Private Law in Eastern Europe

Edited by
CHRISTA JESSEL-HOLST,
RAINER KULMS and
ALEXANDER TRUNK

Max-Planck-Institut für ausländisches und internationales Privatrecht

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Autonomous Developments or Legal Transplants?

Edited by
Christa Jessel-Holst,
Rainer Kulms and
Alexander Trunk

Mohr Siebeck

Christa Jessel-Holst is Senior Research Fellow at the Max Planck Institute for Comparative and International Private Law.

Rainer Kulms is Senior Research Fellow at the Max Planck Institute for Comparative and International Private Law, Privatdozent at the University of Hamburg, and Editor-in-Chief of the European Business Organization Law Review.

Alexander Trunk is Professor of Law at the University of Kiel where he holds a chair for Private Law and East European Law. He is Director of the Institute of East European Law and currently serves as Dean of the Kiel Law Faculty.

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Preface

More than 20 years have passed since the downfall of socialist systems in Central and Eastern Europe. To usher in stable transformation processes, utmost priority was given to the recognition of *property rights*, an indispensable requirement for free market economies. Regulators soon came to realize that the success of transformation was conditioned on a more systematic approach towards codified private law and business law. Current law studies on individual Eastern European countries fail to portray the full sway of transformation dynamics. Moreover, they do not disclose that national policy responses after 1989 are far from homogeneous. Legislative projects oscillate between 'old' socialist codifications and a distinctly autonomous approach. Some countries in Eastern Europe are committed to the *acquis communautaire*. Others do not envisage membership in the European Union. All of them have strong civil law traditions. In March 2009, the Max Planck Institute for Comparative and International Private Law and the Institute of East European Law of the University of Kiel held an international symposium in Hamburg to scrutinize transformation processes from a long-term perspective, based on multi-country comparisons. In this conference volume, international policy advisors and scholars from Eastern and South Eastern Europe (Bosnia and Herzegovina, Bulgaria, Croatia, Hungary, Poland, Romania, Russia, Serbia, Slovenia and Ukraine) assess codification processes in classic private law fields and company and capital market laws. The policy section serves as a prelude to a rigorous analysis of general civil law and property law problems. The section on company law in Eastern Europe concludes.

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Hamburg, November 2010 *Christa Jessel-Holst*, *Rainer Kulms*

Contents

Abbreviations

ABGB	Allgemeines bürgerliches Gesetzbuch (Austrian Civil Code), see also ACC or OGZ
ABOR	Act on Basic Ownership Relations
ACC	Austrian Civil Code (see also ABGB or OGZ)
ADA	Australian Development Agency
AIFM	Alternative Investment Fund Managers
AktG	Aktiengesetz (German Act on joint stock companies)
Am. J. Comp. L.	American Journal of Comparative Law
AO	Aktsionernoje obshestvo (Joint Stock Company)
AOC	Act on Obligations and Contracts
APAPS	Autoritatea pentru Privatizare şi Administrarea Participaţiilor Statului (Authority for the Privatization and Administration of State Participations)
Art.	Article
ARUG	Gesetz zur Umsetzung der Aktionärsrichtlinie (Law for the Implementation of the Shareholder Directive)
AVAS	Autoritatea pentru Valorificarea Activelor Statului (Authority for the State Assests Recovery)
B2B	business-to-business
B2C	business-to-consumer
BAFiN	Bundesanstalt für Finanzdienstleistungsaufsicht (German Federal Financial Supervisory Authority)
BD BiH	Brčko District of Bosnia and Herzegovina
BGB	Bürgerliches Gesetzbuch (German Civil Code), see also GCC
BGH	Bundesgerichtshof (German Federal Supreme Court)
BGN	Bulgarian Lev
BiH	Bosnia and Herzegovina
BMZ	Bundesministerium für wirtschaftliche Zusammenarbeit und Entwicklung (German Federal Ministry for Economic Cooperation and Development)
BSE	Bucharest Stock Exchange
BV	Besloten vennootschap (Limited Liability Company)
CA	Commercial Act
Cardozo J. Int'l. & Comp. L.	Cardozo Journal of International and Comparative Law
CBC-RPS	Center for Business & Corporate Law Research Paper Series
CC	Civil Code
CCC	Commercial Companies Code
CEE	Central and Eastern Europe
CEM	Control-enhancing mechanism

CEO	Chief Executive Officer
cf.	confer, compare
CFR	Common Frame of Reference
CIDA	Canadian International Development Agency
CILC	(Dutch) Center for International Legal Cooperation
CIS	Commonwealth of Independent States
CISG	United Nations Convention on Contracts for the International Sale of Goods
CNCSIS	The Romanian National Council of Scientific Research of the Superior Education
CNVM	Comisia Națională a Valorilor Mobiliare (National Securities Exchange Commission)
Com	Commission
CPA	Consumer Protection Act
CPC	Civil Procedure Code
CPLP	Community of Portuguese Language Countries
CRA	Credit Rating Agencies
DCFR	Draft Common Frame of Reference
DEZA	Direktion für Entwicklung und Zusammenarbeit (Swiss Agency for Development and Cooperation)
DFID	(British) Department for International Development
DG	Director General
EA	Enforcement Act
EBLR	European Business Law Review
EBOR	European Business Organization Law Review
EBRD	European Bank for Construction and Development
ECFR	European Council on Foreign Relations
ECGI	European Corporate Governance Institute
ECJ	European Court of Justice/Court of Justice of the European Union
ED	European Democrats
EEC	European Economic Community
EEIG	European Economic Interest Grouping
EEP	European Peoples Party
e.g.	exempli gratia (for example)
ESFS	European System of Financial Supervisors
ESRB	European Systemic Risk Board
et al.	et alii (and others)
et seq.	et sequentes (and the following)
EU	European Union
Eur. Econ. Rev.	European Economic Review
FAQs	Frequently asked questions
FBiH	Federation of Bosnia and Herzegovina
FC	Family Code
FFP	Fondul Proprietății Private (Private Ownership Funds)
FINA	Financijska agencija (Croatian Financial Agency)
FNRJ	Federativna Narodna Republika Jugoslavija (Federal People's Republic of Yugoslavija)
FPS	Fondul Proprietății de Stat (State Ownership Fund)
FSA	Financial Services Authority
FSC	Financial Supervision Commission

GAAP	Generally Accepted Accounting Principles
GATT	General Agreement on Tariffs and Trade
Ga. J. Int'l. & Comp. L.	Georgia Journal of International and Comparative Law
GCC	German Civil Code (BGB)
GD	Government Decision
GDP	Gross Domestic Product
GEO	Governmental Emergency Ordinance
GmbH	Gesellschaft mit beschränkter Haftung (German Limited Liability Corporation)
GP	General partnership
GTZ	Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) GmbH
GUS	Polish Central Statistical Office
HUK Law Quarterly	Quarterly for the Entire Commercial, Insolvency and Capital Market Law
i.e.	id est (that is)
ibid.	ibidem (in the place cited)
ICC	International Criminal Court
I.C.L.Q.	International Comparative Law Quarterly
IFC	International Finance Cooperation
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
INSOMAR	The National Institute for Opinion Surveys and Marketing
Int'l. Encyclop. Comp. L.	International Encyclopedia of Comparative Law
IPO	Initial Public Offering
IRZ	Deutsche Stiftung für Internationale rechtliche Zusammenarbeit e.V. (German Foundation for International Legal Cooperation)
J. Comp. L.	Journal of Comparative Law
J. Econ. Lit.	Journal of Economic Literature
J. Fin.	Journal of Finance
JITE	Journal of Institutional and Theoretical Economics
J. L. Econ. & Org.	Journal of Law, Economics, and Organization
JSC	Joint Stock Company
KNF	Komisja Nadzoru Finansowego (Polish Financial Supervision Authority)
KNUiFE	Komisja Nadzoru Ubezpieczeń i Funduszy Emerytalnych (Insurance and Pension Funds)
KPWiG	Komisja Papierów Wartościowych i Giełd (The Polish Securities and Exchange Commission)
LIS	Legal Indicator Survey
LLC	Limited liability company
LLM	Master of Laws
LP	limited partnership
LRA	Land Register Act
LTP	Legal Transition Programme
Maastricht J. Eur. & Comp. L.	Maastricht Journal of European and Comparative Law
McGill L. J.	Mc Gill Law Journal

MEBO	Management Employee Buy-Out
MEP	Member of the European Parliament
Mich. L. Rev.	Michigan Law Review
MKAS	Russian Federation Chamber of Commerce and Industry
MüKo	Münchener Kommentar (cited: MüKo/author)
NATO	North Atlantic Treaty Organization
NN	Narodne Novine (Croatian Official Gazette)
No.	Number
NV	Naamloze vennootschap (Joint Stock Company)
OA	Obligations Act
OAO	Otkrytoje Aktsionernoje obshestvo (Open Joint Stock Company)
OECD	Organisation for Economic Cooperation and Development
OGZ	Opći građanski zakonik (Austrian Civil Code), see also ABGB
OJ	Official Journal
OMV	Österreichische Mineralölverwaltung (Austrian mineral oil authority)
OOO	Obshestvo ogranichennoj otvetstvennostju (Limited Liability Company)
OSCE	Organization for Security and Cooperation in Europe
OTE	Hellenic Telecommunications Organization
OZZ	Okvirni zakon o zalogama (zalozima) (Framework Law on Registered Pledges)
p./pp.	page(s)
PA	Property Act
Para.	Paragraph
PECL	Principles of European Contract Law
PILC	Private International Law Code
PLN	Polish zloty
POSA	Public Offering of Securities Act
PPP	Public Private Partnership
PPSA	Personal Property Securities Act
RabelsZ	Rabels Zeitschrift für ausländisches und internationales Privatrecht
RASDAQ	Romanian Association of Securities Dealers Assisted Quotation
RCL	Romanian Company Law
RCML	Romanian Capital Market Law
Rev. L. Econ.	Revue of Law and Economics
RPA	Real Property Act
RS	Republic Srpska of Bosnia and Herzegovina
RSD	Serbian Dinar
RSFSR	Russian Soviet Federative Socialist Republic
SA	Societate pe actiuni (Joint Stock Company)
SARL	Société à Responsabilité Limitée
SAS	Société par Actions simplifiée
SBA	Small Business Act
SCE	European Cooperative Society
SDC	Swiss Development Agency
SE	Societas Europaea (European Company)
SFRJ	Socijalistička Federativna Republika Jugoslavija
SFRY	Socialist Federal Republic of Yugoslavia
SIDA	Swedish International Development Agency

