it is widely accepted that a fiduciary director's inherent discretion to act in a way that he believes to be in the best interests of his shareholders is intrinsic to his power (*Boulting v. Association of Cinematography, Television and Allied Technicians* (1963)<sup>3</sup>). The English jurisprudence does suggest that the stakeholder consideration of directors has traditionally been expected, but the approach of the courts tells us that they have been prepared to support the consideration of stakeholders' interests only on the grounds that such a stakeholder consideration would be subordinate to and ultimately serve the interests of shareholders. This means that the interests of the stakeholders will be only taken into account if this course of action ultimately benefits the shareholders. For example, Bowen LJ in the case of *Hutton v. West Cork Railway Co.* explicitly confirmed the importance of employee consideration. Acting on behalf of their interests in corporate operations was strictly qualified: the only circumstances in which the directors might legitimately promote the interest of any other groups or entities were those where to do so ultimately advanced the interests of the shareholders.

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<sup>3</sup> (1963) 2 QB 606.

### **Protection of the interests of non-shareholder groups in UK company law**

As already mentioned, UK companies are managed for the ultimate interest of the shareholders. However, before the introduction of the ESV principle in the Companies Act 2006, in which directors' consideration of various stakeholders' interests is stated as a part of their statutory duty, only two non-shareholder groups' interests (the interests of creditors and employees) were specified in the UK company law regime for directors' consideration and prescribed in such a manner that shareholders' paramount interests would not be infringed (Wen, 2010). Earlier, the statutory protection for the creditors' interests had mainly been provided for in two legal instruments: the Companies Disqualification Act 1986 and the Insolvency Act 1986, both concerned with the performance of delinquent directors in a company approaching insolvency. Under the Companies Disqualification Act 1986, a director could be disqualified if his conduct as a director of an insolvent company made him unfit to be concerned in the management of a company, for instance, by trading to the detriment of creditors' interests (Farrar, 1998).

Traditionally, in English Law, directors owe no duty to any individual member of the company or any other corporate constituencies, including creditors. As stipulated by Dillon LJ, "*A company as it seems to me, likewise owes no duty of care to future creditors. The directors indeed stand in a fiduciary relationship to the company and they owe fiduciary duties to the company though not to the creditors, present or future or to individual shareholders.*" Under the premise of shareholder value orientation, there is a high risk that directors might be held to be in breach of their fiduciary duty if they act for the benefit of creditors' interests instead of those of shareholders. This was succinctly stated by Buckley LJ in *Re Horseley and Weight Ltd*: "*It is a misapprehension to suppose that the directors of a company owe a duty to the companies' creditors to keep the contributed capital of the company intact*" (Wen, 2015; Riley, 1989). However, one can see the utility of creditors' interests being taken into account by directors in appropriate circumstances, such as in situations of actual or imminent corporate solvency.

### **Company law protection for employees before the 2006 framework**

Before 2006, the interests of employees in the UK were mainly protected under the Employment Rights Act 1996 (ERA 1996) and the Employment Regulations Act 1999 (ERA 1999). The first company statute to acknowledge the interest of employees was the Companies Act 1985, which stated that "*the matters to which the directors of a company are to have regard in the performance of their functions include the interests of the company's employees in general as well as the interests of its members*" (Companies Act 1985, s. 309). Two implementing methods were proposed for employee consideration pursuant to s. 309 of the CA 1985. One was based on the stakeholder argument, and suggested a balancing of employee and shareholder interests, including recognition that shareholders' interests could be overridden by employees' interests where appropriate. The other, in stark contrast, suggested that the consideration of employees' interests should be subordinate to the consideration of shareholders' interests. Shuangge Wen has shown that, since its introduction, there has been no judicial decision demonstrating its positive impact in terms of employee protection. If directors chose to act in the interests of employees rather than in the interests of shareholders, they could be held liable for not acting in good faith to promote the success of the company for the benefit of its members (Birds, 2007). The effectiveness and implications of s. 309 were spotlighted by a company law review in 1999. In the view of CLRSG, the interpretation of s.309 as entitling directors to prefer employees' interests over those of shareholders threatened shareholder primary – the cornerstone of company law – and thus was not feasible in the UK context (French, 2007). To avoid any confusion, this section was repealed by the Companies Act 2006 and the consideration of employee's interests is now explicitly confined to situations when such a consideration would be beneficial to the collective interests of shareholders (Companies Act 2006. s. 172(1)).

The Government's White Paper, which had set the tone for CA 2006, stated that "shareholders are the lifeblood of a company, whatever its size". The pre-2006 company law had suggested the inclusion of stakeholder-friendly attributes within the confines of shareholder primacy. This common law path of "*inclusive shareholder value*" was substantiated into the 2006 regime, and it still directs today's practice.

### **STAKEHOLDER DIRECTION IN UK CORPORATE GOVERNANCE**

As the academics have argued, the stakeholder school of thought has presented both theoretical and practical difficulties. Although British law makers have taken the importance of this model into consideration, the stakeholder model has been perceived as losing out to shareholder primacy in the UK company law reform process. This is because of the given flaws of the stakeholder model and its incompatibility within the UK context. However, it might be of interest to look at the degree of stakeholder consideration within shareholder primacy. In fact, the introduction of the Enlightened Shareholder Value (ESV) principle in CA 2006 has pushed the UK in the stakeholder direction.

The basic rules of UK company law were laid down 150 years ago, and the courts have since been insisting on long-term attributes of corporate conduct in line with most stakeholders' interests. It should be made clear that, while emphasising the interests of shareholders, it does not necessarily imply short-term gains, but broadly embraces the benefits that may accrue to "*the shareholders present and future*". This in no way implicates the interests of shareholders at a particular point of time in the future, but extends to cover the collective interests of shareholders over time (Ferran, 1999). As Shuangge Wen also argues, the logic lies in that the goal of long-term shareholder value can only be successfully pursued by developing sustaining relationships with stakeholders (Miles, 2012). Cases like *Hutton v. West Cork Railway Co.* and *Parke v. Daily News Ltd.* support the promotion of stakeholders' interests under the rubric of shareholder primacy (Wen, 2015). When the CLRSO observed "*we do not accept that there is anything in the present law of directors' duties which requires them to take an unduly narrow or short-term view of their functions. Indeed they are obliged honestly to take account of all the considerations which contribute to the success of the enterprise*", it was logically inferring that shareholder value maximisation in UK company law was in keeping with, rather than in conflict with, the interests of stakeholders and wider interests such as the environment and local community, insofar as such considerations are relevant to the maximisation of shareholders' interests (Armour, 2009).

### **RECENT CHANGES IN UK COMPANY LAW AND CORPORATE GOVERNANCE**

The UK has recently been cited as a pioneer in drifting from the shareholder-orientated position towards the continental direction. There have been two significant changes in the landscape of company law and corporate governance in the UK: the introduction of the ESV principle, and the increase in the practice of responsible ownership. Both these changes can be attributed to the integration of stakeholder considerations into the narrowly defined objective of shareholder value. Under the newly enacted Companies Act, 2006, the fresh objective of the company was set out in the new Companies Act as the ESV approach also stipulated in s. 172(1). Stakeholder consideration by directors is now explicitly emphasised, interpreted as a conscious effort to enhance the long-term interests of the company and its members. The recently enacted Companies Act of 2006 is one of the largest piece of legislation ever enacted in the British history. The ESV principle was included in the Act with the intention of bringing about a clear corporate objective for UK directors to aim for in corporate governance, in particular to promote "*a cultural change in which companies conduct their business*". S. 172(1) reads:

(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to—

- (a) the likely consequences of any decision in the long term,
- (b) the interests of the company's employees,
- (c) the need to foster the company's business relationships with suppliers, customers and others,
- (d) the impact of the company's operations on the community and the environment,
- (e) the desirability of the company maintaining a reputation for high standards of business conduct, and
- (f) the need to act fairly as between members of the company.

This section suggests the way a director should operate while running a company. The director should take into account the non-shareholder groups' interests if they are to discharge their general duty under S. 172(1). For the first time in the history of UK law, a wider range of interests additional to those of shareholders (particularly in respect to the long-term well-being of the corporation) has been statutorily recognised. Further, the wording "*promoting the success of the company for the benefit of its members as a whole*" suggests that the stakeholder consideration and the long-term concern required by this provision have the aim of maximising shareholders' benefits. The explicit recognition of non-shareholder groups' interests in s. 172(1) seems to have the ultimate objective of maximising the wealth of the shareholders. This particular provision has been debated by academics. Some have argued that the shift towards the ESV principle is a testimony to the erosion of the Anglo-American shareholder value. However, some have argued in contrast that the newly enacted statutory directors' duty offers little to non-shareholder interest groups over the traditional common law, and that the shareholder perspective remains intact under the new ESV approach (Birds, 2007).

The ESV approach, however, preserves rather than adjusts the overriding objective of UK corporations: the pursuit of shareholder primacy. The enlightened shareholder value approach does not depend on any change in the ultimate objective of companies: shareholder wealth maximisation (CLRSG, 2009).

## CONCLUSION

This paper has asked a deceptively simple question: whose interests should corporations serve? It has thrown light on the existing debate between shareholder value maximisation and stakeholder consideration. It has explored the genesis, recent changes and development of the corporate objective in the UK, i.e. shareholder value maximisation. The first part of the paper has thrown light on the rationale and scope of shareholder primacy in the UK while also discussing the different schools of thought. Some of the essential elements of the UK corporate governance framework are shareholder orientated, for example the market-orientated economy and the strong reliance on takeovers. In the current scenario, a focus on the maximisation of shareholder returns is still considered to be the best possible means by which corporate law can be used as a tool to advance social welfare. The second half of the paper discussed the recent change in UK corporate law: the introduction of the ESV principle. If we look into the pre-2006 common law heritage regarding the scope of the shareholder primacy principle and the current ESV principle enshrined in s. 172 (1) of CA 2006, both suggest that the codified approach is in keeping with, rather than in conflict with, the traditional common law understanding of shareholder primacy (Wen, 2015). It can be deduced that the new statutory formulation rejects the stakeholder approach and has reaffirmed the accommodating and inclusive nature of shareholder primacy in the UK. However, the significance of the stakeholder consideration in corporate governance, and the increasing Anglo-American awareness of the long-term effects of corporate conduct, cannot be denied. Recent legal and policy changes in keeping with the traditional common law framework make explicit the inclusive nature of shareholder value rather than threatening its primacy (Wen, 2015). The welfare priority of shareholders will always remain sacrosanct in the corporate governance

framework. The post-financial crisis scenario has witnessed intensified calls for directors to be more pro-active and accountable in future corporate governance across the Anglo-American regime. Even in the near future, an emphasis on stakeholder consideration in the context of promoting member benefit is likely to remain. The shareholder value is deeply ingrained in the UK both in theory and case law practice. As discussed above, some of the essential characteristics of the UK corporate governance system (dispersed ownership, ultimate shareholder decision rights and a liquid market) are all necessary concomitants to attain the objective of maximising shareholder wealth. It will be difficult to change the duties of directors and introduce additional rights to redress in favour of a particular class of stakeholders, as this does not seem to be a viable framework in the UK context. As also stipulated by Lord Goldsmith, “*We want the director to give such consideration to the (stakeholder-related) factors identified as is necessary for the decision that he has to take, and no more than that*” (Hansard HL, 2006).

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## THE JUSTICIABILITY OF ECONOMIC, SOCIAL AND CULTURAL RIGHTS IN NIGERIA: A CALL TO FOLLOW GLOBAL TRENDS

MR. PHILIP EBOSETALE OAMEN <sup>1</sup>

### ABSTRACT

Economic, Social and Cultural Rights (ESCR) are almost universally justiciable, owing to a plethora of international instruments and domestic laws in this regard. From South Africa to India, constitutions and courts have enforced these rights over the years. However, in many developing nations, ESCR still remain non-justiciable. In such countries, ESCR are viewed as being mere government aspirations. Chapter II of the Constitution of the Federal Republic of Nigeria, 1999, which relates to Fundamental Objectives and Directive Principles of State Policy, captures ESCR as non-justiciable. Despite the fact that Nigeria is a signatory to international instruments that are protective of ESCR, the Nigerian Courts are unwilling to enforce these rights because of the express constitutional provisions that they are generally non-justiciable. This paper examines the justiciability status of ESCR in Nigeria and a comparative discourse of the trends in South Africa, India and other similarly situated jurisdictions. The author canvasses for a constitution amendment in Nigeria wherein these rights, just like Civil and Political Rights, are made justiciable. The author further advocates a liberal-minded approach from the Nigerian Judiciary. It has also been canvassed that non-governmental organisations should wake up in their sensitisation obligations vis-à-vis the promotion of the rights under consideration.

