



September 2004

Booz | Allen | Hamilton

Commercial Legal and Institutional Reform (CLIR) Assessment Report for Kosovo



A Seldon Project Initiative

Diagnostic Assessment for Kosovo

Table of Contents

<u>I.</u>	<u>INTRODUCTION</u>	1
	<u>THE KOSOVO ASSESSMENT</u>	1
	<u>NOTES ON SCOPE AND METHODOLOGY</u>	1
	<u>SUMMARY OF CROSS-CUTTING THEMES</u>	3
	<u>Legal Education</u>	3
	<u>Continuing Legal Education</u>	5
	<u>Access to Legal Resources</u>	7
	<u>Corporate Governance</u>	8
	<u>Implementation</u>	9
	<u>Donor Coordination</u>	10
<u>II.</u>	<u>SPECIFIC SUBJECT MATTER AREAS</u>	11
<u>A.</u>	<u>COMPANY LAW</u>	11
	<u>1. Overview</u>	11
	<u>2. Legal Framework</u>	12
	<u>3. Implementing Institutions</u>	15
	<u>4. Supporting Institutions</u>	16
	<u>5. Social Dynamics</u>	17
	<u>6. Recommendations</u>	18
<u>B.</u>	<u>CONTRACT LAW</u>	20
	<u>1. Overview</u>	20
	<u>2. Legal Framework</u>	20
	<u>3. Implementing Institutions</u>	25
	<u>4. Supporting Institutions</u>	26
	<u>5. Social Dynamics</u>	28
	<u>6. Recommendations</u>	29
<u>C.</u>	<u>COLLATERAL (FINANCING SECURED WITH PLEDGE OF MOVABLE PROPERTY)</u>	31
	<u>1. Overview</u>	31
	<u>2. Legal Framework</u>	31
	<u>3. Implementing Institutions</u>	32
	<u>4. Supporting Institutions</u>	33
	<u>5. Social Dynamics</u>	34
	<u>6. Recommendations</u>	35

<u>D.</u>	<u>COURTS (COMMERCIAL DISPUTE RESOLUTION)</u>	36
<u>1.</u>	<u>Overview</u>	36
<u>2.</u>	<u>Legal Framework</u>	37
<u>3.</u>	<u>Implementing Institutions</u>	37
<u>4.</u>	<u>Supporting Institutions</u>	38
<u>5.</u>	<u>Social Dynamics</u>	39
<u>6.</u>	<u>Recommendations</u>	40
<u>E.</u>	<u>BANKRUPTCY</u>	42
<u>1.</u>	<u>Overview</u>	42
<u>2.</u>	<u>Legal Framework</u>	43
<u>3.</u>	<u>Implementing Institutions</u>	46
<u>4.</u>	<u>Supporting Institutions</u>	47
<u>5.</u>	<u>Social Dynamics</u>	49
<u>6.</u>	<u>Recommendations</u>	50
<u>F.</u>	<u>COMPETITION</u>	51
<u>1.</u>	<u>Overview</u>	51
<u>2.</u>	<u>Legal Framework</u>	52
<u>3.</u>	<u>Implementing Institutions</u>	54
<u>4.</u>	<u>Supporting Institutions</u>	55
<u>5.</u>	<u>Social Dynamics</u>	56
<u>6.</u>	<u>Recommendations</u>	57
<u>G.</u>	<u>FOREIGN DIRECT INVESTMENT</u>	57
<u>1.</u>	<u>Overview</u>	57
<u>2.</u>	<u>Legal Framework</u>	58
<u>3.</u>	<u>Implementing Institutions</u>	64
<u>4.</u>	<u>Supporting Institutions</u>	66
<u>5.</u>	<u>Social Dynamics</u>	68
<u>6.</u>	<u>Recommendations</u>	68

I. INTRODUCTION

The Kosovo Assessment

At the request of the USAID Mission in Pristina, Kosovo (USAID/Kosovo), Booz Allen Hamilton (Booz Allen) has undertaken a Commercial Legal and Institutional Reform (CLIR) Assessment of Kosovo. The purpose of the CLIR Assessment is to provide USAID/Kosovo with a comprehensive appraisal of the existing legal and institutional framework for governance over economic development in Kosovo. The CLIR Assessment Report will also be used as baseline by the Mission for the purpose of Performance Management Plan in the commercial law area.