SIF	Societate de Investiții Financiare (Financial Investment Company)
SKA	Spólka komandytowo-akcyjna (Kommanditgesellschaft auf Aktien)
SME	Small and medium-sized enterprises
SPE	Societas Privata Europaea (European Private Company)
SRL	Limited Liability Company
SRY	Savezna Republika Jugoslavija (Federal Republic of Yugoslavia)
SSRN	Social Science Research Network
Stanf. L. Rev.	Stanford Law Review
TEC	EC Treaty
TFEU	Treaty on the Functioning of the European Union
UCC	Uniform Commercial Code
UCITS	Undertakings for Collective Investment in Transferable Securities
ULFIS	Uniform Law on the Formation of Contracts for the International Sale of goods
ULIS	Uniform Law on International Sales
UMAG	Gesetz zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts
UN	United Nations
UNCITRAL	United Nations Commission on International Trade Law
UNIDROIT	International Institute for the Unification of Private Law
USAID	United States Agency of International Development
USD	US Dollar
USSR	Union of Soviet Socialist Republics
Va. L. Rev.	Virginia Law Review
VAT	value-added tax
Vol.	Volume
WiRo	Wirtschaft und Recht in Osteuropa
WpÜG	Wertpapiererwerbs- und Übernahmegesetz
WSE	Warsaw Stock Exchange
WTO	World Trade Organization
ZAO	Zakrytoje Aktsionernoje obshestvo (Closed Joint Stock Company)
ZOSPO	Zakon o osnovama svojinskopravnih odnosa (Law on basic property relations)
ZOVO	Zakon o vlasničkopravnim odnosima (Law on Property Relations)
ZSP	Zakon o stvarnim pravima (Law on property rights)
ZV	Zakon o vlasništvu i drugim stvarnim pravima (Law on property and other in rem rights)

Private Law in Eastern Europe

Autonomous Developments or Legal Transplants?
− Welcome Address −

When the socialist regimes in Central and Eastern Europe collapsed after 1990, a new era in the development of private law started. While it had previously been difficult in socialist countries, to identify any legal relationship as "private", *Mestmäcker* characterized the new situation as a renaissance of the civil society and its law.[1] Indeed, the new social order that was established everywhere built upon private initiative pursuing private interests, and policymakers throughout Central and Eastern Europe shared the expectation that the pursuance of private interests in a competitive environment would further the public good.

As a consequence, private law had to be re-construed or even re-written with the aim of creating a legal framework that would fit private plans and reduce the possibility of state intervention in the public interest to a minimum. In several countries the political and legal elite even considered a complete overhaul of their national private law legislation as necessary. A new wave of codification rolled ashore in countries such as Russia or the Baltic Republics; in Hungary, Poland, the Czech Republic and Slovakia codification projects have been put on track and may succeed in the years ahead.

Of course, these projects are not only driven by the turn of society towards private initiative and a market economy. It is safe to assume that regaining full independence after the breakdown of the Warsaw Pact has inspired national feelings in many countries and brought about the desire for national symbols. As we know from the enactment of the first generation of civil codes throughout the 19th century the civil code has often been considered as a symbol of national cohesion.

Other motivations that may appear more economic or technocratic have equally contributed to the continuous stream of private law legislation in

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[1] *Ernst-Joachim Mestmäcker*, Die Wiederkehr der bürgerlichen Gesellschaft und ihres Rechts, Lecture delivered at the Annual Meeting of the Max Planck Society (Hauptversammlung der Max-Planck-Gesellschaft) in Berlin, 7 June 1991, in: Rechtshistorisches Journal 10 (1991), 177 et seq.

Central and Eastern Europe. There were indeed large gaps in the existing legislation which had to be filled. For example laws on corporate entities were either absent or outdated after 50 years of an economy driven by state enterprises. In a similar vein, there had been no need for insolvency laws in socialist times; pertinent statutes were badly needed now. While state enterprises had received their operating funds through grants received from the central government in accordance with the central economic plans, they were now under a constraint to acquire fresh money from capital markets which would grant credit in accordance with the securities provided. However, security rights whether in movable or immovable assets were largely undeveloped or nonexistent, in particular where real property was owned by the State. Similar deficits could be observed in the field of banking contracts or insurance contracts.

These are but some examples of a huge task that was very aptly captured by the term "Systemtransformation" or "transformation of systems". In fact, legal systems had to be "reinvented" or conceived anew, and this was not limited to private law but included large parts of public law and criminal law as well. Scholars from both law and economics soon realized the fundamental and comprehensive character of this task which is evidenced, inter alia, by the foundation of a Max Planck Institute on the transformation of economic systems in Jena in the mid-1990s and the organization, by the predecessors of the present directors in 1996, of a symposium on the transformation of systems in our Institute.[2]

Almost 20 years have gone by since these first efforts. The European Union has proved a great attraction for most countries in Central and Eastern Europe. In 2004 and 2007 ten countries from this region joined the European Union as new Members. European integration has inevitably affected the legal systems of these countries, in particular through the implementation of the acquis communautaire. Given the increasingly intense impact of Union law on the whole legal system of the Member States, an autonomous development of their legal systems appears unlikely, even in areas which are not directly covered by Union law. The same can be said for those countries which, without being a Member of the European Union, aspire towards membership.

This explains the overarching topic of this conference: While the countries of Central and Eastern Europe have succeeded in regaining their national independence which should be a basis for an autonomous development of law including private law, the dynamics of European integration generate practical needs and, in fact, narrow the political latitude of

[2] *Ulrich Drobnig/Klaus J. Hopt/Hein Kötz/Ernst-Joachim Mestmäcker*, eds., Systemtransformation in Mittel- und Osteuropa und ihre Folgen für Banken, Börsen und Kreditsicherheiten, Tübingen 1998.

national legislators even in the areas still left under unrestricted national sovereignty. Moreover, several countries might prefer to follow model legislation that has proven satisfactory in Western European countries. The reception of such transplants may be a particularly promising way for small jurisdictions which have only had a few years to digest a huge mass of Union law, developed over 50 years and which Western countries have had sufficient time to adjust to.

These are the potential extremes of the development of private law in Central and Eastern Europe after 1990. The enquiry of this conference is directed to three specific areas which mirror these influences in rather different ways: While company law has been subject to EU influence to a large extent ever since the 1960s, the impact of Union law in the field of contracts has been more recent and much more limited, namely to consumer contracts; the restrictions imposed by Union law are probably least significant in the field of property, where consequently, we may expect a more distinct national character of the law to be generated by autonomous developments. Before we approach the more specific areas of the law, some more general and theoretical analysis will prepare the terrain for specific enquiries.

From the list of speakers at this conference, significant differences emerge concerning their nationality. While all of them represent countries which adhered to doctrines of socialist law before 1990, some of them originate in countries which are now Member States of the European Union, others are nationals of candidate countries, and a third group is from countries which for the foreseeable future will be good neighbours, but not Members. This composition of our guests promises some insights into the variety of legal solutions and their embeddedness in the respective legal systems as well. Let me conclude by wishing you a warm welcome to the Max Planck Institute and to wish all of us an interesting conference.

Jürgen Basedow

A. Perspectives of Civil Law in Eastern Europe
Policy Issues

Optimistic Normativism after Two Decades of Legal Transplants and Autonomous Developments

RAINER KULMS

I. Origins of a Conference

When *Ajani* assessed the transformation processes in Russia and Eastern Europe in 1995, he noted a strong sense of 'optimistic normativism'. Law had come to be seen as an instrument of social engineering, indispensable for the creation of a free market[1]. The European Union shared this normative approach[2]: The Commission's 'White Paper on the Preparation of Associated Countries of Central and Eastern Europe for Integration into the Internal Market of the Union' urges associated countries to adopt internal market legislation and to establish structures to support the economic reform process[3]. The EU's Copenhagen criteria require a new Member

[1] *Ajani*, By Chance and Prestige: Legal Transplants in Russia and Eastern Europe, Am. J. Comp. L. 43 (1995), 93 (103); cf. *id.*, Law and Economic Reform in Eastern Europe – The Transition from Plan to Market during the Formative Years of 1989 – 1994, in: Buxbaum/Mádl (eds.), State and Economy, Int'l. Encyclop. Comp. L. Vol. XVII, Ch. 3 (2006).

[2] Cf. *Ajani*, Transfer of Legal Systems from the Point of View of the "Export Countries", in: Drobnig/Hopt/Kötz/Mestmäcker, Systemtransformation in Mittel- und Osteuropa und ihre Folgen für Banken, Börsen und Kreditsicherheiten (Beiträge zum ausländischen und internationalen Privatrecht 64 (1998)), 39 (51 et seq.); and *Mádl*, State and Economy in Transformation – Revolution by Law in the Central and Eastern European Countries, in: Buxbaum/Mádl (eds.), State and Economy, Int'l. Encyclop. Comp. L. Vol. XVII, Ch. 2 (2000).

[3] COM(95) 163final, Brussels 3 May 1995.

State to maintain political stability (including institutions guaranteeing democracy and the rule of law) and to accept the Community *acquis*[4].

Two decades after the end of socialist law, legal transplants are commonplace for comparative lawyers who reflect on the trajectory of legal and economic change in transformation countries[5]. Closer inspection suggests that private law developments in Eastern Europe are more complex, going well beyond the mere observance of non-domestic blueprints[6]. By ignoring the institutional peculiarities of the 'importing' country, standardised legal transplants and harmonisation schemes have become unduly rigid[7]. After a sobering experience in privatizing state-owned enterprises *Black/Kraakman/Tarrassova* acknowledged that endogenously developed traditions matter more than the most sophisticated privatisation schemes: Hayek had triumphed over Coase[8]. Governments should focus on building institutions to "control self-dealing and to support a complex market economy"[9]. Although this does not deny the analytical value of econometrics and models measuring efficiency[10], institutional and political economy

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[4] European Union Press Release of 22 June 1993 (DOC/93/3), European Council in Copenhagen 21–22 June 1993, Conclusions of the Presidency <http://europa.eu/rapid/pressReleasesAction.do?reference=DOC/93/3&format=HTML&aged=1&language=EN&guiLanguage=en).

