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The Commercial Code – Symbol of a Ukrainian Malaise

I. Introduction

On 2 February 1998, Professor Valentin K. Mamutov, a respected legal scholar and academician, invited me to visit him in Donetsk and discuss the codification of a 'Civil' Code and a 'Commercial' or 'Economic' Code for Ukraine.

At the time, I was one of the 'team-leaders' at the "Ukrainian-European Policy and Legal Advice Centre" (UEPLAC), which had been set up by the Ukrainian government and the European Union (TACIS) to accompany the legal and judicial reforms and the transition to democracy, the rule of law and a market economy. One of UEPLAC's priorities was to assist a Ukrainian working group during the last phases of the elaboration of the Civil Code[1]. In March 1997, during an international conference in Bremen/Germany, the then Minister of Justice of Ukraine, Serhiy Holovaty, had insisted vigorously that the Civil Code and its implementation were crucial requirements for legal reform.[2]

Relying on my written notes of the meeting[3], I recollect that Professor Mamutov and with him a whole school of thought on complex economic law was displeased with this development. The school strongly believed that the Commercial Code was the most relevant piece of codification, not only for a modern Ukrainian society but universally, for all developed States. It conceded that Civil Codes might still be relevant for day-to-day consumer transactions but insisted that they had lost their economic significance that they had in the 19th and at the beginning of the 20th centuries, when the secular codifications in France, Austria, Germany and Switzerland were accomplished.

The theory of economic law believes that the reason for this development is the evolution of the mode of production and the material base of the political economy to which the legal superstructure has to adapt. In the early phases of capitalist production and distribution of commodities, in the absence of monopolistic enterprises and active intervention of the State into the market mechanism, transactions of goods against money could be organized on a horizontal level, guided and formed by Civil Codes. This historical phase, it argues, has been left behind. The emergence of monopolistic enterprises and powerful financial institutions on the one hand side, and the necessity of the States to intervene into the market mechanism and to act on the market on the other hand side, has definitely transcended the classical separation of a strictly private and a strictly public sector.

As a consequence, both the hitherto private and public sectors must now be considered to be intertwined and organically interdependent in what is called a "mixed economy". This is not only evidenced by the State acting as buyer and seller on the market and also intervening into

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[1] For a detailed analysis of the codification process, which had started in 1992, I refer to A. Dovgert/N. Kusnetsova, Konzeption und Struktur des Entwurfs des Zivilgesetzbuches der Ukraine, in: M. Boguslawskij/R. Knieper, Wege zu neuem Recht, 1998, Seiten 99-126 (in German and Russian)

[2] S. Holovaty, Der Aufbau des neuen Rechtssystems in der Ukraine, in: M. Boguslawskij/R. Knieper, Wege zu neuem Recht, 1998, Seiten 97-98 (in German and Russian)

[3] His thoughts are also expressed in V.K. Mamutov, Die Konzeption eines Wirtschaftsgesetzbuches der Ukraine, in: Monatshefte für osteuropäisches Recht, 1994, S. 373 ff.

the economy by fiscal, monetary, social etc. policies. It is equally evidenced by big, often global corporations that are able to manipulate the market and exercise social and political influence.

In this conception, the "mixed economy" is the material base which must be mirrored in mixed superstructures such as complex codifications, which combines the elements of private and public law. Adam Smith's metaphor of the "invisible hand of the market" is definitely out of use.

Professor Mamutov explained that Ukrainian scholars had drafted the Commercial Code as a milestone of complex codification and submitted the text to the Verkhovna Rada in 1996, that the Minister of Justice had delayed the consultations on the Code to favour the Civil Code, that the Verkhovna Rada had set up a special commission in May 1997 to examine and compare both the Commercial and Civil Codes without a constructive result. He complained about the partisan attitude of UEPLAC in favour of the Civil Code and was particularly upset by the fact that I as a German did not support the Commercial Code despite the fact that Germany had enacted a Commercial Code combining private and public law in reflection of the mixed economy.

II. Systematic Flaws

The meeting was cordial and friendly. However, none of Prof. Mamutov's arguments convinced me, and my arguments did not convince him. We agreed to disagree.

In the end, the Ukrainian legal reform was seriously damaged by a foul compromise, when on 16 January 2003 a Civil Code and a Commercial Code were adopted in parallel thus creating a confusing and ambiguous legislative situation which decreased legal certainty and hindered a sustainable economic development. A number of systematic flaws characterize this codification process.