**Key Words:** Constitution, Court, Justiciable, Enforceable, Right.

### INTRODUCTION

There is no doubt that the Constitution of the Federal Republic of Nigeria, 1999 (the Constitution) recognises the Economic, Social and Cultural Rights (ESCR) in its Chapter II, which provides for the Fundamental Objectives and Directive Principles of State Policy (Directive principles). However, in Section 6(6)(c), the same Constitution expressly provides that the judicial power of the courts does not extend to enquiry into whether or not the government or state actors have complied with the Directive Principles. This is akin to giving a child a gift with one hand and taking it back with the other.

With an estimated population of 170 million people, Nigeria has been touted as the most populous nation in Africa. Despite the natural resources with which God has blessed the nation, about 70% of its population still lives below the poverty line (Omoruyi and Odiaka, 2015, p. 208). To make matters worse, the citizens cannot enforce the rights to social justice which economic, social and cultural rights engender. This is owing to the non-justiciability posture of the Constitution and the attendant judicial pronouncement vis-à-vis the ESCR.

This paper interrogates the continuous non-justiciability status of the ESCR. The author examines the present constitutional and judicial position on justiciability of the ESCR and the regional and international legal and institutional framework for their enforcement, and draws a comparative analysis between the legal trends in South Africa/India and Nigeria. He advocates a paradigm shift in Nigeria by urging the nation to borrow a leaf from South Africa and India, where the ESCR have been constitutionally and judicially made enforceable. The writer concludes by urging the courts in Nigeria to be more liberal in interpreting the constitutional provisions that relate to the ESCR, while equally canvassing for a legislative intervention by way of a constitutional amendment to herald a justiciability platform for ESCR in Nigeria.

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## **CLASSIFICATION OF HUMAN RIGHTS**

Human rights have been classified into three major types: first generation, second generation and third generation rights as per Vasak (1992). We shall now briefly examine these categories.

### **First Generation Rights**

These are civil and political rights that gained recognition in the 17<sup>th</sup> century in Europe. They are rights that protect the liberty and fundamental freedoms of individuals. These rights are usually made justiciable under the respective constitutions of most nations. For example, Chapter IV of Nigeria's Constitution contains first generation rights, including the rights to life (section 33), the right to dignity of the human person (section 34), the right to personal liberty (section 35), the right to a fair hearing (section 36), the right to private and family life (section 37), the right to freedom of expression (section 38), the right to freedom of thought, conscience and religion (section 39), the right to peaceful assembly and association (section 40), the right to freedom of movement (section 41), the right to freedom from discrimination (section 42) and the right to acquire and own immovable property anywhere in Nigeria (section 43). These rights can also be found in Articles 2–21 of the UDHR and Articles 7–17 of the African Charter.

### **Second Generation Rights**

These are economic, social and cultural rights that came about as by-products of the evolutionary struggles and socialist movements of the early 19<sup>th</sup> Century. These rights gained full prominence in the 20<sup>th</sup> century when nations like the US, Mexico and Germany began to include them into their constitutions (Dakars, 1986–1990, p. 39). These rights include the right to work, the right to fair and just conditions of service, the right to form and belong to a trade union, the right to freedom from unemployment, the right to social welfare, the right to clothing, shelter, food and education, and the right to an adequate standard of living. The second generation rights are embodied in Chapter II of the Nigeria's constitution and are generally not justiciable. We shall return to this later. Articles 22–27 of the UDHR also contain second generation rights.

### **Third Generation Rights**

These are also referred to as solidarity rights. Comparatively, they are the most recently acquired rights, and evolved as a result of the nationalistic struggles of developing and dependent nations to free themselves from western domination. These rights include the right to self-determination, the right to peace, the right to a balanced and safe environment, the right to humanitarian relief during disaster, and the right to development (Idigbe, 2003, p. 239).

However, it is pertinent to state here that all human rights, whether first, second or third generation, should be treated equally on the basis of the principles of universality, indivisibility and the interdependence of human rights. The principle of universality means that every person possesses human rights by virtue of their humanity, without reference to race or place of birth/residence. The principle of indivisibility means all rights are indivisible and one right cannot be said to be enjoyed in isolation from other rights. The principle of interdependence means that each human right depends on other rights, in other words that the enjoyment of any given human right is a function of the realisation of all or some of the other rights (Igwe and Ovat, 2010, p. 89-90).

## **THE LEGAL STATUS OF ESCR UNDER THE NIGERIAN CONSTITUTION**

The Nigerian Constitution recognises ESCR, which are embodied under Chapter II as Directive Principles. Under Chapter II, the Constitution makes provision for the duty of the state and all its organs and authorities to conform, observe and apply the provisions relating to ESCR in Nigeria. For example, Section 13 of the Constitution provides that it shall be the duty and responsibility of all organs of government, and all authorities and persons who exercise legislative, executive and/or judicial powers in Nigeria, to conform to, observe and apply the

said Chapter II of the Constitution. However in another breath, Section 6(6)(c) of the same Constitution provides that none of the ESCR recognised in Chapter II of the Constitution are legally enforceable or justiciable. Hence, in *Archbishop Olubunmi Okogie (Trustee of the Roman Catholic School and Ors. V. Attorney-General of Lagos State* (1981)<sup>2</sup>, the court stated that the right to education (one of the rights recognised under Chapter II of the Constitution) is inferior to the right recognised under Chapter IV of the Constitution, and that the right is not generally enforceable against the government unless and until there is a legislative framework or a statute that specifically recognises it as an enforceable or justiciable right. Thus, it has been held that the Government or any other person can enforce a right created by a statute, even if such a right is one of the non-justiciable rights under Chapter II of the Constitution (Igwe and Ovat, 2010, p. 89-90).

Quite apart from the constitutional but non-justiciable recognition of the ESCR under the Nigerian Constitution, the Nigerian Government has ratified or signed several regional and international human rights instruments that recognise and urge enforceability of these rights in member states. These include the ESCR, UDHR and the AC. For example, the preamble to the UDHR 1948 enjoins all member nations (including Nigeria) not only to give recognition to ESCR, but also to see that these rights are enforceable.

Similarly, Nigeria, as a signatory to the International Covenant on Economic, Social and Cultural Rights, is expected to see those rights as legal and enforceable rights in Nigeria. These rights are geared towards meeting the basic human needs of the average citizen, thereby using the law to reduce global poverty (Dankofa, 2010, p. 34). Dankofa (2010) is therefore of the view that any action or inaction of government that leads to global malnutrition, poverty, child mortality and lack of access to primary health and educational care amounts to a gross violation of human rights within the purview of Article 2(4) of the ICESCR 1966. As laudable as the provision of the ICESCR may be in engendering a framework to ensure the full physical and mental development and wellbeing of the citizens of the signatory states, it is argued to be inferior to the provisions of the Constitution. Hence, in Nigeria, except when a local statute expressly provides otherwise, all the ESCR embedded in Chapter II of the Constitution remain non-justiciable. We are worried that Nigeria might take a position of non-recognition of ESCR. This is despite the fact that the nation voluntarily agreed to abide by the provisions of the ICESCR without any noticeable reservation. The position of Nigeria and the Nigerian judiciary on the issue of non-justiciability of ESCR, especially in view of the high poverty level in the country, has formed the subject of scholarly admiration and criticism (Adekoya, 2011, p. 2).

Nigeria cannot feign ignorance of its obligations under the ICESCR. Article 2(1) of ICESCR urges the government to deploy maximum resources towards realising ESCR by appropriate means, including legislative measures. The Committee on Economic, Social and Cultural Rights (the Committee) had posited that every signatory to the ICESCR has the obligation to ensure that the ICESCR norms are recognised and enforced within its domestic or municipal legal order, and that remedial mechanisms should be put in place. According to Jeen-Bernard (2003, p. 257), state parties to the ICESCR are obligated to recognise, implement and enforce the ESCR within their jurisdictional conclave. Therefore, Article II of the ICESCR, which provides for the “right of everyone to any adequate standard of living for himself and his family including adequate food, clothing and housing and to the continuous improvement of living condition”, as well as Article 25(1) of the UDHR, which states that

Everyone has the right to a standard of living adequate for the health and well-being of himself and his family, including food, clothing, housing and medical care and necessary social services and the right to security in the event of unemployment, sickness,

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<sup>2</sup> (1981) 1 NCLR 218.

disability, widowhood, old age or other lack of livelihood in circumstances beyond his control, should have resulted in offering Nigerian citizens an enforceable solution to their desire for a better society and economic package since Nigeria acceded to the ICESCR on 29 July 1993. However, the Nigerian Courts have always interpreted these international instruments through the lens of the non-sustainability clause in Section 6(6)(c) regarding those rights. As seen in the *Archbishop Olubunmi Okojie case* (1981), the right to education is not justiciable in Nigeria, although it is a recognised right under international human right instruments (Oyajobi, 1993, p. 12).

The Nigerian posture is a radical departure from that of the international community on the enforceability of ESCR. For example, at its 22<sup>nd</sup> Session, the General Comment 14 and paragraph 1 of the General Comment provides that,

Health is a fundamental human right indispensable for the exercise of other human rights. Every human being is entitled to the enjoyment of the highest attainable standard of health conducive to living a life in dignity. The realisation of the right to health may be pursued through numerous complementary approaches, ... the right to health includes certain components which are legally enforceable.

Going by the above comment on ESCR, one tends to agree with Ortuanya (2012, p. 102) that “the right to health [and indeed all other ESCR] is a human right hence the right-holder is human being a human being in general. It is a right accruing to human beings irrespective of nationality, religion, sex, race, political affiliation or any other differences.”

The closest enforceable recognition of ESCR in Nigeria was given under the African Charter (1981). The African Charter, the most potent document on ESCR in Nigeria, is a known rights instrument that serves as a tool to address African’s political rights issues and provide for some modicum of enforceable ESCR with a view to protecting Africans from deprivation, poverty and other legal challenges peculiar to Africans. The African Charter thus seeks to combine African values with international norms in engendering a better rights package.

Commendably, the African Charter provides for ESCR such as the right to work under equitable and satisfactory conditions, the right to enjoy the best attainable state of physical and mental health, and the right to education (Articles 14, 15, 16, 17 and 22 of the African Charter). Nigeria as a nation has not only ratified it, but has also gone ahead to domesticate it by incorporating it into its corpus of law. This is by virtue of the African Charter on Human and Peoples Rights (Ratification and Enforcement) ACHPR (RandE) Act. Section 1 of the Act domesticates the African Charter and makes it enforceable in Nigeria. The Charter has thus been used to advance ESCR in Nigeria. In *Ogugu v. State* (1994)<sup>3</sup>, the Supreme Court of Nigeria held, *inter alia*, that “*the human and people’s rights of the African Charter are enforceable by the several High Courts depending on the circumstances of each case and in accordance with the rules and practice of each court.*”

Similarly, in *Fawehinmi v. Abacha* (1996)<sup>4</sup>, the Court of Appeal of Nigeria also held that, by enacting the African Charter into the Nigerian Organic Law, the tenor and intendment of the ACHPR (RandE) Act was to vest the Act with a greater vigour and strength than a mere Decree, that the Charter had been elevated onto a higher pedestal than the Constitution of Nigeria, and that its violability had become actionable in court. The court further observed that, in the realm of jurisprudence and the rights of citizens to seek remedy in cases of a violation of any right recognised under the Charter, it cannot be said that no remedy exists. However, when the matter proceeded to the apex appellate court, while agreeing that the ESCR and CP

<sup>3</sup> (1994) 9 NWLR, Pt. 366, 4.

<sup>4</sup> (1996) 9 NWLR pt.475, 710

rights under the African Charter are enforceable by virtue of the domestication Act, the Supreme Court held that the Court of Appeal was wrong to have held that the African Charter was superior to the Constitution of Nigeria because of its international flavour. According to the Supreme Court in *Abacha v. Fawehimi* ((2000)<sup>5</sup>:

No doubts, Cap 10 (the ACHPR (RandE) Act) is a statute with international flavour. Being so, therefore I would think that it is presumed that the legislature does not intend to breach an international obligation. To this extent, I agree with the Lordships of the Court of Appeal below that the Charter possesses “a greater vigour and strength” than every other domestic statute. But that is not to say that the Charter is superior to the constitution, nor can its international flavour prevent the National Assembly ... from removing it from our body of municipal laws by simply repealing Cap 10.