[5] Cf. *Pistor/Keinan/Kleinheisterkamp/West*, Evolution of Corporate Law and the Transplant Effect: Lessons from Six Countries, The World Bank Research Observer 18 (1) (2003), 89 et seq., and country studies in: Welser (ed.), Privatrechtsentwicklung in Zentral- und Osteuropa, Veröffentlichungen der Forschungsstelle für Europäische Rechtsentwicklung und Privatrechtsreform an der Rechtswissenschaftlichen Fakultät der Universität Wien 1 (2008). For a spirited criticism of legal transplants see *Legrand*, The Impossibility of 'Legal Transplants', Maastricht J. Eur. & Comp. L. 4 (1997), 111 (113 et seq.).

[6] Cf. *Graziadei*, Legal Transplants and the Frontiers of Legal Knowledge, Theoretical Inquiries in Law 10 (2009), 723 (727 et seq.); *Michaels*, Comparative Law by Numbers? – Legal Origins, Doing Business Reports, and the Silence of Traditional Comparative Law, Am. J. Comp. L. 57 (2009), 765 et seq.

[7] See *Milhaupt/Pistor*, Law & Capitalism – What Corporate Crises Reveal about Legal Systems and Economic Development around the World (2008), 20 et seq., 197 et seq., warning that over-attachment to a simplified evolutionary model of legal change may taint law reform efforts, including legal transplant and legal harmonisation projects pursued by the European Union.

[8] *Black/Kraakman/Tarrassova*, Russian Privatization and Corporate Governance: What Went Wrong?, Stanf. L. Rev. 52 (2000), 1731 (at p. 1802). Cf. *Roggemann/Lowitzsch*, Privatisierungsinstitutionen in Mittel- und Osteuropa (2002), 62 et seq., on statutory privatisation schemes in Central and Eastern Europe.

[9] *Ibid.* For a political science analysis of East European transformation processes: *Merkel, W.*, Systemtransformation (2nd ed. 2010), 324 et seq.

[10] Cf. *Armour/Deakin/Lele/Siems*, How Do Legal Rules Evolve? Evidence from a Cross-Country Comparison of Shareholder, Creditor, and Worker Protection, Am. J. Comp. L. 57 (2009), 579 (626 et seq.).

analysis is apposite to furnish meaningful answers on how legal systems evolve, shedding light on the impact of decision-making processes and pre-socialist legal traditions[11].

II. Legal Origins, the Acquis Communautaire and Notions of Efficiency

In explaining the potential of legal transplants *Watson* observed that changes in legal systems are the result of borrowing[12]. This, he declared, was true, both for the "Western world's private law of Roman Civil law and English Common law"[13]. The transfer of non-domestic concepts was unproblematic although the respective rules had not been specifically devised for the recipient society in which they then operated[14]. *Watson* does not offer a detailed explanation why lawmakers adopt foreign legal concepts when domestic laws are unable to cope with economic change[15]. Implicitly, he rejects socio-economic analysis[16]. *LaPorta/Lopez-de-Silanes/ Shleifer/Vishny* mark a radical departure from *Watson*'s approach towards legal transplants[17]: The historical origin of a country's legal rules is highly correlated with its current regulatory climate and economic outcomes[18]. *LaPorta et al.* describe common law as market-supporting whereas civil law is characterised as policy-implementing[19]. The upshot of this cate-

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[11] Cf. *Streit/Mummert*, Grundprobleme der Systemtransformation aus institutionenökonomischer Perspektive, in: Drobnig/Hopt/Kötz/Mestmäcker (*supra* note 2), 3 (at 12 et seq.).

[12] *Watson*, Legal Transplants – An Approach to Comparative Law (1974), at p. 95: "… transplanting is, in fact, the most fertile source of development. Most changes in systems are the result of borrowing".

[13] *Ibid*.

[14] *Watson* (*supra* note 12), at 96: "…usually legal rules are not peculiarly devised for the particular society in which they now operate and also (…) this is not a matter for great concern".

[15] Cf. *Teubner*, Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Divergences, MLR 61 (1998), 11 (16); *v. Hein*, Die Rezeption US-amerikanischen Gesellschaftsrechts in Deutschland (Beiträge zum ausländischen und internationalen Privatrecht 37 (2008)), 358.

[16] *v. Hein* (*supra* note 15), 355.

[17] *LaPorta/Lopez-de-Silanes/Shleifer/Vishny*, Legal Determinants of External Finance, 52 (3) (1997) J. Fin. 1131 et seq.; *LaPorta/Lopez-de-Silanes/Shleifer*, Corporate Ownership Around the World, 54 (2) (1999) J. Fin. 471 et seq. For a more recent account of their theoretical findings, see: *LaPorta/Lopez-de-Silanes/Shleifer*, The Economic Consequences of Legal Origin, J. Econ. Lit. 46 (2008), 285 et seq.

[18] *LaPorta/Lopez-de-Silanes/Shleifer* (*supra* note 17), 285 et seq.

[19] *LaPorta/Lopez-de-Silanes/Shleifer* (*supra* note 17), 285 (326).

gorisation is that the legal origin of norms translates into different forms of capitalism. The World Bank Development Reports build on this categorisation, promoting legal regimes which are tailored to support competitive markets[20]. In a 2008 article, *LaPorta et al.* defend their initial analysis, conceding that a clear case for the superiority of common law has not been established[21]. Nonetheless, they urge that legal origins theory should operate as a regulatory blueprint to discern legal and regulatory inefficiencies[22]. This does not bar 'importing countries' from borrowing from common and civil law countries, cumulatively in one codification as the case may be.

Legal transplants pose a two-fold efficiency problem. Even if they meet the efficiency criteria for market-supporting regulation, they still have to pass the reality test within the socio-economic context of the 'importing' country[23]: ultimately, the institutional arrangements in the 'importing country' will decide whether the non-domestic regulatory product is successful after adaptation to local circumstances[24]. A plea for institutional analysis in the importing country might be misunderstood as surrendering to regulatory fatigue and path dependence. Legal transplants are efficient if they support competitive market developments provided that they avoid negative transplant effects[25] and propel institutional reform[26]. The *acquis communautaire* has not been devised as a legislative agenda which discards the law and economics of regulation in applicant countries for the sake of European integration. In fact, the integrationist rhetoric of the EU

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[20] World Bank Doing Business Report (various years), available at <www.doing business.org>.

[21] at J. Econ. Lit. 48 (2008), 285 (326).

[22] Cf. on the implications of this approach *Beck/Demirgüç-Kunt/Levine*, Law and finance: why does legal origin matter?, J. Comp. Econ. 31 (2003), 653 (654 et seq.), and *Siems*, Legal Origins: Reconciling Law & Finance and Comparative Law, McGill L. J. 52 (2007), 55 (62 et seq.).

[23] *v. Hein* (*supra* note 15); *Berkowitz/Pistor/Richard*, The Transplant Effect, Am. J. Comp. L. 51 (2003), 163 (179); *Waelde/Gunderson*, Legislative Reform in Transition Countries: Western Transplants – A Short-Cut to Social Market Economy Status?, I.C.L.Q. 43 (1994), 347 (371).

[24] *Berkowitz/Pistor/Richard* (*supra* note 23), 163 (190); cf. on 'assimilation' mechanisms which include legal hybrids: *v. Hein* (*supra* note 15), 369; *Dunning/Pop-Eleches*, From Transplants to Legal Hybrids: Exploring Institutional Pathways to Growth, Studies in Comparative International Developments, 38 (Winter 2004), 3 et seq.

[25] Cf. *Berkowitz/Pistor/Richard* (*supra* note 23), 163 (179 et seq.).

[26] Cf. *Radziwill/Smietanka*, EU's Eastern Neighbours: Institutional Harmonisation and Potential Growth Bonus, Centre for Social and Economic Research, CASE Network Studies & Analyses No. 386/2009 (Warsaw, 2009), 16 et seq., on extending econometric analysis beyond economic liberalisation (i.e. first-stage reforms) in order to evaluate the progress of institutional reforms (i.e. second-stage reforms). As a corollary, policy makers and scholars will have to develop new criteria for measuring the efficiency of legal transplants and transformation processes.

cannot obscure the fact that the *acquis* is also informed by the regulatory technique of legal origins and their influential proponents[27]. Nonetheless, the *acquis* adds a cooperative element to the legal origins hypothesis. Common rules induce candidates for EU membership to make *ex ante* investments to reduce switching costs[28]. Thus, an assessment of law reform in an applicant state will have to weigh the results of traditional efficiency analysis against the benefits of cooperative behaviour under the European harmonisation game. Conversely, countries may be incentivised to raise the price for cooperative behaviour (i.e. the switching costs) once they have joined the European Union[29]. As a corollary, candidates for EU membership will have to assess their switching costs in the face of regulatory competition between Anglo-Saxon (common law) concepts and civil law principles.

III. Whither Private Law in Eastern Europe?

In retrospect, the World Bank's legal origins hypothesis and the EU's *acquis communautaire* have operated as powerful political incentives to accelerate legal reform. 'Outside anchors' can relieve *ex ante* and *ex post* constraints for domestic reformers.[30]. But it is by no means a foregone conclusion that legal transplants recommended by outside institutions will automatically influence economic behaviour[31]. The peculiarities of national decision-making processes will persist and the menu of legal mechanisms implementing change is likely to vary from country to country. Thus, practitioners from 'outside anchor' institutions invariably emphasise the need to cooperate with local regulators[32].

This volume covers the countries committed to the *acquis communautaire* and others not envisaging membership in the European Union. All of

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[27] For an assessment of the EU's regulatory technique *Pistor/Raiser/Gelfer*, Law and finance in transition countries, Economics of Transition 8 (2) (2000), 325 (340 et seq.); passim *Siems*, The End of Comparative Law, J. Comp. L. 2 (2007), 133 (144).

[28] *Carbonara/Parisi*, The paradox of legal harmonization, Public Choice 132 (2007), 367 (372).

[29] Cf. *Carbonara/*Parisi (previous note), 367 (372).