II.1. The German type Commercial Code

To a certain extent, the roots of the German Commercial Code reach back to the mercantilist concept of a special merchant Estate, which was different from the nobility and also from the third Estate. In 1673, the French Minister Colbert had enacted an 'Ordonnance sur le Commerce' to regulate the relations between merchants. Despite its origins in the *ancien régime*, the Ordonnance was maintained after the French Revolution, and confirmed in 1807 as 'Code de Commerce'.

Before its unification in 1871, the different German independent States elaborated a 'General Commercial Code' in knowledge of the 'Code de Commerce'. It was enacted in the North German Confederation, Austria, and Liechtenstein between 1863 and 1869. It survived the German unification in 1871 mostly because the German Reich did not have the legislative competence from the beginning of its existence to enact a Civil Code.[4]

Thus, the reason for the persistence of a Commercial Code in Germany side by side to the Civil Code was of a technical nature and not at all due to structural specificities of a commercial sphere as opposed to a private sphere of legal relations. On the contrary, the French as well as the German-Austrian-Liechtenstein Codes were strangely out of date when they were enacted in 1807 and 1863-1869 as copies of the Ordonnance of 1673: they were entrenched in concepts

[4] For the legislative history I refer to R. Knieper, Gesetz und Geschichte – ein Beitrag zu Bestand und Veränderung des Bürgerlichen Gesetzbuches, 1996

of merchants' guilds and estates that had been abolished together with the *ancien régime,* instead of reflecting the necessities of industrial production and markets.

It is true that in the 1920ies and 1930ies some authors propagated a specific economic law, particularly in France and Germany. They were inspired by ideas of an organic nation where every member of the nation has its predefined place and where ethnic ties and bonds should be stronger than individualism and private rights and transactional obligations. Such ideologies gained some prominence in German fascism. They were abandoned after 1945 without ever having led to legislative acts.

Therefore, it comes as no surprise that modern codifications from the early 20th century onwards succeeded to include all subject matters that were separated in Germany into one unique Civil Code. Indeed, the separation had not been structural but was artificial. That started in 1904/1911 with the Civil Code and the Law of Obligations of Switzerland, and found its latest successful results in the Civil Code of Quebec of 1991 and the Civil Code of the Netherlands as from 1992 onwards, not to forget the Civil Codes of the post-soviet newly independent States, where some jurisdictions such as Uzbekistan flirted for a while with the idea of a Commercial Code, only to abandon it correctly, and the Civil Code of the PRChina, which went step by step, partly due to constitutional constraints with respect to private property of land, but leaves no doubt that, once completed, will be comprehensive, without additions in a Commercial Code.

That does not mean that civil codes do not distinguish between certain classes and groups of subjects in certain regards. Certain rights and obligations may be specific for entrepreneurs or for consumers, as they have always been for minors, seniors and/or mentally retarded persons. Fortunately, the distinction between men and women with respect to legal capacity has disappeared by now. That is a matter of legal policy, legislative technique and explicit provisions but not one of guild, estate or corporatist privilege as in the *ancien régime*.

In any event, the commercial codes, where they still exist outside Ukraine, are purely private law with a special focus on business and market transactions. They did not and do not even try to reflect a "mixed economy" and abstain from mingling the sphere of private law from the sphere of public law.

The last codification which does not distinguish between public and private law is the "General State Law for the Prussian State" or "PrALR" of 1794, evidently not to reflect the evolution of capitalist production but in recognition of the corporatist structure of the Prussian society in the 18th century.

Therefore, the denomination of the Ukrainian code as 'Commercial Code' is a terminological fallacy.

II.2. The amalgamation of public and private law

The idea that an evolution of the material base of the political economy, from a simple production and distribution of commodities to a high accumulation of capital in global monopolies and integrated and complex networks of distribution, should be mirrored in a complex legal superstructure emerges from a school of thought that labeled itself as dialectical materialism. It was less an analysis of historical developments and their complexities but a mechanical model that predicted an inevitable ever higher concentration of capital resulting in a final breakdown of the system and the triumph of a new society.

The school of thought had a “western” equivalent, equally inspired by Hegelian dialectics, that alleged that history had moved forward in the three-step waltz ‘thesis – antithesis – synthesis’ to ever higher stages of social developments and had finally reached “The End of History”[5] in liberal democracies (and not, as Hegel himself had thought, in the State of Prussia).