The CLIR Assessment was carried out from August 30 through September 15, 2004 by a team of three expatriate lawyers and one project manager, with invaluable assistance from USAID/Kosovo and local private-sector counterparts. The team members and their areas of specialization were:

Expatriate Team		
Dillon H. Coleman	Booz Allen, Commercial Law Specialist	Foreign Direct Investment, Contracts Law
Thomas Jersild	Booz Allen, Commercial Law Specialist	Company Law, Courts, Collateral Law
Edwige Stephen	Booz Allen, Project Management	Team Leader
Louise D. Williams	Booz Allen, Commercial Law Specialist	Bankruptcy Law, Competition Law
Local Assistants		
Leartha Gunga	BA, University of Pristina, Faculty of Law	

The CLIR Assessment consisted of two parts. First, the team reviewed laws, regulations, and related literature, with assistance in distilling and updating from local assistants and various legal professionals. Second, the team interviewed numerous government officials, NGOs, multilateral and bilateral donor representatives, judges, lawyers, investors, and businesspeople to assess the CLIR environment in Kosovo. All of them, including the government authorities, were generous with their time and lent full support to this endeavor.

This Report examines the legal foundations for economic activity in Kosovo, with an emphasis on how the CLIR environment currently impacts Kosovo's commercial activity and economic growth. In addition, this Report makes specific recommendations pertaining to CLIR program assistance in the future. Pursuant to USAID's direction, the Team has examined seven CLIR topics: Company Law, Contract Law, Collateral Law (Secured Transactions), Courts, Competition, Bankruptcy, and Foreign Direct Investment.

Notes on Scope and Methodology

The CLIR Diagnostic Methodology was designed to help USAID Missions achieve the following objectives:

1. To provide a factual basis for characterizing the degree of development and the status of commercial law reforms in a country;

2. To provide a methodologically consistent foundation for identifying describing the root causes of the "implementation/enforcement" gap; and
3. To provide analytical and planning tools and metrics that will help USAID design new approaches to sustainable, cost-effective CLIR interventions.

For the purposes of this CLIR Assessment, "commercial law" is defined to include the following substantive legal areas:

- **Companies.** The legal regime(s) for market entry and operation that define norms for organization of formal commercial activities conducted by two or more individuals. This area incorporates **Corporate Governance**, the systems through which companies are directed and controlled.
- **Contracts.** The legal regime and institutional framework for the creation, interpretation, and enforcement of commercial obligations between one or more parties.
- **Collateral.** Laws, procedures, and institutions designed to facilitate commerce by promoting transparency, predictability and simplicity in creating, identifying, and extinguishing security interests in assets.
- **Courts (Commercial Dispute Resolution).** Courts play a significant role in most areas of commercial law and require analysis within the general context of the specific subject areas.
- **Bankruptcy.** Mechanisms intended to facilitate orderly market exit, liquidation of outstanding financial claims on assets, and rehabilitation of insolvent debtors. The term "insolvency" refers to the condition of having insufficient assets to meet debts and liabilities.
- **Competition.** The legal and regulatory regime crafted for the purpose of ensuring open and free markets, protecting consumers from uncompetitive market distortions, preventing conduct that impedes fair competition among businesses, and stimulating enterprise innovation and efficiency.
- **Foreign Direct Investment.** The laws, procedures, and institutions that regulate the treatment of foreign direct investment.

Within each of these substantive areas, four "dimensions" of CLIR are examined as a conceptual framework for comparison. These include:

- **Legal Framework.** How closely do existing laws reflect emerging global standards? How well do they respond to commercial realities that end-users face?
- **Implementing Institutions.** How well do implementers and enforcers carry out their duties in terms of efficiency, transparency, and predictability? Are user needs well served? Do institutional behaviors create barriers to participation and predictability?

- **Supporting Institutions.** How deeply rooted in civil society are the laws and institutions that govern economic life? Do the many needed individual parts of the “system” exist, and if so, do they work together efficiently?
- **Social Dynamics.** How well does the legal system respond to users’ evolving needs? How receptive to change are the key stakeholders? What forces or factors govern the pace and direction of change in the system and society as a whole?

Summary of Cross-Cutting Themes

Study of the seven subject-matter areas produced a series of cross-cutting themes that warrant careful attention. These themes are (1) legal education; (2) continuing legal education for lawyers and judges; (3) access to legal resources; (4) corporate governance; and (5) implementation of new commercial laws; and (6) donor coordination. They are discussed in turn.