[30] *Berglöf/Roland*, The EU as an 'Outside Anchor' for Transition Reforms, Stockholm School of Economics, SITE Working Paper No. 132 (October 1997); cf. on the role of 'outside anchors' from the perspective of a recipient country: *Chanturia*, Recht und Transformation – Rechtliche Probleme aus der Sicht eines rezipierenden Landes, RabelsZ 72 (2008), 115 (119 et seq.).

[31] *Pistor/Raiser/Gelfer* (*supra* note 27), 325 (340 et seq.).

[32] See the reports in the policy section of this volume, *infra*, and *Chanturia* (*supra* note 30), 115 (120 et seq.).

them have strong civil law traditions. The contributors present introductory surveys over their respective countries' private law systems and traditions before proceeding to a detailed analysis of general private, property and company law issues. Pre-socialist codifications are relevant considerations as they establish legislative preferences in the context of the legal origins hypothesis and its economics, as do the different influences of legal transplants and autonomous developments. As the contributions to this volume demonstrate, the idea of codification is alive and well in Eastern Europe. Codifications are informed by free-market economy thinking although there is evidence that a long-term impact assessment is crucial. It is not only a matter of statutory statistics whether codifications prefer mandatory rules over extensive private ordering[33]. A substantial number of default rules may also reflect a deliberate policy decision by a national legislator.

Enforcement problems have been observed during transition periods as the judiciary, *inter alia*, experiences difficulties in coping with new legislative concepts[34]. Thus informal mechanisms and private ordering may in fact fill some gaps and permit markets to function where judicial intervention is difficult to obtain[35]. From the perspective of regulatory policy, it is, however, decisive to distinguish between private ordering which 'opts out' of the legal system voluntarily and 'forced opt-outs' due to severe enforcement problems[36]. This is not just a legislative device for contract and property law problems, it is also employed for regulating corporate governance and capital market issues[37].

Corporate governance and capital market regulation relies on a complex network of mandatory law, voluntary codes of conduct and regulation through shareholder litigation. In fact, observance of the codes of conduct marks a voluntary acceptance of industry standards. It evidences a volun-

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[33] Cf. *Posner*, Creating a Legal Framework for Economic Development, The World Bank Research Observer 13 (1) (1998), 1 et seq., making a plea for a system of relatively precise legal rules, as distinct from more open-ended standards or heavy investment in training the judiciary.

[34] For a study on the determinants of trust against the background of court and reputational enforcement in transition countries: *Raiser/Rousso/Steves/Teksoz*, Trust in Transition: Cross-Country and Firm Evidence, J. L. Econ. & Org. 24 (2008), 407 (416 et seq.), using data from the World Bank and the European Bank for Reconstruction and Development.

[35] *Trebilcock/Leng*, The Role of Contract Law and Enforcement in Economic Development, Va. L. Rev. 92 (2006), 1517 (1546 et seq.); cf. *Hay/Shleifer/Vishny*, Privatization in transition economies – Toward a theory of legal reform, Eur. Econ. Rev. 40 (1996), 559 (560 et seq.).

[36] *Trebilcock/Leng* (previous note), 1517 (1547); cf. *McMillan/Woodruff*, Private Order Under Dysfunctional Public Order, Mich. L. Rev. 98 (2000), 2421 (2435 et seq.).

[37] See the studies in: Fox/Heller (eds.), Corporate Governance Lessons from Transition Economy Reform (2006).

tary opt-out of the legal system in as far as there are no immediate legal sanctions for not observing industry codes, which are condoned by statutory law. In a way, company law and capital market issues tend to exemplify regulatory aspirations and inefficiencies during the transition period of transformation countries. Moreover, the ownership structure of companies translates directly into legal and measurement problems as the quest for mature competitive markets continues.

The quandary regulators and policy-makers face in transition countries cannot be explained away by emphasising the influence of 'outside anchors'. Legislators have to accommodate non-domestic concepts in an environment which experiences problems of assimilation and perhaps (dis-) orientation. Once transformation counties have come to master immediate codification challenges, more attention will be devoted to evolutionary processes and enforcement mechanisms[38]. Positivist judges play a role different from those of their colleagues who accept the challenge of making an innovative codification or legal transplants work in a new institutional framework[39]. But this is not just an issue of improving judicial training. In fact, both, the *acquis* countries and those staying away from the European Union should be supplied with an analytical framework scrutinising institutional change and public choice problems[40] (including regulatory capture). The focus on the institutional context of law reform should also usher in a debate under what circumstances transplant law is inferior to domestic law-making[41]. In this context, numerical comparative law may be necessary to explore the long-term implications of legal transplants and autonomous law developments, including econometric analysis and empirical evidence[42].

The contributors to this volume present a fascinating kaleidoscope of insights into law reform processes in Eastern Europe. They have also been able to refine the notion of Euro-centrism by adding a specific Eastern European perspective. Moreover; they converted the conference into a fo-

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[38] The quality of contract enforcement is not conditioned by the legal origin of a country's rules on civil procedure: *Spamann*, Legal Origin, Civil Procedure, and the Quality of Contract Enforcement, JITE 166 (2010), 149 et seq.

[39] In this context, an exchange of views between regulators, practitioners and academia would be an asset.

[40] See *Radziwill/Smietanka* (*supra* note 26); and *Smits*, The Harmonisation of Private Law in Europe, Ga. J. Int'l. & Comp. L. 31 (2002), 79 et seq., emphasising the need to scrutinise the processes of legal change.

[41] Cf. *Grajzl/Grajzl-Dimitrova*, The Choice in the Law-Making Process: Legal Transplants vs. Indigenous Law, Rev. L. & Econ. 5 (1) (2009), 615 et seq.

[42] Cf. *Reitz*, Legal Origins, Comparative Law and Political Economy, Am. J. Comp. L. 57 (2009), 847 (851 et seq.), and *Siems*, Numerical Comparative Law: Do we need statistical evidence?, Cardozo J. Int'l. & Comp. L. 13 (2005), 521 et seq.

rum where Eastern Europeans, by talking to other Eastern European scholars, discovered many similarities and disparities in their transformation processes. This is a significant autonomous development which deserves a warm welcome even by the most ardent supporters of the legal origins hypothesis.

Promoting Legal Reform in Eastern Europe: the EBRD Approach

MICHEL NUSSBAUMER and FREDERIQUE DAHAN*

Since its creation in 1991, the European Bank for Reconstruction and Development (EBRD) has been promoting commercial law reform in the countries of Central and Eastern Europe undertaking the transition from state-controlled economy to market economy, with a strong focus on private sector development and access to credit. The Bank aims to encourage development of the legal rules, institutions and culture on which a vibrant market-oriented economy depends. This article focuses on EBRD efforts in setting standards and assessing reform progress, which, the authors argue, are very efficient tools to promote reforms in the region. The article shows how, over the past fifteen years, EBRD legal assessments have been evolving, experimenting with new approaches and methodologies, guided by these economic objectives.

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* This article reflects the individual opinions of the authors and does not necessarily represent the views of the EBRD.

I. Introduction

There is a good deal of misconception around legal reform, and myths surrounding the concept abound. Some see it as a 'big bang' that governments sometimes undertake (think: Napoleonic Code of 1804 in France which went on to fundamentally change the face of the country and those jurisdictions influenced by it). Others think of it as a standard political process that goes on in a rather mundane and peaceful fashion. Still others view it as the sterile and misguided course led by lawyers isolated from the real world and whose choices will go on to haunt market players for decades to come. Where legal reform is associated with developmental aid, the negative perception is usually intensified as the wholesale import of concepts foreign to the recipient jurisdiction, that usually results in undue influence and conflicts of interest, and may give rise to accusations of 'colonialism'.[1] The practice of 'legal transplantation' is often associated with the failure of aid programmes in the 1970s and 1980s.[2]

The fact is that those who are directly involved in legal reform rarely take the floor to give an account of their actions, motivations and methods.[3] This may be changing, possibly due to the increasing prominence given to

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[1] Kahn-Freund, Otto (1974) 'On the Uses and Misuses of Comparative Law', 37 *Modern Law Review*, 1–27; Watson, Alan (1993) *Legal Transplants: An Approach to Comparative Law,* 2nd ed.*,* University of Georgia Press: Athens, Georgia; Ajani, Gianmaria (1995) 'By Chance and Prestige: Legal Transplants in Russia and Eastern Europe', 43 *American Journal of Comparative Law*, 93–99; Legrand, Pierre (1997), 'The Impossibility of "Legal Transplants"', 4 *Maastricht Journal of European Comparative Law*, 111–119; Waelde, Thomas W., Gunderson, James L. (1994) 'Legislative Reform in Transition Economies: Western Transplants – A Short-Cut to Social Market Economy Status', 43 *International and Comparative Law Quarterly,* 345. For a good overview of the issues and biography, see Gillespie, John (2006) *Transplanting Commercial Law Reform – Developing a 'Rule of Law' in Vietnam*, pp. 1–16 Ashgate: Farnham.

[2] Seidman, Ann and Seidman, Robert B. (1996) 'Drafting Legislation for Development: Lessons from a Chinese Project', 44 *American Journal of Comparative Law*, 1, esp. at 26; Seidman, Robert B. (1978) *The state, law and development* London: Croom Helm; Seidman, Ann and Seidman, Robert B. (1994) *State and law in the development process: problem solving and institutional change in the Third World* Macmillan: Basingstoke; Dahan, Frederique, McCormack, Gerard (2002) 'International Influences and the Polish Law on Secured Transactions: Harmonisation, Unification or What?/, *Uniform Law Review* Vol. VII 713–736; Dahan, Frederique (2000) 'Law Reform in Central and Eastern Europe: The Transplantation of Secured Transactions Laws', 2 *European Journal of Law Reform*, 369–384.

[3] But see for example, Dahan, Frederique, Dine, Janet (2003) 'Transplantation for transition – discussion on a concept around Russian reform of the law on reorganization', *Legal Studies*, 23(2), 284–310.

the subject of legal reform in the economic sphere over the past ten years.[4] This has enlarged the circle of those who, on the one hand, are interested in understanding the process and, on the other, are entrusted with the review of the effect and impact that law reforms may have had as against the initial objectives. Lawyers, and most importantly policy-makers, economists, and investors, are progressively expressing a direct interest in the effects of law reform. This is good news for those funding international technical assistance programmes, be they bilateral donors or the shareholders of multi-lateral international organizations, who have been increasingly calling for more detailed impact evaluations of these programmes. This too is leading to more scrutiny of legal technical assistance.