Both schools of thought have failed dramatically in their analysis of reality. History itself has demonstrated that it is neither a mechanical clockwork nor a path to ever better stages of civilization, and its course has contradicted the prediction of both ideologies.

In the “eastern” prism of dialectical materialism, the production is organized by monopolies and oligopolies that defy the ‘logic’ of the market and play a direct political role; the State intervenes directly into the sphere of production and distribution of commodities; and the spheres of the private and the public are blurred. All that must be reflected in a legal superstructure, which can no longer maintain a separation of the private and public law. This concept does not stand the test of reality.

Of course, I do not deny that more than once powerful and unscrupulous business people usurp political positions and use the public instruments of the State to foster their private interests. That is not restricted to the transitional societies of the post-soviet world, as well documented by the examples of Italy and the USA at certain moments. Equally, I do not deny that unscrupulous politicians hijack private enterprises and force them to foster their political goals.

However, this is not an expression of systemic or dialectical logic. On the contrary, it demonstrates that the interrelation between the public and the private spheres and their respective institutions, which guarantee the sustainability of the production of wealth and social relations, is violated and in disorder. We can observe that, whenever and wherever a business ‘tycoon’ usurps political power or when politicians usurp business in non-respect of the spheres of private production and public policy, a sustainable economic, social and cultural development is seriously crippled.

I strongly believe that this is the main reason for the sluggish development of many national economies in Africa, Latin America and the post-soviet world, despite their high potential of natural and human resources.

III. The proper places of private and of public economic law

III.1. Private Law

In private law, the objective of civil codes is to establish a balanced frame and an equal playing field for commercial and non-commercial actors on the market and in other horizontal, non-hierarchical relationships. Contracts of sale of goods against money and other synallagmatic transactions and transactions without consideration are as much their subject matter as the confirmation of a wide set of property rights *erga omnes*, the establishment and the performance of rights and obligations, compensation for damages and restitution, relations between members of a family and generations, and the definition, recognition and legal capacity of persons themselves, be they physical or legal.

All these subject matters can be included and embedded in one comprehensive piece of codification. However, more often than not and particularly in jurisdictions where the codes are

[5] That is the title of a famous book of Francis Fukuyama, written in 1989, which was adored for some years only to have fallen into oblivion by now.

of a certain age like in France, Austria, Germany and Switzerland, the core codes may be supplemented and amended by special statutes with respect to certain subject matters. They may appear as practical necessities or have a particularly close connection to international relationships. Statutes on company law or on modern types of contracts are cases in point.

Another reason for specific statutes is a choice in subject matters that have close connotations to both private and public law. A prominent example is the decision of the Dutch legislator that had originally planned to integrate patent law into the new Civil Code but has finally abandoned this approach because patent law is necessarily marked by both private law – the protection and use of the property rights – and public law – the creation and functioning of the patent office.

III.2 Public Law

In public economic law, a variety of subject matters is covered. Perhaps they are connected best by the recognition that – against neoliberal propaganda – "*the market does not do it all*". Sustainable market interaction cannot exist without a complementary public sector and public law represented, enacted and implemented by the State. This awareness has accompanied the emergence of market economies and the modern territorial State from its very beginning in the 15th century. Authors from Niccolò Machiavelli via Jean Bodin to Adam Smith and Karl Marx have analyzed the necessity of the State to organize, regulate and finance public expenditures that "*in the highest degree advantageous to a great society are, however of such a nature that the profit could never repay the expenses to any individual or small number of individuals*", and must be financed by unilateral mandatory contributions – taxes – which according to Adam Smith have to be paid progressively in function of individual wealth.[6]

This is not a paralyzing intermingling in the sense of a mixed economy and a complex superstructure. Rather, there is a functional complementarity where the different spheres have their contours, contents and competence that must not be blurred.

For heuristic purposes, I present some elements of public economic law which I find of crucial importance:

a) The constitutional and administrative law of infrastructure, which prevents discretionary decisions when physical infrastructure such as roads, ports, airports and railroads or social infrastructure such as schools, universities, hospitals are built and maintained;
b) The organization of State and other public bodies (such as the Central Bank or the patent office);
c) The procedures to be employed by administrative and other public bodies for rendering a decision or taking any other action, which is not in the logic of the market (but may favour profit-oriented activities of market participants) as well as administrative and/or judicial recourse against such decisions and actions. I underline that such laws are binding on the administrative bodies, which have to act on their basis and within their scope: the revocation of a business license, a measure of monetary policy, an expropriation or a confiscation, all such administrative acts are only legal when based on law;