The implication of this position is that the African Charter provisions can only be used to activate and ventilate human rights cases to the extent permitted by the Constitution, which remains the supreme law in Nigeria. Thus, since ESCR are contained in Chapter II of the Constitution and Section 6(6)(C) of the Constitution provides that provisions in Chapter II are not justiciable, it follows that the ESCR under the African Charter cannot or are not enforceable beyond the measure of enforceability or justiciability accorded them by the Constitution. According to Fyanka (2009): “*by including social rights in its Chapter II, the 1999 Nigerian Constitution positively prohibits the justiciability of social rights in Nigeria thereby making litigation relating to these rights impossible*” (p. 59). In view of the Supreme Court decision in *Abacha v. Fawehinmi*, there is no doubt that earlier salutary decisions of the lower courts on justiciability of ESCR under the African Charter have been wasted. For example, in *Constitutional Rights Project v. The President* (Unreported Case of Lagos State High Court in Suits No. M/M/102/92 (May 1993)), Hon. Justice Onakaja of the Lagos State High Court held that “*the provisions of the African Charter on Human and Peoples Rights cannot be ousted by any domestic law*”. This still remains the law, though, since the Supreme Court’s decision only promotes the Constitution above the African Charter: that is, the Charter is still regarded as being higher than other domestic laws in Nigeria.

Likewise, in *Oronto Douglas v. Shell Petroleum Development Company Ltd* (1999)<sup>6</sup>, the Court of Appeal of Nigeria was of the view that an action instituted pursuant to the ESCR provisions of Article 24 of the African Charter was justiciable before the Nigerian Courts. A similar position was taken by the court in *Gbemre v. Shell Petroleum Development Company Nigeria Ltd and 2 Ors*<sup>7</sup> to the effect that the right to life includes the right to a pollution-free environment, as provided for under Article 24 of the African Charter.

Another commendable feature of the African Charter is its position on a uniform or indivisible outcome on human rights. The Charter is the only human rights instrument that expressly provides for the normative principle of interrelatedness and indivisibility of human rights in Nigeria by making no ideological distinction between ESCR and civil and political rights (Fyanka, 2009, p. 68). It gives equal treatment and recognition to both categories of rights. Hence, in the exercise of its interpretative powers, the African Commission on Human Rights held in *The Social and Economic Rights Action Centre v. Nigeria*<sup>8</sup> that the right to food is inseparably linked to the right to dignity of the human person.

<sup>5</sup> (2000) 6 NWLR, Pt. 660, 228.

<sup>6</sup> (199) 2 NWLR, pt. 591, 466

<sup>7</sup> Unreported case of the Federal High Court sitting in Benin City in Suit No.FHC/B/CS/53/05.

<sup>8</sup> Communication 155/96, Fifteenth Annual Activity Report of the African Commission on Human and Peoples Rights 2001–2002.

## LESSONS FROM OTHER JURISDICTIONS

It is pertinent to state here that the current global and regional trend is for nations to recognise ESCR as enforceable rights. While some nations have given a constitutional stamp to the justiciability of these rights, others have, through judicial activism, stretched the justiciability of the civil and political rights to ESCR. We shall now examine the positions in South Africa, Ghana and India.

### South Africa

The current trend in South Africa is that the status of ESCR has been constitutionally clothed with justiciability. Flowing from the constitutional recognition accorded to those rights by the South African Constitution, the country's Constitutional Court has, commendably, given value to the rights by developing "a wealth of normative jurisprudence arising from challenges based on the social rights that have been guaranteed by that country's democratic Constitution" (Fyanka, 2009, p. 56).

The 1996 Constitution of the Republic of South Africa expressly provides for enforceable ESCR. We reproduce, below, the relevant portions of the Constitution.

#### *Section 26*

- (1) Everyone has the right to have access to adequate housing; and
- (2) The State must take reasonable legislative and other measures, within its available resources, to achieve the progressive realisation of these rights.

#### *Section 27*

- (1) Everyone has the right to have access to
  - (a) Health care services, including reproductive health care;
  - (b) Sufficient food and water; and
  - (c) Social security, including, if they are unable to support themselves and their dependants, appropriate social assistance;
- (2) The State must take reasonable legislative and other measures, within its available resources, to achieve the progressive realisation of each of these rights; and
- (3) No one may be refused emergency medical treatment.

#### *Section 28*

- (1) Every child has the right
  - (a).....
  - (b).....
  - (c) to basic nutrition, shelter, basic health care and services and social services.

#### *Section 29*

- (1) Everyone has the right
  - (a) To a basic education, including adult education; and
  - (b) To further education, which the state, through reasonable measures, must make progressively available and accessible.

Other relevant sections include Section 23, which deals with the right to fair labour practices and the right to form and belong to trade unions; Section 24, which provides for the right to a pollution-free environment; Section 25, which creates the right to acquire and own property by providing that the state has the duty to implement measures aimed at achieving land redistribution and equitable access to land; and Section 35(2), which protects the rights of prisoners to adequate accommodation, nutrition, reading materials and medical treatment.

### Judicial Pronouncements on ESCR in South Africa

Although Section 7(2) of the South African Constitution enjoins the State to respect, protect and fulfil all rights through legislative intervention and executive policies, it is through judicial pronouncements that ESCR have found expression (Mubangizi, 2006, p. 5-6).

There have been some beautifully rendered decisions from the stable of the South African Judiciary. Andrew (2004) is of the view that the Constitutional Court, which was established to act as the court of last resort on constitutional matters, has handed down such progressive and “activistic” decisions that one can only posit that these decisions are a justification for the impressive profile of the legal minds that have been appointed to man the Court. We now examine some of these epochal cases.

***Thiagraj Soobramoney v. Minister of Health, Kwa Zulu-Natal* ((1998(1) SA 765 (CC); 1997(12) BCLR 1696)**

The *Soobramoney* case was, arguably, the first substantive ESCR case that the Constitutional Court adjudicated on. The case involved a terminally ill diabetic man who, owing to scarce hospital facilities, could not access the dialysis treatment that could have preserved his life for a longer period under a state health policy. The appellant filed an application for an order compelling the state hospital to provide him with dialysis treatment to prolong his life. He hinged his lawsuit on the provisions of the above Section 27(3) and Section 11, which provides for the right to life. His argument was that, having been left without treatment for some time and in view of the terminal nature of his illness, his case could be treated as a medical emergency under Section 27(3). The Court held, however, that the constitutional right to emergency medical treatment did not, by any stretch of imagination, extend to the right to life-prolonging treatment for terminally ill patients like the appellant. The Court however recognised the fact that there was a constitutional right to health.

As expected, the decision in the *Soobramoney* case generated an avalanche of criticisms in legal circles. The Court’s position has been described as unprogressive and anti-liberal. In the opinion of Ngwena and Cook (2005, p.135-137), from the point of view of judicial opinions, the *Soobramoney* case did not contribute much to the understanding of socio-economic rights, nor did it “lay down any guidelines that could be followed when interpreting socio-economic rights so as to illuminate and indigenise jurisprudence on socio-economic rights”. We cannot agree less with these writers. To our mind, what the Court did in the *Soobramoney* case was to engage in needless prevarication on core issues that bordered on a highly sacred and valuable human life. One therefore questions the rationale behind the Court’s decision, which sought to sever the right to care from the right to prolongation of life. The two rights are inseparably intertwined. Unarguably, a man who is terminally ill is in no less a position to seek and obtain medical care from the government than a man who suffers from a fever. We therefore submit that the case would have been conveniently entertained within the purview of Section 27 of the Constitution without doing any violence to the letter and spirit of the law. However, on the other side of the divide, the court decision is justifiable on the basis of the limitation clause embedded in Section 27(2) to the effect that the government was only to take measures “within its available resources”, and there was evidence of the scanty financial status of the government hospital at that time. Christiansen (2007, p. 321) puts it differently by submitting that the proof of lack of adequate reasonable resources must have swayed the court in its decision. There is a need to balance the conflicting interests of scarce state resources and the constitutional right to enjoy ESCR.

The good news, however, is that between the *Soobramoney* case and the present day, the Constitutional Court has departed from its “common law” position and has embraced liberal judicial activism in its espousal of the ESCR vis-à-vis government responsibility to provide for the needy in the society. This new spirit of the Court was demonstrated in the subsequent cases that came before it.

***Government of the Republic of South Africa v. Irene Grootboom and Others (2001 (1)SA 46 (CC))***

As a matter of preliminary point, the position taken by the Constitutional Court in this case was a radical departure from its earlier decision in the Soobramoney case. Though the facts of both cases were dissimilar, both cases addressed issues relating to the justiciability of ESCR.

In the Grootboom case, Irene Grootboom and hundreds of other adults and children were rendered homeless when their homes were destroyed and their personal effects burnt, owing to their eviction from their informal dwelling place by the government. They were compelled to leave a squatter settlement on private land, which the government had earmarked for the erection of state-sponsored low income housing. Consequently, Grootboom and the other victims of eviction filed a lawsuit for an order compelling the government to provide them with shelter, adequate basic nutrition and health care services, pursuant to the provisions of Sections 26 and 28 of the South African Constitution.

The Court held that the State was liable to live up to its constitutional responsibility of providing housing for its citizens, since housing was a “constitutional issue of fundamental importance to the development of South Africa’s new constitutional order”. The Court further held that the housing system that sought to render the applicants homeless amounted to unreasonable neglect as far as the issue of addressing the needs of poor and vulnerable persons was concerned. The conclusion the Court drew was that the housing programme did not meet up with the constitutional framework, as it failed to devise, fund, implement and supervise measures aimed at providing access to adequate housing within available resources. Hence, the court had no choice but to grant the relief sought, by compelling the state to remedy the situation and referring the matter to the independent Human Rights Commission to monitor compliance. The Court maintained the same commendable position in the case of *Minister of Health and Others v. Treatment Action Campaign (2002)*<sup>9</sup>.

***Minister of Health and Others v. Treatment Action Campaign***

In this case, a group of non-governmental organisations led by the Treatment Action Campaign challenged government policy regarding the distribution of some retroviral drugs under the public health care system. It was particularly contended that one of the drugs (Nevirapine), which had the potential of drastically reducing the likelihood of mother-to-child HIV transmission, was being hoarded by government, which refused to ensure a widespread distribution of the drug. The government only made the drugs available to designated pilot sites, and the poor, who really needed them, could not access them. The NGOs urged the Court to compel the government to live up to its constitutional bidding as encapsulated in Sections 27 and 28, by lifting the ban on widespread distribution of the drugs.

The court held the government liable by stating that the government policy and measures to prevent mother-to-child HIV transmission fell under its constitutional duty, and it was thus directed to remedy the situation. According to the Court,

The government policy was an inflexible one that denied mothers and their newborn children ... a potentially lifesaving drug. ... It could have been administered within the available resources of the state without any known harm to mother or child. ... The policy of government ... constitutes a breach of the state’s obligations under section 27 ... of the Constitution.

***Khosa v. Minister of Social Development (2004(6) SA 505 (CC))***

Here, the applicant successfully challenged a statute which sought to exclude non-citizen permanent residents in South Africa from access to social welfare assistance. The Court held

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<sup>9</sup> (2002) 5 SA703 (CC).

that any legislation or executive policy that seeks to discriminate against non-citizen permanent residents was unconstitutional, and so could not stand in the face of Sections 27(1) and 9(3) of the South African Constitution, which guarantees the right to social security and freedom from discrimination.

### **Ghana**

Just as in South Africa, the 1992 Constitution of Ghana also recognises some modicum of justiciability for ESCR. However, the point must be made that the South African constitutional model is more far-reaching and salutary as far as justiciability of ESCR is concerned. The relevant sections of the Ghanaian Constitution will now be briefly highlighted.

Section 20 provides for right to acquire and own private property and the concomitant right to compensation in the event of government compulsory acquisition. Article 22 makes provisions for the spousal right to inheritance, while Article 24 espouses the right to employment and safe working conditions. Article 25 states that everyone has a right to equal educational opportunities and facilities, including the availability and accessibility of basic, secondary and higher education. Article 33(5) makes an omnibus provisions for all rights by stating that the mention of the rights, duties and declarations relating to fundamental human rights and freedoms expressly mentioned in the Constitution does not mean the exclusion of those rights and freedoms not specifically mentioned, but which are considered to be inherent to a democracy and intended to secure the freedom and dignity of humankind. Under this omnibus provision, ESCR such as the rights to health care and shelter, though not expressly constitutionally provided for, can arguably be accommodated under the Ghanaian Constitution.

Pertaining judicial disposition to ESCR in Ghana, although Ghana does not have the luxury of a special court like the South African Constitutional Court, its Supreme Court and other regular courts have had to exercise their judicial *vires* to adjudicate on rights issues being ventilated before them (by virtue of Article 130 (1) of the Ghanaian Constitution). Thus, in *New Patriotic Party v. Attorney-General* (1996–1997)<sup>10</sup>, the Ghanaian Supreme Court held, among others, that there are certain circumstances that could make the otherwise non-justiciable Directive Principles of State Policy judicially enforceable, and such situations would include where the Principles are read together with the justiciable fundamental rights provisions of the Constitution.