Since its foundation in 1991, the European Bank for Reconstruction and Development (the "EBRD") has sought to ensure that as much as possible is learned from the process of 'transition', a process which is in many ways, a truly unique microcosm. The EBRD is an international financial institution that supports projects in 30 countries from central Europe to central Asia.[5] Investing primarily in private sector clients whose needs cannot be fully met by the market, the Bank promotes entrepreneurship and fosters transition towards open and democratic market economies. Possibly because it was a new organization created in the aftermath of historical events, it has always held strong beliefs regarding the significance of law reform:[6]

- Law directly impacts on a market economy, so transition from a command (i.e. planned) economy to capitalism must include significant legal reform. At the same time, meeting the economic objectives of the reform is paramount. As a future user of the new system, the EBRD's focus has, from the very outset, been fixed on results, not on form. Moreover, the Bank has always been very sensitive to the fact that transition countries have different legal traditions and styles and acknowledging the importance of ensuring that new laws fit into the existing framework.

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[4] See for instance the *Doing Business* Reports, World Bank, 2004–2009 which emphasize the importance of laws and regulations.

[5] The Bank is currently operating in: Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Estonia, FYR Macedonia, Georgia, Hungary, Kazakhstan, Kyrgyz Republic, Latvia, Lithuania, Moldova, Mongolia, Montenegro, Poland, Romania, Russia, Serbia, Slovak Republic, Slovenia, Tajikistan, Turkey, Turkmenistan, Ukraine and Uzbekistan. Note that the Czech Republic 'graduated' from EBRD operations in 2007.

[6] The points below derive mainly from the professional experience of EBRD staff working on the Bank's Legal Transition Programme.

- Adopting a regional approach may have a multiplying effect when applied in a given country, which is both efficient in terms of resources (which are always scarce) and fair as providing technical assistance to individual countries is not always possible.
- The EBRD only provides technical assistance to countries that are willing and ready to develop their own legal framework. The EBRD has little leverage power over government programmes[7] as its clients are primarily private commercial sector players, not the state in its government capacity.
- The EBRD also believes that local stakeholders are best placed to ascertain how economic objectives can be reached within their own jurisdictions and that assistance-providers should always refrain from leading the reform. Hence the importance of a consensus building exercise preceding any reform. The Bank always endeavours to foster stakeholder support for the proposed changes.
- Generally speaking, crude implants of foreign solutions into the recipient country must be firmly resisted. Where the EBRD's assistance can make an important difference is by bringing support and expertise to the process of working towards viable results (particularly in economic terms) and reducing obstacles to implementation.
- The Bank has always adopted a holistic approach to legal reform: drafting legal provisions ('black letter of the law') is only a small part of the reform process. 'Institution building' work is just as important in achieving the desired objectives and also needs to be encouraged. This may include helping establish the necessary institutions (e.g. registries), or informing and training stakeholders.

This article's objective is to outline how the EBRD has applied these principles in its legal reform programme over the last two decades. The Bank usually promotes legal reform through various activities: firstly, through participating in the establishment of internationally recognised standards or best practices for commercial and financial legislation, secondly, assessing legal regimes in transition countries against these standards and making recommendations for future reforms, and thirdly, offering technical assistance to individual governments to implement these reforms (for more information and practical examples see the numerous technical assistance projects that the Bank has carried out in transition countries[8]). While country-specific projects generate a good deal of understanding of the law reform process and, where successful, these experiences can be

[7] But the Bank can and has worked with other international financial institutions like the World Bank, which may in some instances have leverage.

[8] Comprehensive information on EBRD technical assistance projects in transition countries can be found at <www.ebrd.com/law>.

disseminated as examples of what a country can achieve, this article will primarily focus on the first two activities (standard setting and assessment), as they aim to develop the tools for law reform promotion and predetermine the whole approach to legal developmental work. More specifically, it will argue that surveys and assessments, if they are conducted in an objective, fair, and balanced fashion, can be the most effective tool for promoting legal reform. We will present the EBRD approach to this subject and how it has evolved over the years, and conclude with a few remarks on the current work agenda and prospects for the future.

II. The EBRD Legal Transition Programme

Since its foundation in 1991, the EBRD has played a unique role for an international financial institution: fostering transition to a market economy through project financing, primarily in the private sector, through careful identification of projects to expand and improve markets, by helping to build the institutions necessary for underpinning the market economy, and demonstrating and promoting market-oriented skills and sound business practices. The sudden and total collapse of the Soviet Union convinced founding countries of the urgency of providing support to a region emerging from decades of political and economic dictatorship. It became clear that boosting the role of the private sector was the linchpin for free and open market economies and crucial to the democratic transition process.

1. Why a legal transition programme?

The process of transition from planned economies to open market economies requires an enormous range of structural transformation. From very early on the EBRD became heavily involved in many areas, including banking system reform, price liberalisation, privatisation (legalisation and policy dialogue) and the creation of appropriate legal frameworks for property rights. The Bank's expertise became well-known for fostering competition throughout the economy, making the necessary changes in managerial behaviour and the establishment of commercial laws and accounting systems.

The countries of the region, at their own individual pace, undertook a radical revision of their legislation to allow for the development of modern market economies. These undertakings often resulted in successes, although, also in some failures.[9] The EBRD has regularly taken on the role

[9] See Taylor, John L., April, François, (1997), 'Fostering Investment Law in Transitional Economies: A Case for Refocusing Institutional Reform', *The Parker School Journal of East European Law,* 4 (1) 1–52.

of observer, participant or moderator in various investments or technical assistance undertakings. The EBRD's Legal Transition Programme ("LTP" or the "Programme") is therefore based on the views and concerns of the private investment community, making assistance measures both credible and practical. The Programme focuses on developing legal rules and establishing legal institutions, as well as nurturing the necessary culture for a vibrant market-oriented economy.[10] The Programme is organized thematically and has grown over the years, focusing on areas that are deemed to be of particular importance to the investment climate. These areas currently are:

- Corporate governance
- Concessions and public-private partnerships
- Judicial capacity and contract enforcement
- Infrastructure regulation and competition
- Insolvency (bankruptcy)
- Public procurement
- Secured transactions
- Securities markets

The proposed thematic approach requires a highly specialised team – the LTP uses a specialist lawyer for each of the above areas. The LTP is centralised within the EBRD Office of the General Counsel, which ensures full consistency for all legal reform activities undertaken by the Bank.

How best to deliver technical assistance was of course the key question for EBRD counsel who started working on transactions.[11] At the first Annual Meeting of the EBRD – in Budapest in April 1992 – the EBRD Office of the General Counsel led a roundtable discussion on economic law reform which had as its chosen topic 'creditors' rights and secured transactions in central and eastern Europe'. The choice of topic recognised the potential role of securities in easing the chronic shortage of credit in the former communist countries. Lenders needed assurance that they would get their money back and this assurance was hard to find in countries where would-be borrowers had no credit experience. A legal system that enables recovery from assets of the borrower could provide a solution which would not only increase the availability of credit, but also improve the terms attached to it, notably the duration and the cost. One of the outcomes of the roundtable discussion was a request made by three eminent lawyers from

[10] Bernstein, D. (2002) 'Process drives success: Key lessons from a decade of legal reform', *Law in transition*, Autumn 2002, EBRD 2–13.

[11] Simpson, John and Menze, Joachim (2000) 'Ten years of secured transactions reform', *Law in transition*, Autumn 2000, EBRD 20–27.

central Europe[12] that the EBRD propose a basis for uniform or similar regulation of secured transactions across the region. The purpose was clear: to lead the way to reform by concrete and practical example, that was distinct and not influenced by other individual systems.

2. The EBRD Model Law and Other Standards: Principles and Role

a) The EBRD Model Law on Secured Transactions

The EBRD embarked on the preparation of its Model Law on Secured Transactions which was published in April 1994.[13] It was stressed from the outset that the Model Law is not intended as detailed legislation for direct incorporation into local legal systems. It is, however, intended to form a basis from which national legislation for transition countries could be developed, to act as a starting point, indicating through a detailed legal text how the principal components of a law for secured transactions could be drafted, whilst allowing for a high degree of flexibility for adaptation into local circumstances and to be a reference point which can be turned to for guidance and illustration.

The need for a model that could be used as an example was greater in the case of secured transactions than for many other areas of law. Apart from the United States and some countries that have followed the US example, there are few countries in the world that have a coherent, comprehensive and effective legal framework for a non-possessory security over movable property. In the rest of the world, the absence of a similar framework has left a gap which has been filled by an array of laws and practices built up over decades, even centuries, often providing different rules for different kinds of assets, sometimes satisfactory, sometimes not. These may enable the astute practitioner to acquire security, but at the same time they impose a substantial economic inefficiency on secured credit markets for example, by increasing transaction costs, or giving only a limited assurance of the right to obtain repayment from the assets given as security. These laws and practices certainly do not provide a suitable template for transition countries to follow. Even Article 9 of the U.S. Uniform Commercial Code (which in effect is a long chapter comprising seven sections of very detailed provisions) is not easily adaptable for other countries, particularly those where the law is based on civil law tradition, and those

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[12] Professor Dr Attila Harmathy of Hungary, Professor Peter Sarcevic of Croatia and Professor Stanislaw Soltysinski of Poland.

[13] The Model Law on Secured Transactions, EBRD, 1994, see also <www.ebrd.com/st>.

that are far from being accustomed to the sophistication of advanced market economy practice.[14]

One principle that guided the drafting of the Model Law was the production of a text that was compatible with civil law concepts and at the same time drew on common law systems, which have developed many useful solutions to accommodate modern financing techniques. It was by deliberate design that the Model Law was prepared by both a civil and a common law lawyer.[15] In addition, the drafters were assisted by an international advisory board comprising 20 eminent lawyers from 15 different jurisdictions[16] which enabled them to draw on the experience of many countries with widely varying legal systems. Another guiding principle was that the Model Law had to be simple in order to be of practical use for economies in transition. It sought to illustrate a basic system on which more sophisticated rules could be developed.