LEGAL EDUCATION

The problems with legal education in Kosovo begin in the dark, crumbling, and even foul-smelling facility of the law school at Prishtina University where most of the lawyers in Kosovo are trained. From there, the issues proliferate: The ratio of students (about 3000) to faculty (about 47), is more than 63:1.¹ Many texts are older than the students who use them and, even where there is access to new laws and concepts, the information is not adequately understood by the faculty charged with teaching them.² Law students are not taught legal writing in any meaningful way. Rumors of corruption in the typically non-anonymous examination process are rampant. Highly politicized leadership, ambivalence over outside involvement in the curriculum, and well intentioned but confusing initiatives to bring the curriculum in step with EU standards³ further combine to render the education offered uneven, at best. These problems are complicated by inconsistent assistance from the donor community, which has launched and abandoned various programs over the years – different clinical legal education programs have been tried, for example – with little emphasis on the relationship between skilled lawyers and economic growth, and even less on donor coordination, monitoring, evaluation, or dissemination and incorporation of lessons learned.

Bright lights exist, however, in the morass. A steady stream of visiting law faculty from the United States and Europe have taught at Prishtina University in recent years, either individually or in teams with Kosovar instructors, injecting new energy, information, and techniques into

¹ For the purpose of comparison, the student-faculty ratio at Georgetown University Law Center is about 16:1; the entire University of Washington system is about 13:1; and the Warsaw School of Economics (Poland) is about 18:1.

² For example, it is telling that, of the scores of articles and resources referenced in a 2004 commercial law text drafted by a law school faculty member, very few of these sources were published after 1975.

³ Beginning this year, the law school is implementing a two-stage degree program for the purpose of complying with the Bologna Declaration of 1999, the EU’s policy document for bringing compatibility and comparability of higher education systems among the member states. The new system establishes a three-year Bachelor’s program, followed by a two-year’s Master’s program in five subjects: criminal law, civil law, administrative law, international law, and economic/financial law. None of the interviewees believed that this change in structure signified meaningful reform: “Rather than taking three years to produce an unqualified lawyer,” one person commented, “they will now take five years to produce an unqualified lawyer.”

teaching and examination.⁴ Two U.S. law schools – the University of Pittsburgh and Chicago-Kent – have made particularly strong commitments to bringing contemporary practices of legal education to Prishtina.⁵ Both schools have hosted law faculty in the U.S., sent instructors to Kosovo, and, through their respective LL.M. programs, trained talented young students who committed to return and share their knowledge. In addition, ABA/CEELI has made an important contribution to the effort to train law school graduates through its sponsorship (supported by USAID) of a “Praktikant Program,” that is, a one-year on-the-job training opportunity for new lawyers who are required to obtain certain formal experience prior to taking the bar exam.⁶

Notwithstanding these promising activities, there is an enormous need for greater coordination among donors, individual projects, and the law school itself, which underscores the relationship between a *vibrant, functioning law school* and a *vibrant, functioning economy*. In short, Kosovo’s economy will never flourish in the absence of a corps of trained lawyers who are up-to-date on market-oriented concepts and new laws; who can draft, interpret, and enforce contracts; and who can write. That corps does not exist now, and no signs point to its rapid development.

USAID/Kosovo has established a Memorandum of Understanding with the Law Faculty of Prishtina “under which training courses on commercial law targeting law students, legal professionals and business people” are envisioned.⁷ This is an important step. Given its access to well-qualified lawyers and its support of the ABA/CEELI work in this area, USAID is positioned to serve as the leader among donors in forging and supporting a coordinated effort to improve commercial legal education. In addition to providing key funding support, USAID could bring together donors and local stakeholders to develop a strategic, coordinated approach to commercial legal education.

When it comes to improving commercial legal education at the law school, evaluation of the “big picture” is warranted. To establish a baseline, the following questions need clear answers:

- What commercial law courses are currently available in the standard law school curriculum? Who is the faculty assigned to teach these courses, and to what extent are these faculty members themselves familiar with recent changes in the law?
- What is the universe of local and donor activity specifically targeted at the law school? Of this activity, which specifically pertains to commercial law? What is the current level

⁴ The “Prishtina Summer University” program, which just completed its fourth summer, has been a relatively successful effort, largely sponsored by the Netherlands, other members of European Union, and affiliated EU institutions, to bring new courses and teaching methods to the University. Most of the summer courses are “team taught” by one visiting professor and one resident professor, with the intent that the local professor will develop a similar course to be taught during the regular school year in the future. In Summer 2004, four courses were taught at the law faculty. None, however, covered commercial law topics specifically. See <http://www.antenna.nl/ysy/PSU2004/participants/infostudents.htm>.