Apart from the judiciary, the Ghana Commission on Human Rights and Administrative Justice plays a key role in the determination of human rights cases. The Constitution vests a modicum of quasi-judicial powers in the Commission to investigate human rights violations and take appropriate steps to remedy any observed abuses (Articles 216–218). In the exercise of these constitutional powers, the Commission has had to entertain and decide human rights cases like the *Parent-Teacher Association of Ghana International School v. Attorney-General and Alpha Beta Educational Complex v. Ghana Education Service*. In the realm of workers' rights, the Commission has held in *Gabor v. Ghana Reinsurance Co. Ltd* that an employer does not have the right to suspend an employee, unless this right has been expressly donated by the contract of employment or statute.

### **India**

Constitutionally speaking, India is on the same page with Nigeria as regards the justiciability of ESCR. By the import of Section 37 of the Indian Constitution, ESCR contained in the Directive Principles of State Policy are not enforceable by the Court. However, the point of divergence between Nigeria and India is that the Indian Judiciary has been liberal-minded enough to clothe the otherwise non-justiciable rights with the garment of justiciability. The Indian courts tend to give a community reading and interpretation to the Constitution in such a

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<sup>10</sup> SCGLR 729 at 788.

way as to make the enforceable rights inseparably and indivisibly intertwined with the non-enforceable ESCR. It is therefore germane to quickly examine some of the pronouncements of the courts in this regard.

In the case of *Francis Coralie Mullin v. The Administrator, Union of Territory of Delhi and Others* (1981)<sup>11</sup>, which dealt with the rights to clothing, shelter and nutrition, the Indian Court held that

The question which arises is whether the right to life is limited only to protection of limb or faculty or does it go further and embrace something more? We think that the right to life includes the right to live with human dignity and all that goes along with it, namely, the bare necessities of life such as adequate nutrition, clothing and shelter and facilities for reading, writing and expressing oneself in diverse forms, freely moving about and mixing and commingling with fellow human beings.

In the subsequent case of *Olga Tellis and Others v. Bombay Municipal Corporation and Others* (1985)<sup>12</sup>, the issue was whether the forcible eviction of pavement and slum dwellers and the removal of their belongings under the Bombay Municipal Corporation Act amounted to the deprivation of their means of livelihood, and (if so) whether such a deprivation amounted to a violation of the right to life. The Court held that

The question which we have to consider is whether the right to life includes the right to livelihood.... It does. The sweep of the right to life conferred by Article 21 is wide and far reaching.... An equally important facet of that right is the right to livelihood, because, no person can live without the means of living.... That, which alone makes it possible to live... must be deemed to be an integral component of the right to life. Deprive a person of his right to livelihood and you shall have deprived him of his life.

Similarly, in *Indian Council of Enviro Legal Action v. Union of India* (1996)<sup>13</sup>, the Indian Supreme Court upheld the ESCR to clean environment as part of the right to life. According to the Court:

When certain industries by their discharge of acid producing plants cause environmental pollution, that amounts to violation of right to life in Article 21 of the Indian Constitution. ... The respondents are absolutely liable to compensation for harm caused.

## CONCLUSION AND RECOMMENDATIONS

In this paper, we have appraised the justiciability status of Economic, Social and Cultural Rights in Nigeria and other selected jurisdictions. In doing so, we have had recourse to the provisions of the constitutions of the affected nations, as well as to the International Covenant on Economic, Social and Cultural Rights 1966 and the African Charter (to which Nigeria is a signatory). Our findings have revealed that the Nigerian domestic *cum* constitutional jurisprudence does not tilt in favour of making ESCR justiciable. We further found that the Nigerian Judiciary has not been broad-minded enough to give life to ESCR in Nigeria. However, our comparative analysis between the present position in Nigeria and that of South Africa, Ghana and India reveals that Nigeria is lagging behind as far as enforcing ESCR is concerned. These other nations have since either given a wholesale constitutional stamp to the enforceability of these rights, or their courts have (through judicial activism) interpreted the ESCR provisions in such a way as to make them justiciable.

We recommend as follows:

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<sup>11</sup> (1981) 2 SCR 516.

<sup>12</sup> (1985) 2 Supp SCR 51.

<sup>13</sup> (1996) All Indian Law Report (AIR) SC 1446

1. There should be a constitutional amendment in Nigeria, wherein the provisions relating to ESCR (currently housed in the non-justiciable Chapter II of the Constitution) can be merged with or moved into the justiciable civil and political rights in Chapter IV of the Constitution, thereby making them constitutionally justiciable. Alternatively, Section 6(6)(c) of the Constitution, which makes Chapter II non-justiciable, should be struck down. After all, Nigeria is a signatory to the African Charter, which in no unclear terms provides that all rights should be treated as indivisible and inter-related. Further, Nigeria is a signatory to the ICESCR, and therefore has an international legal obligation to recognise ESCR and to make sure no domestic laws, including the Constitution, contradict its obligation to respect, protect, promote and fulfil the ESCR provisions under international instruments. It goes without saying that Nigeria is blessed with the wherewithal to engender the enforcement of ESCR, even if in a progressive or graduated manner.
2. The Nigerian Courts should borrow a leaf from their Indian and South African counterparts by being boldly liberal-minded in interpreting the rights provisions of the Constitution. There should be judicial activism and community reading and interpretation of laws in Nigeria. We thus urge the Nigerian Judiciary to carry out their interpretative functions in such a way as to advance, not to defeat, the laudable rights provisions in domestic and international instruments with a view to protecting the common individual. It is trite international law that courts must avoid decisions that would put their States in direct breach of their international obligations, such as the obligation to enforce ESCR (Alston and Quinn, 1987, p. 171).
3. There should be a mass sensitisation or awareness programme for members of the public. NGOs and other publicly orientated bodies should enlighten the public on their rights and the procedure for enforcing them under the Fundamental Rights (Enforcement Procedure) Rules of 2009 and other regular court rules. Happily, the 2009 Rules have heralded a highly simplified procedure and far reaching innovations in the law and practice of human rights in Nigeria, by removing the requirement for *Locus Standi*, leave to apply for enforcement and the statute bar. Citizens should take advantage of these laudable rules and assert their rights in court.
4. The National Human Rights Commission should be more alive to its responsibility by investigating and exposing all manner of rights abuses in Nigeria. The Commission should be legislatively given some quasi-judicial powers to determine human rights cases, just as these are obtainable under the Ghanaian Commission of Human Rights and Administrative Justice. Further, the decisions of the African Court of Justice and the African Commission should be made legally binding on all signatories to the African Charter. The present position of viewing the decisions as recommendations only does not augur well for human rights protection in Africa.

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## THE NEW CONCEPT OF SEX-CRIMES IN CROATIAN CRIMINAL LAW

IGOR VULETIĆ<sup>1</sup> AND DAVOR ŠIMUNIĆ<sup>2</sup>

### ABSTRACT

The new Croatian Criminal Code entered into force on January 1 2013, introducing the new concept of sexual crimes into Croatian criminal law. The reform was, above all, motivated by the efforts of the legislator to follow international standards, especially the ones imposed by the European Union and Council of Europe. However, it is interesting that creators of the new Criminal Code did not follow the usual German model in the case of sex-crimes. Instead, they chose to model sex -crimes on the English example. Such a solution is untypical for the Croatian legal tradition. The new concept significantly expands criminal liability for sexual crimes in several ways. Typical examples can be found in the criminalization of negligent forms of rape and the incrimination of rape by deception. These types of sexual offence are atypical in continental law tradition. Until now, they have not been characteristic of Croatian criminal law and it will be interesting to see how the courts will accept and apply the new model. In this paper, the authors discuss these changes from a theoretical and also a practical point of view. They give a critical analysis of the new concept of sex crimes under the new Croatian CC and comment on some interesting cases from recent court practice in Croatia. Using the examples from case -law, the authors identify some of the main problems underlying the new concept.

**Keywords:** rape, deception, mistake of facts, consent, perpetration, mental capacity, age limit

### INTRODUCTION

For the last twenty years, Croatian criminal law in the field of sex crimes has been characterized by a double trend. On the one hand is a trend of constant liberalization manifested through the decriminalization of certain behaviors. For example, homosexual relations, life in an extramarital community and incestuous activities have mostly been decriminalized (only incest is still punishable, but in a limited scope). On the other hand is a diametrically opposite trend: strengthening of repression in this sensitive area of criminal law. This strengthening can primarily be noticed in the regulation of new forms of criminal offences against sexual freedoms.

Croatian criminal law underwent significant reforms in 2011. In that year a new Criminal Code was passed by the Croatian Parliament. The new code introduced several important changes in the fields of sex crimes and, among others economic crimes, environmental crimes, the principle and the concept of guilt, statute of limitations etc. Probably the best proof for the scope of these changes is the fact that the legislator imposed an unusually long *vacatio legis* of almost two years. This time was given to practitioners to prepare themselves for the application of the new regulations. The new Criminal Code started to apply on January 1, 2013. Since this period, the verdicts reached by the courts have shown how the new solutions function in practice.

The purpose of this paper is to give a critical analysis of the new concept of sex crimes, three years after the new Criminal Code entered into force. This analysis will be given from

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both a theoretical and a practical point of view. First, the authors will present the most important changes in a brief analysis of the new concept. Second, they will analyze available case law. Third, they will identify and discuss the main issues revolving around the new concept of sex crimes and give their suggestions for future improvements.

## REFORM OVERVIEW

The concept of sexual crimes has probably gone through most significant changes in this latest reform of Croatian criminal law. This fact was visible from the very beginning of the reform, when the sex crimes chapter of the new Criminal Code received a new title. Instead of the earlier title “*Criminal offences against sexual freedoms and morality*”, the chapter was renamed “*Criminal offences against sexual freedoms*” (Chapter XVI). This change was explained by the fact that the term *sexual morality* can be misused as a ground for limiting of sexual freedoms, and can also be a potential cause of secondary victimization (Turković/Maršavelski, 2010, p. 513). The new title has therefore emphasized what is considered to be most important: protection of the right to sexual self-determination. Below, we will discuss the most important changes introduced into Croatian criminal law by this reform. In our opinion, these changes can be distilled into three main features: the new legislative concept of non-consensual sexual acts; the criminalization of negligent forms of non-consensual sexual acts; and raising the age limit for involvement in voluntary sexual acts.

### The new concept of non-consensual sexual acts

As has already been pointed out, many changes have been made to the new chapter on sexual crimes. However, for the purposes of this paper, the attention will focus only on the most significant ones that change the character of these crimes in Croatian criminal law. Without any doubt, the first and most important such change is the adoption of the new legislative concept of non-consensual (involuntary) sexual intercourse. Involuntary sexual intercourse is criminalized through three criminal offences:

- Non-consensual sexual intercourse (Art. 152), as a basic offence;
- Rape (Art. 153), as the first qualified form, which is committed by the use of force or direct threat;
- Most severe criminal offences against sexual freedoms (Art 154), as the second qualified form, which is qualified either because of some special characteristics of the victim (victim closely related to the perpetrator, especially vulnerable victim etc.), because of the motive (hate) or because of the especially dangerous modus operandi of the perpetrator (i. e. the usage of weapons etc.).

The new concept of involuntary sexual intercourse emphasizes the lack of the victim’s consent as the key point of criminal liability. Earlier case-law has shown that Croatian courts have often tended to require the victim to demonstrate physical resistance as a *condition sine qua non* of rape and similar crimes. A good example is the verdict of the Supreme Court of Croatia (verdict no. I Kž – 473/94) from 1994 in which it was clearly stated that “*the victim did not show resistance in a clear and undoubtful way, because she stopped resisting at the key moment when the naked defendant approached her and spread her legs.*” As a consequence of this, the Court found that the defendant was not guilty of the criminal offence of rape. However, such practice was in direct opposition to the practice of the European Court of Human Rights in Strasbourg (ECHR). The ECHR has made it very clear in many verdicts that the physical resistance of the victim should not be considered as a necessary element of *actus reus* of involuntary sexual intercourses (see for example the verdict *M. C. vs Bulgaria*, 4<sup>th</sup> Dec 2013, para 166). Other relevant international standards also require incrimination of any non-consensual sexual intercourse, regardless of the physical resistance of the victim. This was the main reason why the new Criminal Code’s Art. 152 stipulated that the sexual act without consent should be a constitutive element of *actus reus*.