The EBRD is often asked how many countries have adopted the Model Law. The answer has to be 'none' because it was never produced to be adopted or transplanted. But it has been referred to and used as a template for reform in virtually all of the EBRD countries of operations (whether the EBRD was involved in the reform process or not) and well beyond the region (also in Vietnam, Sri Lanka, Thailand, China and Latin America).

It is important to understand that the EBRD does not promote a particular domestic law – it does not have a European bias since it is not an EU institution – its largest shareholder is the USA and other non-European countries including Australia, Canada, Japan, Mexico, Morocco and New Zealand are also shareholders. Being a commercial investor, the EBRD is concerned with economic, social and practical considerations. It is also sensitive to the fact that the subject area – be it PPP (Public Private Partnership), insolvency law or corporate governance, is often a heavily debated concept throughout the world, including in high-income countries.

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[14] Article 9 of the Uniform Commercial Code was the single biggest influence on the Model Law. The difficulties of using Art 9 as a model arose from its form and complexity, from its inclusive approach and from certain basic divergences in legal concepts between the United States and continental Europe (for example, regarding ownership and transfer of property).

[15] Jan-Hendrik Röver and John Simpson.

[16] Professor David E. Allan, Australia, Mr Juan F. Armesto, Spain, Professor Milan Bakes, Czech Republic, Professor Mark M. Boguslavsky, Russia, Professor Ronald CC Cuming, Canada, Professor Jan Hendrik Dalhuisen, the Netherlands, Professor Aubrey L. Diamond QC, United Kingdom, Professor Dr Ulrich Drobnig, Germany, Mr John Edwards, United Kingdom, Professor Christian Gavalda, France, Mr Marcello Gioscia, Italy, Professor Attila Harmathy, Hungary, Professor Mary E. Hiscock, Australia, Dr Jaques Périlleux, Belgium, Mr Hugh Pigott, United Kingdom, Professor Stanislaw Soltysinski, Poland, Mr Ken Tsunematsu, Japan, Mr Philip R Wood, United Kingdom, Mr John Young, USA and Dr Peter Zier, Germany.

One example of this can be found in insolvency regimes, where many fundamental issues (such as priority ranking of claims or stay of payment upon commencement of the insolvency proceedings) are debated by quite different schools of thought.

b) Other Standards Prepared by the EBRD

Rather than fitting into a pre-established mould that would be falsely presented as the definitive answer to the legal subject in question, any new legal provisions need to 1) be adapted to the national environment where they are to operate; 2) be well understood in terms of the underlying policy approach so that they can be intelligently reviewed should the choice be revisited at a later date; and 3) fit with the initial economic objectives they were meant to serve when the reform was undertaken. The EBRD standards serve precisely this role. Following the Model Law on Secured Transactions, the EBRD has prepared a number of other standards that it uses when promoting legal reforms aiming to achieve specific economic objectives. These include:

- *Core Principles for a Secured Transactions Law (1998)*[17] *and a Mortgage Law (2008)*,[18] express the fundamental requirements for a modern secured transactions law, which have been adapted to refer specifically to mortgages. The principles do not seek to impose any particular solution on a country – there may be many ways of arriving at a particular result – but they do indicate the result that should be achieved.
- *Guiding Principles for Charges Registries (2004)*[19], address the basic requirements for the development and operation of a registration system for security interests (charges) over movable property, together with guidelines for their implementation.
- *Insolvency Office Holders Principles (2007)*[20], recognize that a solid law is not enough for an effective insolvency system, and provides a set of principles to guide countries in setting standards for the qualification, appointment, conduct, supervision, and regulation of insolvency office holders (be they called trustees, administrators, liquidators, insolvency representatives, or similar functionaries).

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[17] EBRD Core Principles for a Secured Transactions Law, available online at <www.ebrd.com/pages/sector/legal/secured/core/coreprinciples.shtml>.

[18] EBRD Core Principles for a Mortgage Law, available online at <www.ebrd.com/pages/sector/legal/secured/core/mortgagelaw.shtml>.

[19] EBRD (2004) Publicity of Security Rights; Guiding Principles for the Development of a Charges Registry, EBRD.

[20] EBRD Insolvency Office Holder Principles (2007) Available online: <www.ebrd.com/pages/sector/legal/insolvency/legal_framework.shtml> [accessed 23 July 2009].

– *Policy Brief for Corporate Governance in Banks in Eurasia (2008)*[21] was produced by a task force made up of representatives of banks, banking associations and regulators from the Eurasian region, supported by technical assistance and expertise of the EBRD and the Organization for Economic Cooperation and Development. The Policy Brief identifies key corporate governance challenges affecting banks in that region and makes recommendations to address them.

III. The EBRD Legal Assessment Work: Philosophy and Evolution

In order to implement the first tenet of quality legal reform listed above (that legal provisions are adapted to the system in which they should operate), the LTP aims to assess the legal frameworks in the key sectors EBRD is most concerned with.

The philosophy behind assessment work is of course fully consistent with the LTP approach to law reform: the main objective is to promote legal reform by making information available on key commercial law issues. This information must be useful to investors and their advisers, and give clear indications of the changes that are needed if the economic benefits are to be maximised. These assessments are then used to promote policy dialogue and reforms. Also, because the work is, to a large extent, remotely initiated and supervised (due to the centralised nature of the LTP and the fact that it covers all 30 countries where the EBRD operates), maximum impact must be achieved with limited operational and financial resources. A very effective way to build consensus on the shape of a future reform is to point to what neighbouring jurisdictions have achieved. For example, when EBRD advised the Serbian government on the development of the Law on Pledges over movable assets (ultimately adopted in 2003), it was able to refer to the Hungarian, Polish and Slovak laws and the practical solutions adopted in these countries. This requires having a host of details available.

Assessment needs to be precise, accurate and fair. A survey is to provide a uniform basis for objective comparison between all countries from Central Europe to Central Asia by highlighting the strengths and weaknesses of the legal framework in each country. It is difficult for a country

[21] Corporate Governance of Banks in Eurasia: A Policy Brief (2008) OECD and EBRD, available online: <www.ebrd.com/downloads/legal/corporate/policyen.pdf> [accessed 23 July 2009] The countries of Eurasia are Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Mongolia, Tajikistan, Ukraine and Uzbekistan.

to understand its own position in isolation or even by comparison with the laws and practices of countries in Western Europe and North America. Comparison with other transition countries can give a more meaningful indication of the degree of improvement that has been made and can also encourage mutual assistance between transition countries where each can learn from the other and where the benefits of progress can be readily transferred.

Over the years, the LTP has developed various assessment tools, constantly fine-tuning its analysis and methodologies, a reflection of its own evolving understanding of law reform.

1. Legal Indicator Surveys (1995–2002)

As early as 1994, the EBRD Office of the General Counsel endeavoured to provide an overview of the status of legal framework in EBRD countries of operations.[22] The EBRD Legal Indicator Survey (LIS) was initiated in 1995.[23] The LIS was a survey instrument that reported how lawyers in transition economies perceived the development of new legal rules and whether they felt, according to their experience, that these rules were being implemented effectively. The LIS was published in the EBRD's annual Transition Report, which gave a detailed account of progress made by countries in the region going through the transition process. The LIS was the very first attempt to gauge the impact of the formidable changes that were occurring in the region's legal frameworks, and it exposed important lessons to be learned – in particular the widening 'implementation gap' created by hastily adopted legislation with little understanding of its true significance and without adequate means for implementation.[24] While local perceptions were of course of great interest, as the transition process to a large extent was about changing the existing mentality, these local per-

[22] See EBRD Transition Report 1994, Chapter 5, 'The framework of law in transition', 69–77.

[23] LIS results were published in the Bank's Transition Reports between 1995 and 2002. See in particular EBRD Transition Report 1995, Chapter 6, 'The contribution of law to fostering investment', 101–108.

[24] Ramasastry, Anita, Styliadou, Meni and Slavova, Stefka (1998), 'Market perceptions of telecoms reform – survey results', *Law in transition*, Autumn 1998, EBRD 30–37; Ramasastry, Anita, Slavova, Stefka (1999) 'Market perceptions of financial laws in the region – EBRD survey results', *Law in transition*, Spring 1999, EBRD 24–34; Ramasastry, Anita, Slavova, Stefka (1999) 'Market perceptions corporate governance – EBRD survey results', *Law in transition*, Autumn 1999, EBRD 32–29; Ramasastry, Anita, Slavova, Stefka (2000) 'EBRD legal indicator survey: assessing insolvency laws after ten years of transition', *Law in transition*, Spring 2000, EBRD 34–42; Ramasastry, Anita (2002) 'What local lawyers think: A retrospective on the EBRD's Legal Indicator Surveys', *Law in transition*, Autumn 2002, EBRD 14–30.

ceptions could not by themselves be the yardstick that transition countries needed to define their reform programme. As legal reform work intensified at the EBRD, the need for a tool to reflect both the achievements and the challenges ahead became acute.

2. Secured Transactions Regional Survey and other Legal Sector Assessments (1999 to present)

The first attempt to provide a comprehensive comparative assessment of laws and practices in the region was provided by the *Secured Transactions Regional Survey*, first published in 1999 and regularly updated thereafter.[25] This is a tabular analysis of current secured transactions law and practice in 30 countries. The Survey covers consensual non-possessory pledges over movable (including intangible) property. The primary aim of the Survey is to provide an accessible and user-friendly overview of the relevant laws in each country in the region. Inevitably, the information provided is of a summary nature: the questions address the principal issues and give preliminary answers to basic, practical questions which a practitioner needs to know: the rules governing the *creation* of a pledge; the extent to which the legal framework is adapted to the *needs of commercial transactions* in modern market economy; the *effect of security rights on third parties*; and finally the extent to which the legal right given by the pledge on the charged property can be *enforced* in practice. The Survey not only provides information but also enables the evaluation of legal provisions against the Secured Transactions Core Principles benchmark,[26] and encourages improvement and mutual assistance between countries of the region.