⁵ More information can be found at the web pages of the University of Pittsburgh’s Center for International Legal Education (<http://www.law.pitt.edu/academics/cile.php>) and Chicago-Kent College of Law’s Office of International Law and Policy (<http://www.kentlaw.edu/international>).

⁶ See http://www.abanet.org/ceeli/countries/kosovo/2.11.03_success_story.htm.

⁷ See http://www.usaid.gov/missions/kosovo/Activities/Commercial_law.htm.

of donor coordination with respect to commercial law-related assistance to the law school?

- What long-term reforms are necessary to allow the law school to provide a comprehensive and meaningful curriculum in commercial law? How can these reforms be prioritized? What existing structures are in place within Prishtina University and the law school to oversee and guide a long-term reform process, and what new structures might be necessary?
- What short-term methods could be used to get much-needed information and assistance to students now? How could donor and local resources be leveraged to most effectively implement these methods?

In reality, reforms to the legal education system in Kosovo will likely take a generation. Through a shared vision of long-term reform, combined with thoughtful and well executed short-term initiatives, a shift in the learning dynamic and the quality of commercial legal education may finally take place in a sustained and meaningful fashion.

CONTINUING LEGAL EDUCATION

The dearth of qualified commercial lawyers and judges familiar with commercial law topics is attributable to numerous factors, including the virtual exclusion from legal education of Kosovar Albanians between 1989 and 1999; the outdated skills of lawyers and judges trained prior to 1989; the poor quality of education now; and the constantly changing commercial legal and institutional environment. Since 1999, the donor community has engaged in many initiatives to train Kosovar lawyers and judges. Much of what has been done has been considered relatively successful; recent emphasis on enforcement of judgments, for example, has attracted significant interest and participation. An *ad hoc* and uneven approach to Continuing Legal Education (CLE) is maturing to a certain extent into more a structured system. Specifically, the Chamber of Advokats takes seriously its role to provide CLE to lawyers and the Kosovo Judicial Institute (KJI), while still surprisingly weak in light of the significant resources it has received to date, is well known among its constituents.

As one observer has commented, however, “Too much emphasis . . . is focused on human rights and criminal proceedings. Greater emphasis needs to be placed on commercial and business law and lawyering.”⁸ There remains a pressing need for comprehensive training specifically pertaining to commercial law, through which lawyers and judges may obtain in-depth understanding of concepts that, to date, have not been taught in a sustained fashion. Again, this is an area for USAID to use its vast experience and leadership role to develop a coordinated, strategic approach to reform.

⁸ Henry Perritt, *Economic Sustainability and Final Status for Kosovo*, 25 U. Pa. J. Int’l Econ. Law 259, 302-03 (2004).

CLE for Practitioners

Each of the subject-specific chapters in this Report notes a compelling need for lawyers in Kosovo to significantly improve their knowledge-base and skills. A common refrain among individuals interviewed for this Assessment was the need for a CLE initiative for lawyers who wish to work in the commercial law. But it is not enough to offer occasional seminars on an *ad hoc* basis for a few hours or even a full day. Rather, for certain topics, no fewer than 40 hours of training is the minimum background that would qualify a lawyer who expects to begin practicing in a certain field. Whether CLE should be mandatory was not a subject of specific discussion; however, as it was pointed out, it seems impossible that a lawyer who graduated from law school 10 or 15 years ago could be, in the absence of intensive and highly substantive training, capable in any way of representing a client in any of the emerging areas of commercial law.

The construction of a sustained, substantive and comprehensive training program for practitioners in the commercial law would be an enormous undertaking. Such a program would require coordination and consensus among the major donor and local actors. The establishment of a certificate-granting Commercial Law Institute, through which lawyers may subscribe to a respected program that will prepare them to work in the new economic environment, is worth significant consideration. A sample curriculum would include the following:

- Introduction to the Commercial Law of Kosovo (40 hours)
- Drafting for Commercial Lawyers: Correspondence, Contracts and Cases (40 hours)
- Lawyering for Companies and Investors (40 hours, including 15 hours devoted to corporate governance)
- Collateral Law: The Creation and Enforcement of Pledges (40 hours)
- Property Law in Kosovo (40 hours)
- Intellectual Property Law (40 hours)
- Bankruptcy Law (40 hours)
- Competition Law (40 hours)
- Public Procurement (40 hours)

Ideally, each program would be offered two or three times a year, commensurate with demand. Also, to underscore the importance of mastering the topic, an anonymously graded exam as a condition to pass the course would be desirable.