The Criminal Code has also defined when to presume that there is no consent of the victim. According to Art. 152, para. 3, legally relevant and valid consent exists “*if a person has decided to engage in a sexual act by his or her own will and was able to make and express such decision*”. Further on, para. 3 stipulates that it will be presumed (*praesumptio iuris tantum*) that such consent does not exist, especially “*if a sexual act has been performed by the use of threat, fraud, the abuse of position that makes the victim dependent to a perpetrator, the abuse of the inability of the victim to express rejection, or to a person who has been kidnapped*”. While most of these forms were already criminalized by the old Criminal Code, the fraudulent form is new in Croatian criminal law. That means that the Croatian legislator has decided to expand the criminal zone into the field of sex crimes by introducing liability for so-called rape by deception. The legislator, however, did not define what is to be considered as fraudulent behaviour. Is every misrepresentation of facts important enough to be qualified as fraudulent? In official commentary, the authors of the new Code claim that the prosecutor will have to prove that falsely represented facts were key for the victim to decide to have sexual intercourse (or any other sexual act) with the perpetrator (Turković et al., 2013, p. 207). This means that every misrepresentation of fact can be considered fraudulent, as long as the prosecution is able to prove a causal nexus between such fact (f. e. religion or ethnicity, marital status etc.) and a victim’s decision to have sex with the perpetrator. The *Kashour* case in Israel in 2010 is an illustrative example. A man from Jerusalem was convicted of rape because he told the victim that he was a Jewish bachelor instead of an Arab married man, as he was in reality.<sup>3</sup> It will be interesting to see how Croatian courts will interpret these types of cases when they appear. To our knowledge there haven’t yet been any similar cases in Croatian practice.

### **The negligent form of non-consensual sexual acts**

The second very important change is that the legislator has decided to criminalize negligent form of non-consensual sexual offences. This is stipulated in Art. 152, para. 2, and Art. 153., para. 2. However, we must notice that the negligent form has not been criminalized for the most severe forms of non-consensual sexual acts in Art. 154. There is no explanation for this omission, so we must conclude that this has been done by a mistake. This solution is confusing because, if the legislator wanted to enlarge the criminal zone to give additional protection to the victim, *argumentum a minori ad maius* would be even more logical to criminalize negligent form of the most severe criminal offence of this type (Vuletić, 2016, p. 30).

The legislator stipulated liability for the perpetrator who mistakenly assumed that consent existed. That basically means that the Croatian legislator has introduced criminal liability for negligent form of rape. The model for this change has been found in the English Sexual Offence Act of 2003 (Turković/Maršavelski, 2010, p. 514) The English literature also concludes that this type of guilt should be qualified as negligence (Card, 2006, p. 111 and p. 311). Such a solution is new to Croatian legal tradition and has never been criminalized, either in Croatian or Yugoslavian criminal law. Moreover, the negligent form of rape cannot be found in the German, Austrian or Swiss criminal codes, or in any other code of continental Europe. The idea is to share the burden of proof in such cases. Prosecutors must prove sexual act(s) and one of the above-mentioned circumstances (for example the abuse of position), and the defendant must prove the existence of consent (Turković in Derenčinović et al., 2013, p. 162). In the next section, we will present recent case law to show how this solution has been accepted by Croatian courts.

### **The age limit for voluntary sexual intercourse**

The new Criminal Code has regulated sex crimes against children into a separate chapter (Chapter XVII: Criminal Offences of Sexual Abuse and the Exploitation of Children). This

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<sup>3</sup> *Kashour v. State of Israel*, Crim. C. (Jer.) 561/08 (2010) (Isr.)

was done because the creators of the new Code wanted to emphasize the protection of children against sexual abuse. This chapter has been modelled on the Council of Europe Convention on the Protection of Children against Sexual Exploitation and Sexual Abuse.

The new Criminal Code has adopted the new definition of child as “*every person who is younger than eighteen*” (Art. 87). When it comes to children as the victims of sexual abuse and exploitation, Chapter XVII differs between two categories of victims. The first category consists of children under the age of fifteen. These children are considered unable to give legally valid consent to engage into sexual intercourses. In the old Code, the age limit for valid consent was fourteen, and now it has been raised by one year. We may notice that such a solution is stricter than in some other continental European systems, For example, in Germany, where the age of consent is fourteen (Heller and Dubber, 2011, p. 278). Consequently, if a person commits sexual acts with a child younger than fifteen, they will be liable for sexual abuse of a child punishable by one to ten years in prison (Art. 158, para. 1). However, sexual acts between children are not punishable: there will be no criminal liability if the age difference between persons who perform sexual acts is not more than three years (Art. 158, para. 3).

The second category consists of children between the age of fifteen and eighteen. These children can give relevant consent for sexual actions. However, if someone commits sexual act(s) with such a child who has been entrusted to them for education, learning, safekeeping or similar, he or she will be criminally liable and punished with six months to five years in prison (Art. 159, para. 1).

## RECENT CASE LAW

Sexual crimes are not at the top of the list of convictions. Official statistics for 2014 show that only 1.04% of all convictions for that year are convictions for sexual offences. Similar statistics apply to earlier years as well. Criminological debates in Croatia point to relatively large dark statistical figure as one of the key problems when it comes to sexual crimes. There are many reasons for this. Probably the most important reason is the fear of secondary victimization, which is why victims often decide not to report sexual crime (Derenčinović and Getoš, 2008, p. 61). In this section, we will examine recent verdicts in Croatian courts under Arts. 152, 153 and 154 of the Criminal Code. We have chosen these verdicts as the most interesting ones to illustrate the criminal policy of Croatian courts in the field of sex offences.

Croatian case law unfortunately shows examples of brutal sexual crimes, very often committed towards special categories of victims. One such example is the case of the defendant who committed several rapes during four months in 2014. The victim was mentally challenged person who lived with him in the same household. On several occasions during this period he beat her and forced her to have vaginal and anal sex with him. He was found guilty of seven crimes and convicted to five years and six months in prison (Varaždin County Court, no 2 K-33/14-59). Although the defendant was convicted and received a multi-year prison sentence, one may ask whether the penalty should have been even stricter due to the fact that he brutally and repeatedly abused a person with a mental disorder, especially if one bears in mind that the Criminal Code has prescribed a punishment of three to fifteen years for each such crime.

Another interesting verdict to debate is the verdict no Kov-41/15 (Split County Court). The defendant was found guilty of a criminal offence under Art. 154 para. 2 (the most severe criminal offence against sexual freedoms committed by the use of force and in a very humiliating way). According to the verdict, he and his two friends took a girl (aged 17) to the men’s room of the bar where they were all drinking together and then held her by her hands and hair while forcing her to have sexual intercourses several times with each of them, despite the fact that she has shown verbal and physical resistance. What is interesting about this case is the fact that the defendant was given a parole, despite the fact that this was very serious crime, punishable by between three to fifteen years in prison. If he breaches the parole terms

he will be sent to prison but only for one year, which is also a very mild punishment. Such criminal policy is not adequate for this type of crimes.

In a very similar case (K-23/14, Zadar County Court), three defendants were found guilty, also under Art. 154 para. 2. They had sexual intercourses several times with a drunk victim and they used force. Although they had committed the same offence as in the previous example, they were given much stricter punishment. The first defendant was sentenced to four years and ten months in prison, the second to three years, and the third to one year. This shows that Croatian courts have very different criminal policy in similar criminal matters, which is not good for the reasons of legal certainty and the principle of *nullum crimen sine lege certa*.

It seems that Croatian courts generally have a relatively soft criminal policy toward sexual offenders. During our research we have studied several verdicts for non-consensual sexual intercourse under Art. 152 and mostly found parole sentencing, even when the circumstances of the act suggested that the perpetrator acted fraudulently or abused the fact that the victim was unable to resist. We can mention two such cases. In the first (Split Municipal Court, no K-677/14) the defendant sneaked into a sailing boat in a harbor at Bol Island in Croatia. The victim was sleeping naked so approached her and started to perform sexual acts on her naked body. She then woke up and started screaming and calling for help so he ran away. He was convicted, but sentenced to parole.

In the other case (Osijek Municipal Court, no 24 K-653/2015-15) the defendant met the victim in a bar and started trying to persuade her to have sex with him. After she rejected him several times he decided to deceive her, so he told her that father and his brother wanted to speak with her in his brother's house. She believed and went with him to the house. When they arrived, she saw there was no one there and tried to leave but the perpetrator had already locked the door. He told her to sit on the bed and started to kiss her and undress her and, although she repeatedly asked him to stop, had sexual intercourse with her. He was convicted to one year in prison, but the Court did not force him to serve the sentence. Instead he worked community service. In our opinion this case is interesting, not only because of the relatively lenient sentence, but also because of the arguable qualification of the defendant's behavior as a non-consensual act under Art. 152: one can argue that the act described should be qualified as rape (Art. 153) because the victim repeatedly asked the defendant to stop. Instead, he continued to kiss her and undress her and have sexual intercourse despite the fact that she had actively (and above all verbally) resisted him. Such behavior can be qualified as the use of force, which is a constitutive element of the *actus reus* of rape, as a qualified form of non-consensual sexual intercourse.

Probably the most controversial case in our research was a verdict of Zagreb County Court (no 5-K-133/2013). This verdict has already been criticized in Croatian literature (Ritossa and Martinović, 2014, p. 535). The defendant was convicted for non-consensual sexual intercourse because he had sexual intercourse with the victim on the back seat of his car. She voluntarily entered his car, kissed him, removed her clothes and had sexual intercourse. However, later she claimed that she had agreed to have sex with him only because she saw a knife on the back seat when they were transferring from the front to the back. She claimed that seeing the knife caused fear and that she was afraid to reject sexual intercourse, although she did not say anything to the defendant or show him in any other way that she did not want to have intercourse with him. The Court convicted him under Art. 152. This case clearly demonstrates that the existing legislative definition of consent can be abused by excessively broadening the interpretation of consent (Ritossa and Martinović, 2014, p. 535). This is not acceptable because it questions the *nullum crimen* principle, and the subsidiarity character of criminal law in a very dangerous way.

## CRITICAL COMMENTS ON THE REFORM

In the first two sections we have presented the main characteristics of the recent legislative reform of sex crimes in Croatian criminal law and also shown some illustrative examples from recent case law. In this section we will give our critical remarks on the new concept.

There is no doubt that the last reform of Croatian criminal law has introduced a significantly stricter regime of sex offences than the one it replaced. This claim can be supported by several facts. Above all, the new regime is based on the new concept of consent followed by a legislative definition of it, which was not the case in the old Criminal code. The new definition is based on the so-called "consent plus" approach, which requires each time that consent be given clearly and without any doubt by a person capable of making and expressing such a decision. This concept has already been criticized by Croatian authors. Ritossa and Martinović point out that this definition moves the focus from the quality of the consent to the capability of the person (victim) to give and express consent. They claim that such a solution is not sufficient because it puts certain categories of persons into the position of potential victims. They cite the example of mute persons who, because of their inability to speak, have potential problems in expressing their clear and direct consent (Ritossa and Martinović, 2014, p. 535). We agree with these remarks and may also add that the new concept of consent could limit the right to free engagement into sexual intercourses for certain persons, especially the mentally challenged. It is important to notice that persons with mental difficulties often have strong sexual urges, so is it justified to ask that a person who is not mentally incapable should *a priori* avoid engaging in sexual intercourse with a mentally challenged person because they can never be certain that they will not be charged and prosecuted for a criminal offence as a result? It has already been pointed out in the literature that it is not justified to emphasize the protection of "especially vulnerable groups" without a deeper examination of their vulnerability (Dubber and Hörnle, 2014, p. 765). Moreover, does the new concept actually imply that one should always ask for clear consent before having sex with someone? What should the quality of the consent be? Should it be verbally articulated, or even written? The above-mentioned verdict of the Zagreb County Court (5-K-133/2013) obviously indicates that one should never presume the existence of consent based only on victim's behavior. These questions are not clearly answered by the Criminal Code which significantly diminishes the level of legal certainty. The *nullum crimen sine lege certa* principle, which is one of the basic principles underlying continental criminal laws, requires that everyone must know what they may or may not do. Only then does the law have the legitimacy to convict and punish perpetrators for their crimes. In our opinion, the existing regulation of consent for sexual intercourses and other sexual acts does not provide the required level of legal predictability.

Increased strictness of the new regime can also be seen through the fact that the new Code has introduced negligent forms of non-consensual sexual intercourse and rape. We have already pointed out the illogical solution that these negligent forms haven't been incriminated by the most severe forms of sexual offences (Art. 154). Moreover, we have difficulty imagining how it could even be possible to act with negligence in cases of rape? The crime of rape in Croatian criminal law implies that the perpetrator has used either physical force or threatened direct usage of such force. In that kind of circumstance, it is not clear what the legislator had in mind when it regulated a situation in which a perpetrator may not be conscious that he or she is acting without consent of the victim. Is it possible to use force or to threaten someone and still think that this person agrees to whatever you are forcing him or her to do? Such a claim is just not empirically correct or logical. That is why it is not clear why the negligent form of rape has been criminalized. It seems that the only effect will again be to increase legal uncertainty.