Table 1: Secured Transactions Law – A comparison of selected EBRD countries of operations

1. Key elements of a charge					
	Poland	**Russia**	**Slovak Republic**	**Turkey**	**Ukraine**
1.1. Does the charge create a proprietary security right?	✓✓✓	✓✓✓	✓✓✓	✓✓✓	✓✓✓

[25] See EBRD website on secured transactions at <www.ebrd.com/pages/sector/legal/secured.html>, the country reports at <http://www.ebrd.com/pages/sector/legal/cla.shtml> and Fairgrieve, Duncan, Andenas, Mads, (2000) 'Securing progress in collateral law reform: the EBRD's Regional Survey of secured transaction laws', *Law in transition*, Autumn 2000, EBRD, 28–35. See also Dahan, Frederique, and Simpson, John (2004) 'Secured transactions in Central and Eastern Europe: EBRD Assessment', *Uniform Commercial Code Law Review*, 36, 77–102.

[26] <www.ebrd.com/pages/sector/legal/secured.shtml>.

1.2. Can the charge be granted by any person?	✓✓✓	✓✓✓	✓✓✓	✓✓✓	✓✓✓
1.3. Can the charge be granted to any person?	✓✓	✓✓✓	✓✓✓	✓✓	✓✓✓
1.4. Can the charge secure any debt?	✓✓✓	✓✓	✓✓✓	✓✓	✓✓
1.5. Can the charge cover all types of asset?	✓✓	✓✓	✓✓✓	✗✗	✓✓
1.6. Does the charge give priority over all other creditors?	✓✓	✗✗	✓✓	✓✓✓	✓✓✓

2. Creation of the charge					
	Poland	**Russia**	**Slovak Republic**	**Turkey**	**Ukraine**
2.1. Is the manner of creation of the charge clearly defined?	✓✓✓	✓✓✓	✓✓✓	✗✗	✓✓✓
2.2. Is it simple?	✓✓	✓✓✓	✓✓✓	✗✗	✓✓✓
2.3. Is it quick?	✗✗✗	✓✓✓	✓✓✓	✓✓	✓✓✓
2.4. Are charges publicised through registration?	✓✓✓	✗✗	✓✓✓	✗✗	✓✓✓
2.5. Are costs of creation low enough not to dissuade the parties involved	✓✓✓	✓✓✓	✓✓	✗✗	✓✓✓

3. Commercial effectiveness					
	Poland	**Russia**	**Slovak Republic**	**Turkey**	**Ukraine**
3.1. Can the chargor use the charged property?	✓✓✓	✓✓✓	✓✓✓	✗✗✗	✓✓✓
3.2. Can property be described generally?	✓✓	✗✗	✓✓✓	✗✗✗	✓✓
3.3. Can a charge be given over post-acquired property?	✓✓✓	✓✓	✓✓✓	✗✗	✓✓✓
3.4. Can a charge cover a fluctuating pool of assets?	✓✓	✗✗	✓✓✓	✗✗✗	✓✓
3.5. Can the secured debt be defined generally?	✓✓✓	✗✗	✓✓✓	✓✓✓	✓✓
3.6. Can a future debt be secured?	✓✓✓	✓✓✓	✓✓✓	✓✓✓	✓✓✓
3.7. Can the debt be in a foreign currency?	✓✓✓	✓✓✓	✓✓✓	✗✗	✓✓✓

3. Commercial effectiveness					
3.8. Can a fluctuating pool of debt be secured?	✓✓✓	✖✖	✓✓✓	✓✓✓	✓✓
3.9. Do parties have wide flexibility to agree commercial terms?	✓✓✓	✓✓	✓✓✓	✖✖✖	✓✓✓
3.10 Are subsequent charges permitted over the same property?	✓✓✓	✓✓✓	✓✓✓	✖✖	✓✓✓

4. Effect of the security right on third parties					
	Poland	**Russia**	**Slovak Republic**	**Turkey**	**Ukraine**
4.1. Does a charge give priority in a charged property?	✓✓	✖✖	✓✓✓	✓✓✓	✓✓✓
4.2. Does the secured creditor have priority in bankruptcy?	✓✓✓	✖✖	✓✓	✓✓✓	✓✓✓
4.3. Can a third party determine whether property is charged?	✓✓✓	✖✖✖	✓✓✓	✓✓	✓✓✓
4.4. Does a third party acquire property free from charges in the ordinary course of business?	✓✓✓	✓✓✓	✓✓✓	✖✖✖	✓✓✓
4.5 Is person acquiring in good faith and without a notice of charge, protected?	✓✓✓	✖✖✖	✓✓✓	✖✖✖	✓✓✓

5. Enforcement of the charge					
	Poland	**Russia**	**Slovak Republic**	**Turkey**	**Ukraine**
5.1. Is the manner of enforcement of charge clearly defined?	✓✓	✓✓	✓✓✓	✓✓✓	✓✓✓
5.2. Is there tried practice?	✓✓✓	✓✓	✓✓✓	✓✓✓	✓✓✓
5.3. Can the chargeholder protect assets?	✖✖	✖✖	✓✓	✓✓✓	✓✓
5.4. Can the chargeholder obtain rapid realisation?	✖✖✖	✖✖	✓✓✓	✖✖✖	✓✓✓
5.5. Can the chargeholder exercise control on the way realisation takes place?	✖✖	✖✖	✓✓✓	✖✖✖	✓✓✓

5.6. Does the enforcement procedure allow expectation of reasonable realisation proceeds after costs?	✖✖	✓✓	✓✓✓	✖✖	✓✓✓
5.7. Does commencement of enforcement have to be publicised?	✖✖✖	✖✖✖	✓✓✓	✖✖✖	✓✓✓
5.8. Is purchaser in enforcement procedure protected?	✓✓✓	✓✓✓	✓✓✓	✓✓✓	✓✓✓

✓✓✓Yes ✓✓ Yes, but with reservations ✖✖✖ Categorical no ✖✖ Indicates that response is negative, but there are some mitigating factors in law or practice
Source: EBRD Regional Survey on Secured Transactions 2006–2008

It was fundamental to the design of the Survey that the assessment should be perceived as being fair, objective, and non-judgemental. It is not the EBRD's place to dictate what countries ought to do, and there is a lot of sensitivity associated with a 'league table' of countries being ranked one against the other. The Survey therefore grades each question by reflecting a gradual progression from a clear "yes" (✓✓✓) to a clear "no" (✖✖✖), with intermediary grading to reflect reservation in practice or in law or mitigating factors (see Table 1). It shows at a glance the areas which are most deficient and why, and the explanatory notes ensure a consistent approach to the questions in all countries.[27]

The Survey has been expanded to cover several related areas such as collateral (pledge) registers[28] and mortgage law[29].

Furthermore, from 2002 onwards, Legal Sector Assessments were prepared for other commercial law areas where the EBRD was actively involved, in particular corporate governance, insolvency, securities markets, and concessions. These assessments, however, differed from the Regional Survey described above as they simply benchmarked existing laws against a checklist of ingredients essential for a sound legal regime and evaluated how well these laws approximate international standards.[30] Although the Regional Survey is arguably more comprehensive as it evaluates the existing laws and their implementation and practical application, Legal Sector Assessments have proved useful as they are easy to understand, very detailed (the assessment usually comprises up to 100 questions) and convenient for policy dialogue. Sector assessments are produced by

[27] <www.ebrd.com/pages/sector/legal.shtml>.

[28] <www.ebrd.com/pages/sector/legal/shtml>.

[29] <www.ebrd.com/pages/sector/legal/secured/core/mortgagelaw.shtml>.

[30] The Bank refers to this type of analysis as showing 'extensiveness' of legislation as opposed to 'effectiveness' which is captured by other tools (e.g., new Legal Indicator Surveys).

selected experts in the field – either the EBRD's own legal transition team or external consultants, who evaluate commercial laws throughout the EBRD region of operations to ensure a higher consistency of responses than that provided by the local respondents for the LIS. Additionally, countries are no longer rated numerically; instead they are evaluated and placed in categories, depending on the degree to which various commercial laws reflect international standards and practices (see Table 2). It should be noted however that these assessments are by definition only partial and theoretical, and cannot be used as a replacement for an examination of the actual functioning of the system itself.

Table 2: Legal Sector Assessment: Level of compliance with international standards for corporate governance

Very high compliance	High compliance	Medium compliance	Low compliance	Very low compliance
0 countries	8 countries	14 countries	2 countries	6 countries
	Hungary Lithuania Czech Republic Romania Russia Slovak Republic Slovenia Turkey	Armenia Bosnia & Herzegovina Bulgaria Croatia Estonia Kazakhstan Kyrgyz Republic Latvia FYR Macedonia Moldova Mongolia Poland Serbia Uzbekistan	Albania Turkmenistan	Azerbaijan Belarus Georgia Montenegro Tajikistan Ukraine

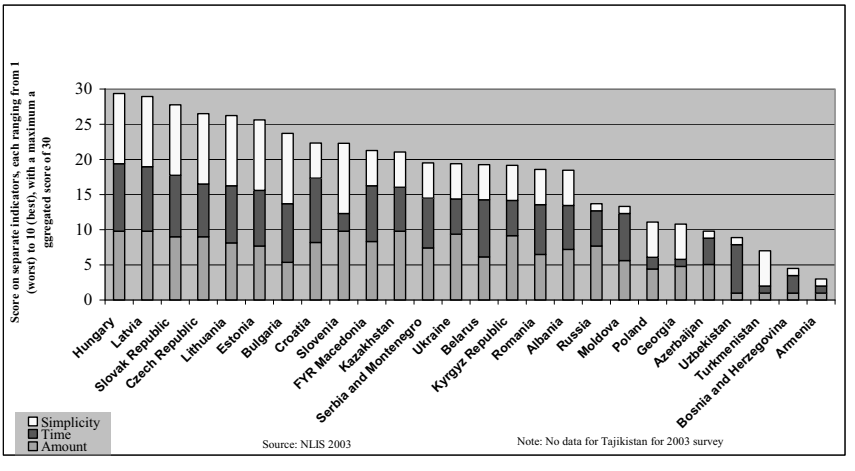
Source: EBRD Legal Sector Assessment on Corporate Governance 2007