CLE for Judges

The Kosovo Judicial Institute was established by the Organization for Security and Cooperation in Europe (OSCE) and since 1999 has served as the chief source of training for judges and prosecutors in Kosovo. The KJI has sponsored at least 200 training programs, and most judges and prosecutors in Kosovo have attended at least one program. The KJI's mission is currently being re-focused into service exclusively for judges, with the strong likelihood of the development of a new resource for prosecutors only. Many donors have used the KJI as a vehicle for developing and providing training for judges. For example, USAID has offered professional skills courses through the KJI. The World Bank and Germany's Icon Institute have arranged training at the KJI for "commercial law judges."

The KJI's capacities remain significantly underdeveloped, particularly in the area of commercial law. The World Bank's efforts to begin training judges in commercial law topics should be taken to the next level, that is, to a comprehensive and sustained curriculum for judges who face commercial law issues in the future.

ACCESS TO LEGAL RESOURCES

Lawyers in Kosovo lack access to commercial law resources. There is clearly a shortage of books, manuals, commentaries, case decisions, hard copies of laws, and other resources, particularly for those people who do not have access to the Internet or who do not speak English. Perhaps just as important, there is an alarming lack of awareness of *how* to access the universe of information pertaining to the commercial law in Kosovo.

In general, access to commercial law and information takes place through the following mechanisms:

- **The UNMIK website.** This resource is the most reliable for law that is actually in force. The threshold issue for a practicing lawyer, of course, is whether he or she is capable of accessing this information from the internet. In addition, complaints about this source ranged from the slowness with which enacted laws are posted, the quality of translations it provides, and its inadequate system of indexing.⁹
- **Other websites.** Various institutions in Kosovo that have a direct or indirect relationship to commercial law have been created. For example, several of the Provisional Institutions of Self-Government, along with Kosovo's Banking and Payments Authority and the Kosovo Trust Agency, have websites.
- **Courts.** Judges in Kosovo are said to have access to new laws through a system in which copies of the Official Gazette and other "justice circulars" are sent to Court Presidents. This system is said to be slow and unreliable.
- **Library at the Kosovo Supreme Court.** This library, located in Prishtina, focuses chiefly on human rights and criminal law issues.
- **Library at the Commercial Court.** The World Bank has sponsored the establishment of a small library devoted to commercial law, located at the Commercial Court in Prishtina. Awareness about the library is limited, and whether and to what extent individuals other than judges and court staff may access its materials is not clear.

⁹ In response to this last issue, CEELI has partnered with the OSCE, UNMIK, the Council of Europe and the Kosovo Law Center to compile adopted legislation in the Cumulative Index of United Nations Legal Materials Produced and Applied in Kosovo and publish it in Albanian, English and Serbian. Those who use the index have said that it is most useful in finding and applying UNMIK regulations and administrative directions, Security Council resolutions, statements and other documents, especially in their native language. Yet distribution of this resource is limited due to unresolved issues concerning authority over the information therein. These issues should be resolved without further delay.

- **Kosovo Law Center.** The KLC was established by OSCE in 2000 “to cultivate the professional skills of local legal talent in order to establish a locally run, independent, and sustainable NGO that embodies, develops and promotes democratic principles, multiculturalism, high ethical standards, the rule of law and respect for human rights.”¹⁰ The KLC houses a library of “applicable law, decrees, regulations, jurisprudence, administrative acts and respective translations” and also offers “a variety of international materials with particular focus on the region.” The KLC's library is open to the public. In addition, the KLC publishes compendia of the law in Kosovo, along with volumes of Supreme Court Cases. The KLC’s resources, however, focus almost exclusively on criminal law and human rights law.
- Other resources, such as the **Criminal Defense Resource Center** and the **Law School Library**, are similarly focused on human rights law and criminal law and procedure.

The need for dramatically improved access to commercial law resources is clear. Lawyers and judges – particularly those who are unfamiliar with the Internet – also need targeted assistance in improving their understanding about how to access information. Such an initiative should be conceived and implemented through a process of coordination and consensus-building among the major donor and local actors.

CORPORATE GOVERNANCE

Achieving a good environment for domestic and foreign investment in Kosovo will take an enormous commitment at all levels to the foundations of a welcoming investment environment, including the rule of law, efficient judicial and regulatory systems, low corruption, and a commitment to competitiveness. Good corporate governance is a critically important part of this.