Finally, the increased strictness of the new regime is also visible from the fact that the legislator decided to raise the age of consent for involvement in sexual intercourse from

fourteen to fifteen. The age limit varies from state to state. The overview of comparative law in Europe shows that countries decide to set the age limit between fourteen (for example Germany, Hungary, Italy, Portugal, Serbia, etc.) and eighteen (Malta, Turkey and the Vatican City). This decision of the legislator is above all based on estimating of the average age of children's psychological maturity. However, it can also be influenced by other factors (state politics, different lobbies, etc.). We will not argue whether it was good or bad to raise the age limit. This question requires more detailed psychological and sociological research and is beyond the scope of this paper. However, we must notice that this important change has not been explained in any of the scientific papers or comments on the Criminal Code written by the members of work group responsible for drafting it. The fact remains that this change expands the zone of criminal liability.

### **INSTEAD OF A CONCLUSION, SUGGESTIONS *DE LEGE FERENDA***

The previous sections have pointed to the main features of the latest reform of sexual delicts in Croatian criminal law. A critical overview of the changes and of the relevant case law was also given. Based on the presented material, we will try to give our suggestions for future legislative changes.

Above all we strongly argue for repeal of negligent forms of sexual crimes. As we explained above, the negligent form brings confusion to the theory and practice of criminal law. It also causes legal uncertainty. Moreover, negligence is not in the nature of sexual crimes, as crimes which are always committed with *dolus directus*. The main goal of these crimes is to express aggression, to humiliate the victim and to satisfy sexual urges. That is why it is not to be expected that these crimes will be committed through negligence. The negligent form allows criminalization and punishment for behaviour which should not be treated as a criminal offence due to the subsidiarity principle. The negligent forms of sexual crimes is not in the tradition of continental Europe and none of the countries which have traditionally been a role models for Croatian criminal law have a similar categorization.

The next problem in our opinion is the legislative definition of consent in Art. 152 para. 3 of the new Criminal Code. As we already explained, this definition implements the *consent plus* concept, which requires three cumulative elements for legally valid consent: willingness of the consent, capability to make the decision and capability to express the decision. As Ritossa and Martinović correctly point out, it is arguable whether willingness of the consent should be an element. Earlier practice did not give gravity to unwillingness of the consent if it was only of internal nature and was not in any way manifested. As we have already shown through the example of the Zagreb County verdict, the new case law tends to require both internal and manifested willingness, which introduces too wide a definition of criminal liability for sex offences. It also favors the outdated theory that the state has the obligation to protect the sexual freedom of those people who are unable to decide for themselves (Ritossa and Martinović, 2014, p. 536). We agree with the argument of Ritossa and Martinović and strongly suggest that the definition of consent should be erased in future reforms of the Croatian Criminal Code.

Finally, we believe that the legislator should limit the courts' ability to impose parole sentences and other alternatives for a prison sentence in cases of sexual crimes. These crimes are among the most difficult and most dangerous, and imposing such lenient sentence is not in accordance with the purposes of punishment, especially not with general and special deterrence in mind. It would be desirable for the legislator to cancel the possibility of parole, at least in cases of rape and the most severe criminal offences against sexual freedoms.

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## ONCE A DEBTOR, ALWAYS A DEBTOR: LESSONS FROM BULGARIAN DEBT COLLECTION PRACTICES

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### ABSTRACT

The paper aims to prove that, once a debt is in default, individual bankruptcy is in both creditors' and debtors' best interest. The most reasonable solution is individual bankruptcy proceedings and a second chance for the debtor. To persuade the reader, we depict the extreme consequences of household over-indebtedness: the reality of debt collection in Bulgaria - a country where individual bankruptcy is still a myth. We examine the legal framework of the executive proceedings to show that they usually lead to an increase in the debt rather than a decrease, as well as to the unequal distribution of the debtor's assets among the creditors. We present quantitative data regarding household debts and the number of executive proceedings in Bulgaria. We also discuss some of the malicious debt collection practices that develop when debtors are left at the mercy of debt collectors without any legal protection.

**Key Words:** Debt collection, Individual Bankruptcy, Consumer Over-indebtedness

### INTRODUCTION

During the last few decades, most European countries have adopted a legal concept completely new to the civil law tradition on the continent: consumer bankruptcy. Across the Atlantic, individuals in the United States have long been able to benefit from the discharge of their debts and recover after financial difficulties.<sup>2</sup> The differences between consumer bankruptcy statutes in Europe and in USA are substantial. While 11 U.S.C. provides both straight liquidation in no asset cases under Chapter 7, applicable to entities and individuals alike, and debt adjustment without debtors losing all or any of their property under Chapter 13, most EU countries have adopted only the second type of bankruptcy proceedings. Although there are substantial variations from state to state, the EU countries which allow consumer debt discharge require payment plans to be strictly followed, and at least partial payments of the debts must be made before a discharge is granted (McCormack et al., 2016).

Here “[i]t should be noted at this stage that only Bulgaria, Croatia, and Malta do not recognize Consumer Over-indebtedness in that they have no Bankruptcy or Debt Settlement Procedures that cater for Consumers” (McCormack et al., 2016, p. 316). Although a draft bill for individual bankruptcy was proposed to the Bulgarian Parliament in February 2015, legislators have not yet discussed it.<sup>3</sup>

In the light of the by far delayed statutory actions, the paper examines the necessity of the legal institute of consumer bankruptcy and compares the benefits it brings to the alternative. We present the current situation in Bulgaria regarding over-indebtedness, executive proceedings, and debt collection. Our aim is on the one hand to urge legal action in Bulgaria towards debt collection and consumer bankruptcy regulations, and on the other to depict the harsh consequences when consumers are held responsible for their debts without any protection or relief as a lesson for any person or legislative body not in favor of such provisions.

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<sup>2</sup> The US Bankruptcy Act of 1841 granted the right of discharge to every individual debtor, not only merchants, as had been the case before its enactment (Tabb, 1995).

<sup>3</sup> Information and full Bulgarian text is available from <http://www.parliament.bg/bg/bills/ID/15220> [Accessed 7 November 2016].

## LEGAL FRAMEWORK

### Enforcement agents

In Bulgaria, only legal persons can currently declare bankruptcy under Part Four of the Bulgarian Commercial Act. Natural persons do not have any legal recourse when they are in debt. In cases of default, creditors file claims, obtain writs of execution and enforce them through executive proceedings. Debtors' whole property and wages, except for a small, legally defined part,<sup>4</sup> are used to satisfy the debts.

Until 2006, state enforcement agents were the only executive body that existed for the collection of debts. In 2006, the body of private enforcement agents was created to increase the effectiveness of the enforcement proceedings. Now there are 113 state<sup>5</sup> enforcement agents and 193 private enforcement agents (Chamber of Private Enforcement Agents, 2015). Once creditors obtain the writ of execution, they can either initiate executive proceedings or join such proceedings against their debtors, choosing between state and private enforcement agents. The difference is that, in Bulgaria, private enforcement agents are self-employed professionals like attorneys and notaries, while state enforcement agents are state employees and their remuneration is not related to their effectiveness or the number of enforcement actions they initiate. The fact that private enforcement agents collect the fees of the proceedings for themselves was supposed to enhance their motivation and effectiveness, but this has been proven to hamper the debt collection process even more.

### Executive proceedings

The first serious drawback is that there is no automatic stay on debts when an individual becomes insolvent. The enforcement on a debtor's property thus works on the principle of "first come, first served": creditors whose debts become delinquent first have the chance to be the first to obtain writs of execution and begin the execution proceedings, despite the debtor's imminent inability to pay other debts as well.<sup>6</sup>

The second serious problem comes as creditors file separate claims to court to obtain writs of execution for their claims. Usually the result is many separate claims and separate proceedings. One debtor thus could, and often does, end up with multiple enforcement procedures with different enforcement agents at the same time, and multiple creditors. The result is a huge number of open cases and no guarantee that debtors even know about the different pending procedures against them. Bankruptcy proceedings would prevent this complication by imposing an automatic stay on the debts and unifying them all into one single court and enforcement proceeding.

Probably the worse consequence of the lack of individual bankruptcy is the multiplication of costs due to the high number of executive proceedings. Court and attorney fees, as well as fees paid during the enforcement proceedings, are at the expense of the debtor.<sup>7</sup> All the fees for every separate writ of execution, every open case, every enforcement action, therefore exacerbate the already indebted consumer's position. Such proceedings could hardly be called efficient. The usual and logical result is the perpetual impossibility of the debtor to pay back the multiplied debts.

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<sup>4</sup> The list of unseizable income and property is stated in Arts. 444–446 of the Civil Procedure Code.

<sup>5</sup> Art. 264 (1) of the Judiciary System Act.

<sup>6</sup> Secured creditors take priority over unsecured ones for money allocation.

<sup>7</sup> According to Art. 34 of the Tariff of Fees and Costs of Private Enforcement Agents, costs of execution proceedings are paid by the creditor in advance and are at the expense of the debtor. However, it was explicitly recognized in Interpretative Decision 2/2013 of the Supreme Court of Cassation from June 2015 (pp. 25–26) that costs and fees are often directly collected from debtors, leading to an excessive increase of the debt. Although the Supreme Court declared such practices as grounds for disciplinary responsibility of the enforcement agent, we cannot know if this convenient practice exists or not.

To illustrate the gravity of the matter, we would like to give the simplest possible example of how disproportionately high fees increase the whole debt once the executive proceedings begin. For a 1,000 lv. (1 lev = € 1.95) consumer debt, the absolute minimum possible court expenses would be:

- + 25 lv. for the writ of execution;
  - + 20 lv. for the initiation of enforcement proceedings;
  - + 10 lv. to invite the debtor to pay; and
  - + 100 lv. for the enforcement agent fee.<sup>8</sup>
- Total costs: 155 lv.

So, 15.5% of the debt is the minimal debt increase during the enforcement proceedings, possible only if the debtor pays voluntarily and no attorney fees were charged. This hardly happens. Usually what follows is that interest, numerous fees for property investigations, seizures, wage garnishments, etc. increase throughout the whole proceedings. What is more, even a 15% debt increase is significant for an over-indebted person.

Here we should mention that there is no guarantee the creditors and private enforcement agents act in good faith toward the debtor's difficult situation. Usually multiple attorney fees are added to the final balance of the debt. In fact, the actual scale of unfair and encumbering practices in the debt collection and executive proceedings is so big, that the urgent need for change in the statutes governing the enforcement proceedings has been among the priorities of both the current and the former ombudsman.<sup>9</sup> We found another example of the common way a debt increases multiple times during the enforcement proceedings in the current ombudsman M. Manolova's Annual Report (2015):

- 100 lv. initial debt;
  - + 25 lv. for the court fee;
  - + (at least) 300 lv. attorney fee for the court proceedings;
  - + 350 lv. attorney fee for the executive proceedings;
  - + interests or liquidation damages, which could be more than the main debt; and
  - + 108 lv. for the private enforcement agent fee.
- Total: 883 lv. in the best-case scenario.

If, however, we add + 300 lv. for court proceedings in case the debtor makes an objection, and + 2 x 150 lv. for expert witness reports, the total debt equals 1,483 lv.<sup>10</sup>

A stunning example of a real case (Тази сутрин, 2012)<sup>11</sup> concerning debt for an unpaid bill to a mobile provider amounting to 37 lv. involved adding the following costs:

- + Executive order and writ of execution: 25 lv.;
- + Attorney 1's fee: 120 lv.;
- + Attorney 2's fee: 360 lv.;
- + Garnishment costs: 144 lv.;
- + Enforcement Agent fee: ~300 lv.;

In total: debt of 986 lv.

This equals a 2665% increase of the debt.

<sup>8</sup> According to the Tariff of Fees and Costs of Private Enforcement Agents.

<sup>9</sup> Despite their efforts and the actions they have undertaken within their powers, there have not been any changes in the legal framework regarding executive procedure.

<sup>10</sup> The report presents these calculations as the common case with unpaid bills owed to the only Heating Supply Company in Sofia. The ombudsman's annual report reveals a spate of complaints against the company, and presents another case where for a debt of 29 lv. the debtor must pay 794 lv (27 times more), although the due amount has been paid before the beginning of the proceedings and due objections made under Bulgarian legislation (p. 23).

<sup>11</sup> The case was presented in the report of one of the national TV channels and included an explanation of the costs by the private enforcement agent who was responsible for collecting the debt.

To make matters worse, according to Art. 136 of the Obligations and Contracts Act, the costs of the executive proceedings and debts towards the State (such as taxes) must be collected first. Hence, debtors pay for years before they actually start paying their own debts. Once individuals fall into the trap of insolvency, they can hardly cope with it.

The logical question that arises is: until when could the executive proceedings, and consequently the debt increase, be prolonged?