3. New Legal Indicator Survey (2003 to date)

In 2003, the Bank launched a new Legal Indicator Survey based on a different methodology. Rather than assessing general perceptions of effectiveness, as was the case between 1995 and 2002, the EBRD decided to try and assess the effectiveness of commercial legal reform in a more reliable and verifiable manner. This assessment gauges how the law works in practice for a given scenario. A selected law firm in each of the EBRD's countries of operations is presented with a consistent and fixed set of facts concerning a hypothetical legal case and then asked to provide specific,

factual answers about how the case would be resolved in practice. As the *practical outcome* is compared, rather than a list of applicable rules, this approach allows for a more reliable comparison of law effectiveness across countries, providing less subjective responses. Moreover, expert respondents are encouraged to supply more detailed narrative responses to questions, providing a factual basis for their responses and opinions. There is thus more scope for exploring the flaws or bottlenecks which prevent the system from producing satisfactory outcomes. For the first case study in 2003, the EBRD secured transactions experts devised a case involving a secured creditor whose claim was not satisfied. The practical outcome was to predict the amount the creditor could recover, and how long it would take to enforce his security and realize the pledged assets (see Chart 1). Countries were thus evaluated based on the ability of their legal system to produce specific desirable outcomes, which were able to be quantified as much as possible ('how many pennies to the pound will the secured creditor expect to receive in case of default?').[31]

Chart 1: EBRD New Legal Indicator Survey: Enforcement of Charged Assets



Source: EBRD New Legal Indicator Survey 2003

A case study has the advantage of concentrating on the *facts* as opposed to the *rules*, and to assume a situation as close as possible to the context of

[31] Overall, EBRD assessment thus consists of both evaluation of the sector assessment for a number of key commercial law areas as well as further analysis of the law in action for the same sectors.

normal commercial practice. Using case studies to survey legal systems is a road which many organizations have recently taken, for instance the World Bank's Lex Mundi project[32] and also the Trento project on "The Common Core of European Private Law".[33] Judicious drafting of the case study is paramount to the quality of the responses: if the case is too wide, the results will not be comparable across jurisdictions; if it is too narrow, it may not leave the respondent sufficient scope to describe particularities of the legal system which may have dramatically affected the results. The approach to quantifying the impact of laws and regulations was spearheaded by the work of development economists in the last decade, such as De Soto and De La Porta et al.[34] It is best known through the World Bank Reports on *Doing Business* published since 2004, which have brought the practical importance of good regulation to the fore of the economic development theory. They followed the seminal work of Shleifer[35] on law and financial markets. Ultimately, practical results (e.g. time required to evict a tenant; or to register a business) matter just as much as the black letter of the law.

However, lawyers often feel uncomfortable with such an approach: firstly situations in reality are considerably more complex than can be incorporated into the facts of a case study. The factual assumptions of the case study must be well defined, thereby limiting the scope of the analysis, which makes the assessment results difficult to use as a proxy for the full scope of the law. Secondly, some practical aspects, such as the fairness, flexibility or certainty deriving from regulations cannot be measured, but still play an important role.[36]

For the EBRD, the response to the limitations of the New Legal Indicator Survey highlighted above was to design an assessment that focused on practical, economic outcomes being detached from the formality of the

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[32] The Lex Mundi project, which forms part of a larger World Bank project on "Doing Business" in various jurisdictions throughout the world. See Simeon Djankov, Rafael La Porta, Florencio Lopez De Silanes, and Andrei Shleifer, 'Courts: The Lex Mundi Project (March 2002)' *Yale ICF Working Paper* No. 02-18; *Harvard Institute of Economic Research Paper* No. 1951.

[33] See <www.common-core.org/>. See also *Security Rights in Movable Property in European Private Law. The Common Core of European Private Law* (2004) Eva-Maria Kieninger (ed.), Cambridge University Press

[34] Djankov, Simeon, La Porta, Rafael, Lopez-de-Silanes, Florencio, Shleifer, Andrei (2003) 'The New Comparative Economics', *Journal of Comparative Economics* 31 (4), 595–619.

[35] Schleifer, Andrei, La Porta, Rafael, Lopez-de-Silanes, Florencio, Vishny, Robert (1998) 'Law and Finance' *Journal of Political Economy*, 106 (6), 1113–1155.

[36] See Armour, John, Deakin, Simon, Lee, Priya, and Siems, Mathias (2009) 'How do legal rules evolve? Evidence from a cross-country comparison of shareholder, creditor and worker protection', *American Journal of Comparative Law*, 57 (3), 579–630.

law, its structure and conceptual underpinning, whilst managing to grasp the complexity and interwoven nature of the law and the way it impacts on users' behaviour. This is what the following type of assessment attempts to achieve.

4. The Legal Efficiency Approach and EBRD Most Recent Assessments

a) Mortgage Law Assessment

In its recent work on mortgage law and mortgage securities, the EBRD developed the concept of 'legal efficiency' as the basis for its assessment of the sector. The term 'legal efficiency'[37] is used to indicate *the extent to which a law and the way it is used fulfils the purpose for which it was designed and provides the benefits that it was intended to achieve.*

The key function of a secured transactions law is economic as the secured credit market has essentially an economic function (whilst recognising that it may also have important social function and consequences). The fact that any jurisdiction can function without a secured credit market makes it facilitative in nature. A relatively simple indicator of the success of a secured transactions law reform (or primary motive for reforming secured transactions law) is the subsequent increase in the volume of secured lending. This however is a crude and narrow indicator, and wholly inadequate by itself. The intended function of the secured credit market is more than merely to boost the amount of credit granted against security. It may also include, for example, opening up credit to new sectors of society, encouraging new housing construction, or allowing privately-funded infrastructure projects. Legal efficiency is thus analysed by looking at the degree to which the legal framework enables secured transactions, first, to achieve their basic function, and secondly, to operate in a way which maximises economic benefit. And, as shown in Table 3a, the second criterion is broken into five separate headings: simplicity, cost, speed, certainty and fit-to-context.

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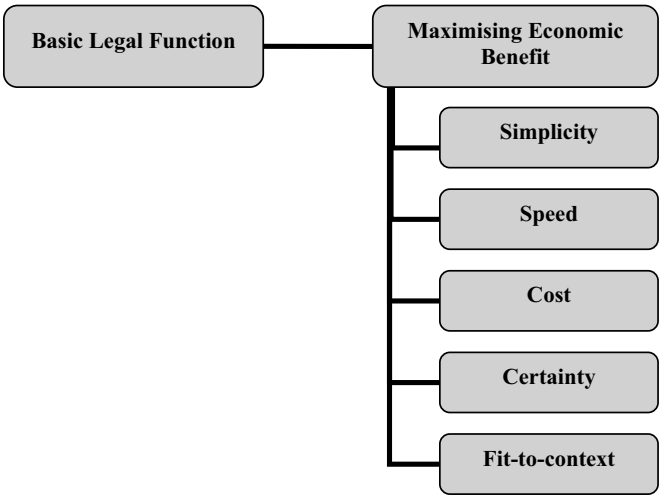
[37] Dahan, Frederique and Simpson, John (2008) 'Legal efficiency of secured transactions reform: bridging the gap between economic analysis and legal reasoning' *Secured Transactions Reform and Access to Credit,* Dahan, Frederique and Simpson, John (eds) Edward Elgar Publishing Limited, Cheltenham, pp. 122–140.

Table 3(a): Criteria for legal efficiency of secured transactions law



The basic legal function of a secured transactions law is to allow the creation of a security right over assets which, in the case of non-payment of a debt, entitles the creditor to have the assets realised and the proceeds applied to the satisfaction of his claim prior to those of other creditors. If a secured transactions law only gives the creditor a personal right but no right to the assets, or if there is no right to enforcement, or no priority vis-à-vis other creditors, the law fails to achieve its basic legal function. An absolute priority for taxes and other state claims ahead of the secured creditor, or the right in insolvency of ordinary creditors to share in a portion of the proceeds, are more than inefficiencies in the secured transactions law. They are defects which prevent it from fully achieving its basic function. They may be intentional (a super-priority of the state usually is) but they reflect a compromise between two laws with conflicting purposes. Any such compromise inevitably inhibits the effective operation of secured transactions law and introduces uncertainty into the minds of lenders.

If the legal framework for secured transactions is to operate in a way which *maximises economic benefit*, the system for creation and enforcement of pledge or mortgage should be simple, fast and inexpensive, there should be certainty as to what the law is and how it is applied, and it should function in a manner which fits to the local context.

Simplicity – Simple does not mean simplistic: it is necessary to strike a balance between simplicity and the sophistication required by the market.

In many countries complexities have developed and become entrenched over time as laws have been adapted to new circumstances, not because of the complexity of these circumstances but rather from limitations inherent in the legal system.

Speed – For most aspects of the legal process, the less time it takes the more efficient it is. There are exceptions: a notice period or a cooling off period has to be of appropriate length, but for registration of a pledge or mortgage, for example, there can only be benefits if it takes only a few minutes rather a month, and a lender who knows that enforcement of the pledge or mortgage is likely to take several years will derive less comfort from his security.

Cost – Legal costs almost inevitably have an adverse impact on the economic benefit of a transaction. Delay, complexity and uncertainty all tend to add to costs so there is a close relation with the other aspects of legal efficiency. Some costs are within the control of the parties, at least to a certain extent. Before taking legal advice on structuring a transaction the parties can assess the value of doing so. The cost of legal advice on a complicated transaction may be outweighed by the benefits, but the cost of legal advice incurred because of defects in the legal framework always reduces efficiency, as do fixed costs (for example registration, notary or court fees).

Certainty – Certainty is a critical element of any sound legal system. A grain of uncertainty in the legal position can have a pervasive and disproportionate effect. Little makes a banker more hesitant than hearing there is some doubt regarding the legal robustness of a transaction. Transparency can often strengthen certainty: for instance, easy universal access to information in the land register allows potential mortgage lenders to find out about the property and any other mortgages that may be claimed.

Fit-to-context – The 'fit to context' criterion is the most elusive but nonetheless important as it covers a number of facets. It is not enough to adopt a law which clearly and unambiguously establishes a simple, fast and inexpensive regime for pledge or mortgage security. The efficient functioning of the law will also depend on whether it is adapted to the economic, social and legal context within which it is to operate. It needs, for example:

- To respond to the economic need. Markets are constantly changing, and the law has to be able to adapt to new products, as for example when loans are proposed with flexible interest rates.
- To achieve an appropriate balance between fulfilling the economic purpose and ensuring that the effects of the reform are acceptable in context. The rights of consumers and occupiers of property to appropriate protection cannot be eliminated to suit the economic needs of the se-