Corporate Governance is the system by which companies are directed and controlled. Good corporate governance requires both a company law and a business environment in which persons who control a company – including directors, managers and controlling owners – are fully committed and accountable to investors in the company. It requires a system in which there is adequate disclosure of financial and other information so that investors can have a meaningful voice in choosing directors and effective ability to choose and protect their investments. It also requires a court and judicial system in which investors can enforce their rights if necessary by litigation against a company or against persons who control it who abuse their positions of trust. Kosovo’s Company Law generally requires businesses to delineate the rights and responsibilities of its different participants in their founding documents – including its board(s), managers, shareholders, and other stakeholders – and to spell out the rules and procedures for making decisions on company affairs. This delineation of roles, or system of Corporate Governance, establishes the structure through which company objectives are set, the means of attaining those objectives, and how performance will be monitored. In the absence of systems that provide for corporate transparency, accountability, and responsibility, the environment for investment is diminished.

¹⁰ See www.kosovolawcentre.org.

Thus, as further detailed in this Report, lawyers in Kosovo need training in how to counsel their clients in matters of Corporate Governance. Further, donor-sponsored business assistance programs, including those that assist Micro-Enterprises, Small and Medium-Sized Enterprise, State Owned Enterprises, and Publicly Owned Enterprises, should include practical components in Corporate Governance, including the purpose of and protections afforded by corporate structures that provide for limited liability; the importance of enlisting legal counsel to assist with business formation; contracts and other transactions; disclosure requirements; enforcement of debts; and, if necessary, dissolution; and additional principles and practices of Corporate Governance, such as director duties and shareholder rights.

IMPLEMENTATION

In Kosovo, the urgency of getting certain laws enacted has occurred at the expense of comprehensive, multi-donor planning for the “whole picture” of entering a new law into force. Ideally, the whole picture should begin with inviting all interested parties into the legislative drafting process – assessing their strengths, weaknesses, needs and concerns, for the purposes of both improving the draft law *and* for further capacity-building – followed by a carefully constructed program for introducing the new law to all affected constituencies (including judges, lawyers, businesspeople, civil servants, the media, newly created agencies, the public, educational institutions, and so forth). Implementation necessarily implicates donor support, along with a clear understanding of *which* donors or local authorities intend to assume tactical and financial responsibility for *which* aspect of implementation, with all bases covered and minimal duplication of effort.

The Bankruptcy Law is emblematic of the problems in which legislation becomes enacted without such a program for actual implementation and donors fail to cover all bases. On the one hand, judges along with some lawyers and economists received training from *various* donors on the topic of Bankruptcy, and at least one major commentary has been published. On the other hand, implementing bankruptcy rules, though drafted, remain unreleased to the general public; no steps have yet been taken to train or certify bankruptcy administrators; and, 15 months after its entry into force, the law remains unused.

The Competition Law and the Foreign Direct Investment law threaten to become further examples of legislation preceding institutional consensus-building, prioritizing, and forethought. Both laws anticipate new agencies being created, requiring highly trained staff that hold discrete skill sets that are vital to their success. In the case of the Competition Law, the opportunity cost of supporting an implementation program, including the development and support of a Competition Board, has not received sufficient consideration by the donor community. In its June 2004 Report entitled *Kosovo’s Business Environment: Constraints to Growth*, the World Bank calls for a Competition Law to combat the anti-competitive practices arising from the “gray economy.” But the relative priority of a new legal regime vis _ vis the other suggestions the World Bank makes for reducing the gray economy¹¹ – not to mention pursuing additional measures to promote economic competitiveness – has not received sufficient attention.

¹¹ These suggestions include (a) strengthening enforcement of regulations within municipalities; (b) encouraging data-sharing and better coordination among municipalities, the Business Registry, Tax Administration, and Customs; (c) considering changes in tax policy that would reduce the tax advantages of illegal operation (such

DONOR COORDINATION

There is no formal donor coordination mechanism for commercial law coordination at this time, and the need for greater coordination among donors is clear. Indeed, the ever-increasing complexity of the international development arena makes project coordination among donors more important than ever. In January 2004, USAID's Bureau of Policy and Program Coordination (PPC), Office of Donor Coordination and Research, issued a report entitled *Donor Coordination, Strategies and Perspectives*,¹² a useful resource for contemplating and planning around the issue. The report defines the key characteristics, objectives, and types of donor coordination; identifies the major actors and issues pertaining to donor coordination; and sets forth strategies and special issues pertaining to donor coordination.