[6] Adam Smith, An Inquiry into the Nature and Causes of the Wealth of Nations, 1776, Book V, Chapter 1; I am aware that this is inadmissibly short. For a fuller analysis, I have to refer to R. Knieper, Nationale Souveränität – Versuch über Ende und Anfang einer Weltordnung, 1991, pages 64 ss.

d) The regulatory requirements which have to be fulfilled by any physical or legal person, be it private or public, that wants to enter the market and act lawfully in the economic sphere. The core of these rules and regulations concern notification, licensing and supervision of general and special business, i.e., the whole range of activities, including hairdressers, restaurants, banks, insurances, producers, manufacturers. I underline that the administrative bodies have a duty to grant the notification, license etc. if the requirements are met and are not entitled to ask for anything more.

III.3. The interrelation of private and public law

While private law protects the freedom of property and sets the frame for transactions, public law might require a license to start a business. Where property is not protected, a business license will be of little practical value. Conversely, well-developed provisions on the freedom of contract and protection of property may by without value if licenses are granted or refused arbitrarily or against illicit payments and bribes.

Both spheres are of crucial importance, both need their specific institutions and procedures of enforcement, be it before courts of general jurisdiction, administrative courts or before arbitration tribunals.

The spheres are clearly distinguishable. The Civil Code may provide for the frame of transactions between banks and private persons, and a specific law on banking supervision will cover the public law aspects of licensing, capital requirements and control of banks. The Civil Code or a specific statute of private law may provide for the frame of transactions between insurers and clients, and a specific law on insurance supervision will cover the public law aspects of the insurance companies.

It would be confusing to mix the spheres. They follow different rationales.

Private law is concerned with horizontal relations and the freedom of participants. When the aspect of freedom is obviously distorted by an unequal distribution of market power, the legislator will enact private law provisions to compensate the material inequality and restrict the freedom of contract by mandatory norms in protection of the weaker party.

Public law establishes the frame for vertical relations between the State and physical and legal persons of private law where the State exercises its *puissance publique*, its right to order unilaterally when and to the extent public law authorizes it to do so. Discretion and the freedom to act are limited.

The idea to confound the spheres in mixed or complex legislative acts such as the Commercial Code of the Ukrainian type entails necessarily negative consequences for the rule of law and confuses responsibilities of both the State and private persons.

IV. The State in Civil Relations

The State has a Janus face in most jurisdictions of the world, including in Ukraine. As said further up, it is the holder of public and sovereign power, of *puissance publique*, and at the same time: "*In civil relations the state shall act on equal rights with other participants to these relations*" (Article 167.1 Ukrainian Civil Code (**UCC**)). In this vein, Article 2.2 UCC enumerates the State and other subjects of public law as potential participants of civil relations; it is liable with its property (Article 174 UCC), which it owns – with certain qualifications – not differently from other legal persons (Article 326 UCC). Like any other

person, the State may create and incorporate legal persons of private law (Article 167.3). Its double face and role appear in Article 167.2 UCC, which reserves the capacity to create legal entities of public law to the State.

Thus, the State exercises its public power to regulate the economy by binding laws and other normative acts, including vertical administrative acts. At the same time, it acts on a horizontal playing field like any other physical or legal person within the limits of its authority, established by the constitution and law. As participant in civil relations, the State submits itself to these laws, acts and statutes when it enters into market transactions, for instance by executing a contract of purchase and sale of office equipment for a ministry. These latter relations are normal business relations where the State will not be authorized to exercise its public power but where it enjoys the freedom of contract.

There is nothing spectacular about the provisions of the UCC. They correspond to a standard which is observed in most civil codes and/or national jurisprudence. The distinction between sovereign acts of public law and commercial transactions under private law by the State corresponds also to modern international law, as documented in the 'UN Convention on Jurisdictional Immunities of States and Their Property'.

Their appropriate systemic understanding would be impeded by the concept of 'complex' codification of the Ukrainian Commercial Code type. Public and private law must not be confounded but distinguished, as convincingly done in the UCC: when the State acts in its capacity as holder of public power and regulates the economy, public, i.e., constitutional and administrative law applies; when the State acts as participant in civil relations, the Civil Code applies.

Again, there is no conceptional and even less a legislative need for a specific economic law to regulate the participation of the State and the other public bodies in transactions on the market. Rather, it provides further evidence that, indeed, the Commercial Code of Ukraine is a legislative error and should be repealed.

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