### Statutory limitations

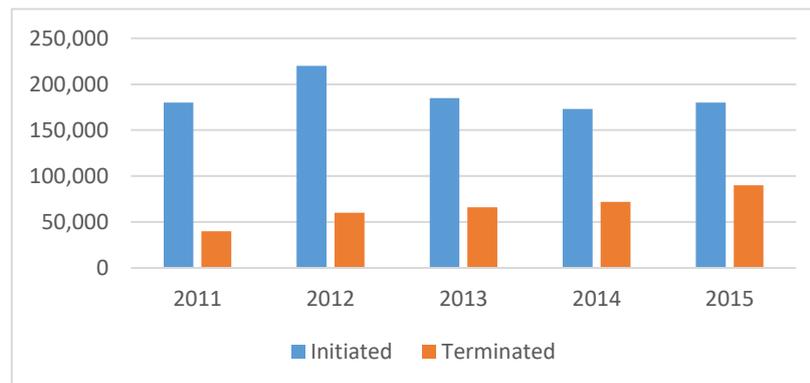
In theory, executive proceedings can continue forever. Statutory limitations for court claims is three years (for default in periodic payments) or five years from the default. The writ of execution's prescription is then five years (Art. 110 and Art. 111 of Obligations and Contracts Act). The enforcement proceedings are terminated, except for payment or the creditor's waiver of claim if no enforcement action is taken for two consecutive years (Art. 433 (1), item 8 of the Civil Procedure Code). This means that the absolute minimum timespan during which the debtor could be asked to pay is at least 10 years. This rough estimation does not include court and enforcement proceedings, which enforcement actions often prolong for years.

Mere logic leads us to the conclusion that executive cases would only increase in number, especially in times of economic crisis like the recent one. Cases would continue for years. This conclusion is supported by the empirical data.

### EMPIRICAL DATA FOR EXECUTIVE PROCEEDINGS IN BULGARIA

As stated above, private enforcement agents are considered a more efficient option for executive proceedings. According to their own data (Chamber of Private Enforcement agents, 2015), their effectiveness is shown in Figure 1 below. Unfortunately, there is no available data to show us the total number of open cases, including the overlapping ones from previous years. Nevertheless, the data demonstrates the increasing number of enforcement proceedings against debtors.

**Figure 1. Private enforcement proceedings**

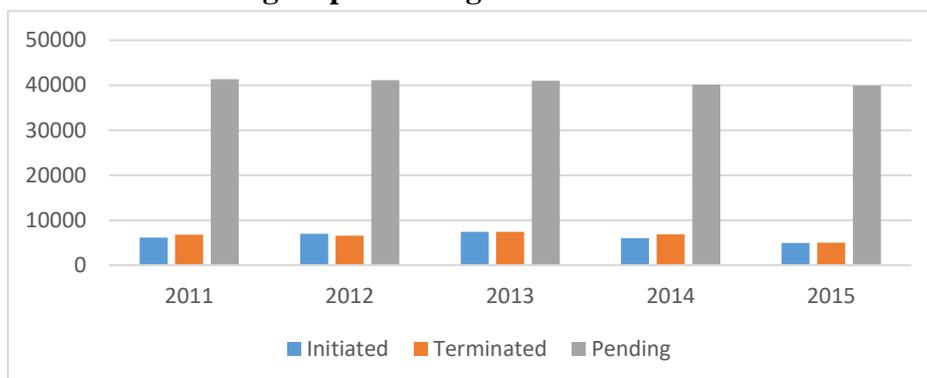


The data above presents only the private enforcement agents' cases. Similar data about state enforcement agents is found only as part of district courts' annual reports. However, most of this data, however, is very limited. Nevertheless, we analyzed the available data for six<sup>12</sup> of the biggest Bulgarian cities. As seen from Figure 2, the decrease in the number of pending cases is insignificant. The slight decrease in open proceedings can be explained by the creditors' preference of private enforcement agents to public ones. Despite that, the number of pending

<sup>12</sup> The cities are Varna, Plovdiv, Burgas, Pleven, Stara Zagora and Shumen (Annual Reports, 2011–2015). Unfortunately, data about Sofia's District Court – the court serving the capital, which is the most populated city in Bulgaria – was not sufficient to be included.

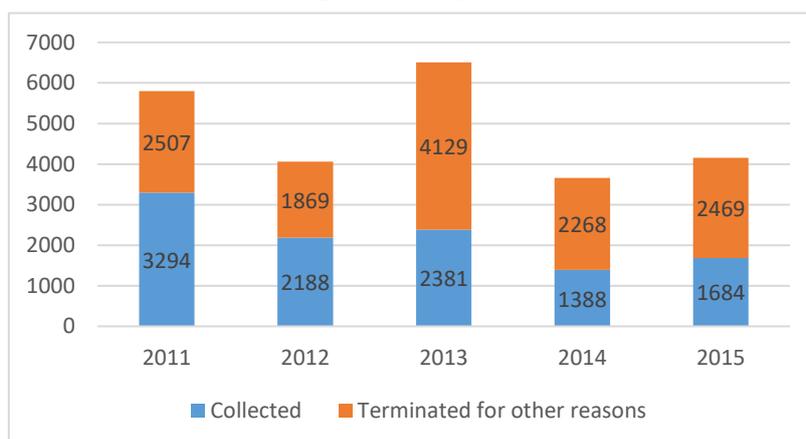
cases is remarkably stable. This, combined with the much higher number of open cases in comparison to the closed ones in the private enforcement agents' statistics, gives us reasonable ground to suspect that the pending cases of private enforcement agents are not decreasing in number either.

**Figure 2. State Enforcement Agent proceedings**



A terminated case does not, however, necessarily mean a collected debt. In fact, the creditor has received the debt in only a small percent of the terminated cases. Figure 3 presents the number of terminated cases in four cities.<sup>13</sup> As we see, at least half the cases are terminated due to the expiration of statutory limitations, amicable settlements between debtors and creditors, the lack of creditor action for more than two years, etc. The data presented includes numbers from only four of the largest cities in Bulgaria due to the lack of more data, but it is enough to depict the current ineffectiveness of the enforcement proceedings.

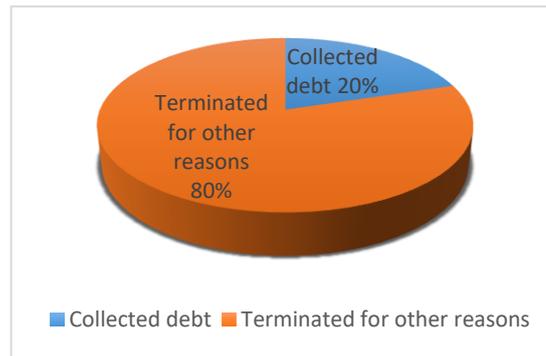
**Figure 3. Terminated state executive proceedings**



*A striking example is the Sofia Regional Court's statistics for 2015 (Annual Report).<sup>14</sup> Out of the 6881 terminated cases, the debt was only collected in 1388 (Figure 4).*

<sup>13</sup> The four cities are Varna, Burgas, Stara Zagora and Shumen (Annual Reports, 2011–2015).

<sup>14</sup> Unfortunately, there is no available data for previous years.

**Figure 4. Terminated executive proceedings in Sofia's District Court**

One of the biggest concerns of individual bankruptcy is that creditors will not receive their claims. As we have seen, even now, when no debt relief is possible, only a small fraction of the enforcement proceedings end with the debtor paying the creditor. Cases usually stay pending for years, leading to the accumulation of higher debts due to fees, and debts eventually become impossible to collect. Debtors end up with no property, no income and increased debts. This prevents them from being viable members of the social and economic world. Moreover, it is an equally unfeasible situation for the creditors. Alternative solutions are thus gaining popularity: debt purchase and debt collection agencies.

### THE DEBT COLLECTION ECOSYSTEM

Jiménez (2015, p. 106) calls creditors, debt buyers, collection agencies, and collection law firms “the entire collection ecosystem.” It is an ecosystem indeed. The debt collection agencies provide easy disposal of non-performing loans for the credit institutions. They can not only charge the debts off their accounts but also receive a price for them. In fact, credit institutions already release their debtors after receiving only whatever proceeds are available at the beginning of the execution process.

Creditors’ expectations and attempts to recover debts are over after their assignment. However, debtors’ struggles are just beginning. Debt collection agencies may not be the original creditors who extended these loans, but their employees nevertheless pursue the payments as if this were the case. This often leads to unfair or malicious practices and intrusion into debtors’ time and life. It is not surprising as the incentives<sup>15</sup> used to encourage the collectors are well chosen to encourage collectors to employ all kinds of measures.

### Examples of common debt collection methods<sup>16</sup>

The easiest and most widely used method of collecting the assigned debts is through phone calls. Debtors are usually called on the phone, and at first informed politely that they must pay immediately. When they pay voluntarily, they are not disturbed more than once a month. If they do not pay, they are disturbed countless times. The polite tone is then replaced by more effective means. Harassment is the very first cruel but extremely effective weapon a debt collector uses. Multiple phone calls, arrogant behavior, all kinds of threats and insults are the usual “arsenal”. “Debt collection companies use extremely aggressive, even coercive methods

<sup>15</sup> As in many other industries, including banks and other credit institutions, the incentive is the target bonus. Collectors are usually given a relatively low salary, but each month a certain target of a collected amount of money is given. If collectors reach their targets, they receive a decent bonus in addition to their salary – a simple and effective method.

<sup>16</sup> The author bases the following exposition on her own professional experience in the field of debt collection, her research on the decisions of the Commission for Personal Data Protection (infra.), the interviews and annual reports of both former and current Bulgarian ombudsman (as they, as representatives of the citizens of the State, have addressed these issues numerous times), and various other media sources.

of debt collection. Citizens complain of psychological harassment and threats for their health and life, or the health and lives of their relatives, even employers” (Penchev, 2013). As a result of the persistent calls and threats many people pay voluntarily, often just to make the calls stop.<sup>17</sup>

Collectors commonly threaten to order immediate wage garnishments or public auctions of debtors’ property. Of course, such action is beyond their capacity.

A trick to obtain more information about a debtor is through disturbing neighbors and relatives. Either because debtors have changed their phone numbers or addresses to prevent collectors to get in touch with them, or just because more information might be helpful, a collector will often call the neighbours to gather more information about the debtor. They ask questions about the debtor’s residence, job, current affairs, etc. Some are quite ingenious, for example, claiming that the debtor has won something so that a neighbor or relative will provide information about them. “Debt collection companies, by unclear and dubious ways, acquire information about mobile phone numbers of relatives, colleagues, employers of debtors, through whom they exercise duress” (Penchev, 2014). Another practice is visiting the debtors’ home addresses to scare or at least disturb them enough to make them pay (Penchev, 2014).

Many times, the information about the initial creditor is provided only if the debtor pays the obligation or signs an agreement with the new one. Sometimes such information is not even available or is incorrect.<sup>18</sup> Sobol (2014) uses a very suitable metaphor: “Aggressive collectors can resurrect ‘dead’ debts into live or zombie debts. Collectors can achieve this transformation when they persuade consumers to pay some amount against their debts, acknowledge the debts, or enter into new agreements.” Usually these amicable agreements have serious legal consequences: acceptance of the debt and renewal of the debt’s statutory limitations. Another common practice is to propose a discount on the debt to lure debtors to sign settlements or pay any amount possible. Debtors are offered to pay only up to 50% less if they pay the other part in one or several instalments. Collectors usually use such tactics when there are no securities and enforcement proceedings have been unsuccessful. In other words, even new creditors are ready to give up a significant amount of their claim to receive whatever payment is possible. When concluding such agreements, it is entirely a matter of bargaining skills and having a better position. It is curious to remark that if the debtor has a wage garnishment or makes voluntary payments, no good agreement conditions will be offered. It is an unfair game where collectors take advantage of conscious and honest debtors and make the most of the unscrupulous ones. It is a world where the more insolent a party is, the better!

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<sup>17</sup> A client of mine was contacted multiple times by debt collectors for a supposedly unpaid bill to a mobile provider. He was threatened that unless he paid by the end of the week, the collector would impose a garnishment on his pension. As the debt collection agency was acting as a representative of the creditor, it had neither the documents, nor the authorization to file a petition for such an enforcement measure. Although the client was paying his bills every month, he was so stressed that he wanted to pay immediately regardless of the fact that he did not owe anything. It took me more time to convince him not to pay than to verify the total lack of legal grounds for such threats.