Fundamentally, the report emphasizes that donor coordination is a means to an end, meaning that it is used to advance development objectives by addressing certain relational or circumstantial issues that technical design and implementation alone cannot resolve. Donor coordination is intensely process-oriented and puts a priority on relations and linkages among actors. The objectives of donor coordination include the following:

- Addressing the foreign policy context (i.e., conflict prevention)
- Reducing redundancies
- Encouraging collaboration on activities
- Forging consensus on issues, processes, and frameworks
- Supporting country leadership
- Compensating for weak host-country capacity
- Advancing best practices
- Making use of comparative advantages
- Knowledge-sharing
- Forging macro-economic linkages

It is widely agreed that the most effective donor coordination occurs where a country (or, in this instance, Kosovo) takes ownership of its own development strategy and is committed to harnessing the various competencies and strengths of the donor community. As summarized by the PPC report, the four major types of donor coordination range from the basic and often perfunctory, to quantifiable efforts to align programs that reduce transaction costs and strengthen host-country capacity. In order of relative effectiveness, they include the following:

Information exchange. The most basic type of coordination, usually involving regular meetings of donor representatives working in a particular sector. Types of information exchanged include programmatic details, economic and political analyses or forecasting, or evaluation findings. Information exchange may include representatives of the host government. Policy differences often persist with this type.

as an increase in the VAT); and (d) increased penalties to businesses for failure to comply with legal requirements.

¹² http://www.dec.org/pdf_docs/PNACW251.pdf

Division of Labor. Coordination moves beyond talking about programs already in place to some sense of shared planning, however *ad hoc*. Donors benefit from comparative advantage and specialization. The host government may be engaged. With its central goal of avoiding duplication of effort, this type of coordination is typically static and preventative.

Common Framework. The host government and donors agree on development policy and program objectives and specific activities are planned to improve aid effectiveness, not merely to avoid duplication. In the strongest instances, the host government is actively engaged in managing aid resources and coordination. A common framework allows donors to identify key constraints and gaps. (Where the host government is particularly weak or recalcitrant, the donors may devise a framework amongst themselves.)

Harmonization. Donors align their practices and procedures to reduce transaction costs and strengthen host-country capacity. Harmonization theoretically occurs at the implementation phase, and may include alignment around a common framework for development, certain procurement practices, financial management, leveraging of resources, and joint monitoring and evaluation.

Donor coordination is everyone's responsibility, and requires sensitivity, humility, and resourcefulness among the individuals and organizations that bring different strengths, perspectives, priorities, and even cultural norms to the table. If commercial law and institutional reform is to be advanced in Kosovo, donor coordination *must* be improved.

Once again, USAID can take a leadership role with respect to establishing a framework for donor coordination based on the PPC *Donor Coordination, Strategies and Perspectives* report. Coordination would need to go beyond monthly donor meetings – although monthly meetings pertaining to commercial law reform would be a good place to begin. Involvement of PISG officials who are charged with coordinating efforts is also crucial.

As demonstrated in the remainder of this report, these cross-cutting themes permeate virtually all aspects of the specific subject matter areas discussed. Effective Commercial Legal and Institutional Reform in Kosovo will require renewed focus on the issues of legal education, CLE for practitioners and judges, legal resources, corporate governance, implementation, and donor coordination.

II. SPECIFIC SUBJECT MATTER AREAS

A. COMPANY LAW

1. OVERVIEW

Company law plays a crucial role in market economies by providing the legal environment for the formation and operation of businesses. Company law encourages entrepreneurship by setting limits on the liability of investors. Specifically, owners or shareholders are normally at risk only

to the extent that they have invested in a company, rather than having their personal assets at risk to satisfy the debts and other obligations of the business.

The purpose of company law also is to set forth basic principles of corporate governance – that is, the rules that outline the division of roles and responsibilities between company management, boards of directors and supervisory boards, investors or shareholders, employees, and outside stakeholders. Corporate governance entails disclosure and transparency requirements regarding the type of information that companies must report to their investors and, in many cases, to the public. Good corporate governance practices provide proper incentives for company boards and management to pursue objectives that are in the interests of the company and shareholders and should facilitate effective monitoring, thereby encouraging firms to use resources more efficiently.¹³

As detailed in this chapter, although the existing company law in Kosovo is sound for the time-being, an updated version that reflects modern, market-oriented principles – including an improved foundation for corporate governance – should be given urgent priority. The draft law that was rejected by the Assembly in 2004 was a backward-looking non-starter. In addition, significant work needs to be done with respect to advising growing businesses about the advantages of limited liability – most companies in Kosovo, even large ones, are currently registered as personal business enterprises and are therefore missing out on certain advantages of incorporation. Also, there is a strong need in Kosovo to help incorporated enterprises implement the principles of sound corporate governance.