<sup>18</sup> Although complaints on the Internet and other media abound, court practice on debt collection practices is scarce, as most of the victims of harassment rarely search for legal help. However, one particular case (Decision No. 1913, 5/14/2012, on civil case No. 14576/2011 in Plovdiv’s Regional Court, illustrates the problems victims face quite well. The claimant was alleged to be delinquent in the payment of a debt, which was later assigned to a debt collection agency. The collectors refused to present the contract which was supposed to prove the existence of the debt unless the claimant paid the full amount first despite his objections that he had never signed any contract with the initial creditor. In the course of the trial, it was proven that the initial creditor made a mistake in the personal data of the party and the claimant had been disturbed without any fault on his part. Nevertheless, his claim for indemnity for the caused suffering was dismissed as the legal ground for the claim was not applicable to representation between legal entities.

## Protection from Debt Collection Practices

### *Criminal code*

Difficult conditions for indebted citizens are worsened by the lack of any regulative body to protect them and control debt collection activities. Unlike in the USA, where the Fair Debt Collection Practices Act is in force, there are no administrative regulations to provide legal grounds for state interference and sanctions in Bulgaria. The only possible grounds for sanctions are when the debt collector has committed a crime. Under the Bulgarian Criminal Code the possible crimes could be insult, threat, coercion or blackmail. However, as the disturbing conversations are usually carried out over the phone, without witnesses and without the cooperation of the collection agencies, such complaints are very difficult to investigate. Charges are rarely pressed due to lack of evidence (Penchev, 2013).<sup>19</sup> Moreover, calling someone repeatedly is not considered a crime, nor is it a misdemeanor under Bulgarian laws.

Despite the scale on which these practices are happening, despite the attention of the ombudsmen and the media, there is still no legal ground on which a debtor can be protected from the harassment they endure. So far, the only successful claims have been on the grounds of protection of personal data.

### *Commission for Personal Data Protection*

The only control exercised over debt collectors is with regard to the protection of individual personal data.<sup>20</sup> Debt collection agencies register as personal data controllers<sup>21</sup> in the register<sup>22</sup> kept by the Commission. Except for the police, this Commission is the only state authority where people can file their complaints against debt collection practices. We thus analyzed all its available decisions<sup>23</sup> concerning debt collection practices.

We identified 198 decisions on individual complaints claiming personal data infringements, committed either by creditors or debt collectors when transferring personal data in debt assignments. Our analysis (Figure 5) shows that only 31 complaints (16%) were upheld. 109 (55%) of all the complaints were rejected. In 15 cases (7.5%), the Commission issued a stay of proceedings due to the concurrent investigation on a related matter by another administrative body. In fact, in all of these cases the individual who filed the complaint also filed one to the police claiming that he or she had never signed any agreement with the creditor and that his/her signature must have been forged or his/her data stolen. In 13 cases (6.5%) the appellants came to amicable settlements with the creditors and withdrew the complaints. The proceedings were thus terminated. In these cases, the creditor admitted there had been a mistake and the debt had been discharged. This is the easier escape for the creditor as otherwise they would most probably have been sanctioned by the Commission. Faults in 30 complaints (15%) led to their termination and they were never investigated.

Only 16% of all claims were well-founded because debt assignments and debt collection by third parties are mentioned neither in the text of the agreement, nor during the negotiations. Only a reference to the application of the General Terms and Condition of the creditors is made in the agreements. The creditors' right to distribute personal data is explicitly stated only in the General Terms and Conditions. Debtors hardly even know about the existence

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<sup>19</sup> Despite making efforts to do so, the author was not able to identify a single case where an indictment was brought to court in any of the available legal databases.

<sup>20</sup> According to Art. 2 of the Law for the Protection of Personal Data, personal data is defined as "any information relating to an individual who is identified or identifiable, directly or indirectly, by reference to an identification number or to one or more specific features".

<sup>21</sup> In compliance with Art 17.

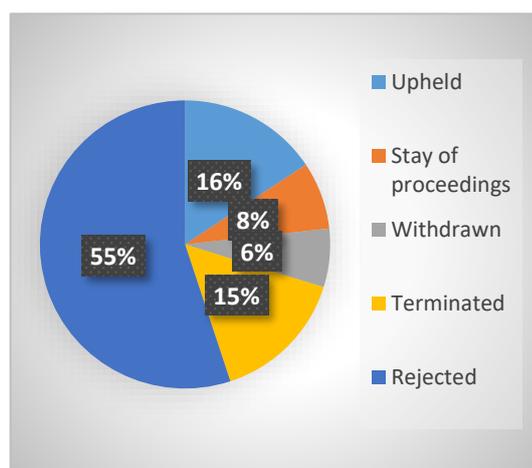
<sup>22</sup> Art. 10, para. 1, item 2.

<sup>23</sup> The decisions of the Commission are available at <https://www.cpdp.bg/?p=search> [Accessed 6 November 2016].

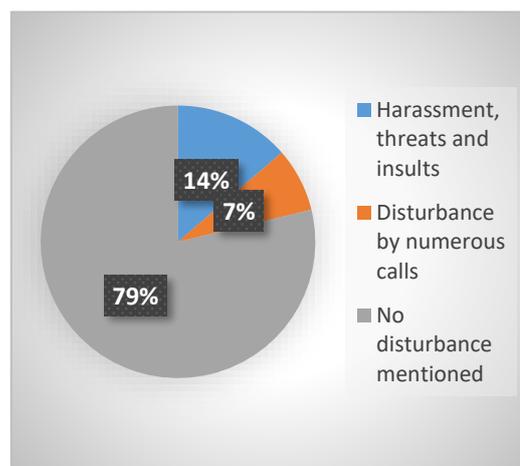
of such terms. This common practice was observed in the cases of our study. Fair or not, this is a perfectly legal practice from a legal standpoint.

Our analysis also confirmed that debtors not only express concerns about their personal data, but also complain of the debt collection practices of the creditors. In 25 of all the claims (13%), the claimants explicitly stated that they were threatened, harassed or both. Insults and rude behaviour by the debt collections were mentioned in two of the complaints, and 15 more claimants stated they were disturbed multiple times or even constantly. Together, the cases where claimants reported being disturbed numbered 42 (21%), which is more than the ones upheld by the Commission (Figure 6).

**Figure 5. Commission for Personal Data Protection: Decisions**



**Figure 6. Commission for Personal Data Protection: Decisions**



This happens because the Commission's competency is limited to, among few other things, protecting individuals' data protection rights<sup>24</sup>, executing control over personal data controllers,<sup>25</sup> and investigating complaints by individuals.<sup>26</sup> However, the Commission only has the authority to investigate infringements regarding the use and distribution of personal data. Every other infringement is beyond its scope and power. This limit obliges the Commission to ignore every other complaint that does not directly concern the distribution of personal data. Weak as this protection may be, people still file their complaints to the Commission, seeking protection from the relentless debt collectors.

### ***Sub-conclusion***

There is no legal ground for this Commission, or for any other state body, to intervene in debt collection methods. We must therefore insist that, along with new regulations to limit debt collection malpractices, a state body must be appointed to monitor the debt collection industry and investigate every complaint filed by a consumer. As the creation of a new state body may be difficult, the Consumer Protection Agency may assume these functions, since in most cases the victims are consumers.

### **CURRENT TRENDS**

In conclusion, we would like to give the reader a more general perspective of the reason we have focused on individual debts. At present, only legal entities in Bulgaria can turn to court when they are over-indebted. In contrast, most of the extended loans are household loans. Consequently, most of the non-performing loans are also household. Diagram 7 (Bulgarian

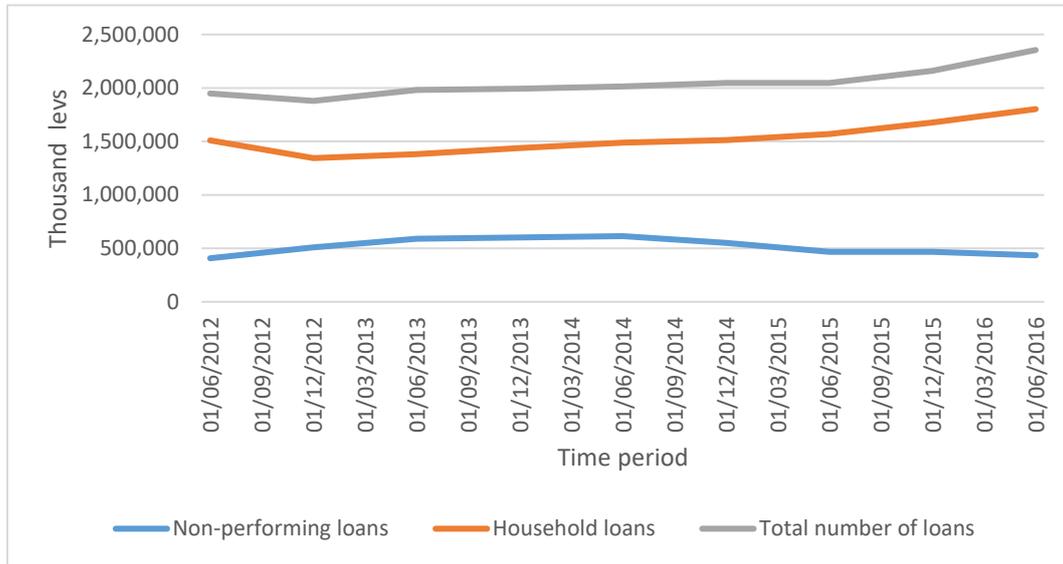
<sup>24</sup> Art. 5, para. 1, item 1 of the Rules on the activity of the commission for personal data protection and its administration.

<sup>25</sup> Art. 10, para. 1, item 3; and Art. 5, para. 1, item 12.

<sup>26</sup> Art. 10, para. 2, item 7; Art. 38 of the Act; and Art. 5, para. 1, item 11.

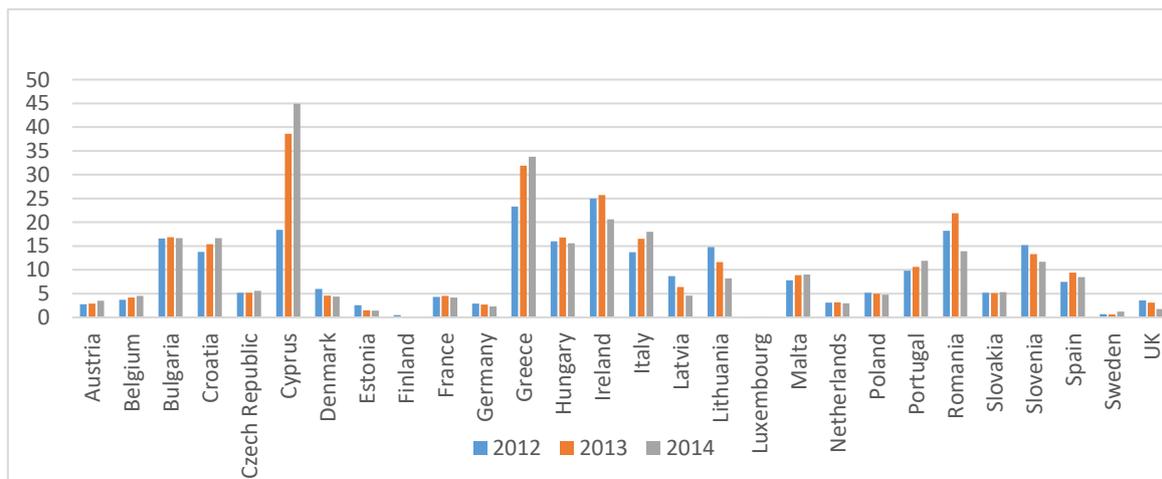
National Bank, 2016) shows us that the steady level of non-performing loans, most of which belong to households, are approximately 25% of all loans. This is a very significant amount. Also, the increase in loans in 2016 can only indicate that an increase in delinquent debts should be expected.

**Figure 7. Loans in Bulgaria**



The picture does not improve in comparison with the other member states in the EU. Figure 8 (International Monetary Fund, 2015) indicates that Bulgaria is among the countries with the highest percentage of nonperforming loans to total gross loans in the EU. As seen from both Figures 7 and 8, non-performing loans and over-indebtedness is not a temporary difficulty, but rather a constant state for many Bulgarian citizens.

**Figure 8. Bank Non-Performing Loans to Total Gross loans (%)**



## CONCLUSION

We could provide more examples and statistics, but we believe our point is clear: the current statutory regulation, or more precisely the lack of it, results in permanent consumer over-indebtedness. Debtors reach an impasse: they end up without any remaining assets, with wage garnishments and constantly increasing debts which “haunt” them for years through constant phone calls, harassment and threats.

In conclusion, we remind our readers that individual bankruptcy was introduced with the aim of serving justice for creditors rather than for debtors, ensuring the equal and fair distribution of debtors’ property. Since at present neither creditors nor debtors are satisfied with the legal framework, it is high time Bulgarian legislators adopted individual bankruptcy law and finally brought the country into line with other European nations.

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