2. LEGAL FRAMEWORK

Drafting authority. Legislative authority over company law is among the areas that were transferred from UNMIK to the Kosovo Government in 2001 pursuant to the Constitutional Framework for Provisional Self-Government in Kosovo (UNMIK Regulation 2001/9).

Thus, while UNMIK acting alone issued the current company law, (entitled the Regulation on Business Organizations (Regulation 2001/6)) prior to the implementation of the Constitutional Framework in May 2001, future amendments or replacements of that Law are to be adopted by Kosovo’s popularly elected Assembly – although still subject to ultimate approval by UNMIK under the Constitutional Framework.

As a practical matter, this also means that responsibility for drafting a future company law lies with the Office of the Prime Minister of Kosovo and the Office of the Assembly of Kosovo, rather than with the UNMIK Office of the Legal Adviser to the SRSG. The legal staff of the Office of the Prime Minister and the Office of the Assembly were interviewed at length and were fully aware of the needs in this area.

The current company law. The current legal regime for the formation and operation of enterprises in Kosovo consists of the above-described Regulation on Business Organizations, along with UNMIK Administrative Direction 2002/22, entitled “Implementing UNMIK Regulation 2001/6 on Business Organizations.” The Regulation on Business Organizations is a

¹³ See OECD Principles of Corporate Governance (April 1999) (www.oecd.org/daf/governance/principles.htm).

basic and general company law, while Administrative Direction 2002/22 covers the specific subject of company registration and information-keeping.

Regulation 2001/6 can be characterized as a good but abridged version of what is contained in major Western company laws, and as basically adequate for conditions to date. For the future, however, a comprehensive and thoroughly modern replacement is needed. As described below, a draft of a new law was submitted to the Assembly in 2004, but was rejected and returned to the Offices of the Prime Minister and the Assembly for revision and replacement.

Regulation 2001/6 (the current law) is like other laws in the region (including those of all the newly-independent former Yugoslav republics) in prescribing the following legal forms for businesses:

- personal business enterprise;
- general partnership;
- limited partnership;
- limited liability company; and
- joint stock company

Any new Kosovo company law can be expected to continue these forms in effect without basic change.

A “personal business enterprise” is similar to a sole proprietorship in the United States or Western Europe. The owner is an individual who is personally liable for all debts of the business and the business is not considered to be a “legal person” separate from the owner. The owner may, however, register the business trade name, which has legally protected priority under the company law.

“General” and “limited” partnerships are similar to those in the United States and countries in Western Europe. General partners conduct business in the name of the partnership and bear individual liability for all of its obligations, while limited partners bear risk of loss only up to their contributions to capital and do not take part in the business.

The “limited liability company” (LLC) is a vehicle for doing business that is increasingly used – though still underused – in Kosovo. It is a company founded by one or more persons, each of whom bear the risk of loss only to the extent of their committed capital contributions. Under the current law, the minimum capital requirement to establish an LLC is 2500 Euro. An LLC may not offer its shares publicly and may not have more than 50 shareholders. Unless the charter or by-laws of an LLC provides otherwise, a shareholder of the LLC may not sell his shares without first offering them to the other shareholders or the company. Restrictions like these are typical of European LLC laws (including those of other Balkan countries and Germany and France). In this, European LLC laws are different from U.S. LLC laws, which are more flexible.

The “joint stock company” (JSC) is a legal entity that may issue shares publicly and may have any number of shareholders. Shareholders of a JSC are not liable for the obligations of the JSC and bear the risk of loss only up to the value of their investment in the company. The shareholders of a JSC may dispose of their shares without the consent of other shareholders. In

general, a Kosovo JSC is very much like a JSC in other countries in South Eastern Europe and much like a U.S. corporation. The minimum capital requirement to establish a JSC in Kosovo is 25,000 Euro.

The undeveloped state of capital markets in Kosovo can be seen in the fact that there are very few JSCs in Kosovo – 84 as of September 8, 2004. LLCs and partnerships are as-well or better-suited as vehicles for family and closely-held businesses which engage in trading and retailing and which account for most of the business activity at this time.

Plusses and minuses of the current company law. The current law contains many provisions which in modern Western company laws promote good corporate governance and encourage investment including foreign investment. It is clearly drafted; it includes a form of the business judgment rule which protects directors from personal liability for good-faith business judgments which are later second-guessed as having been mistakes; it includes a brief statement of the duties of care and loyalty of company directors; it prescribes that a JSC will have one single board of directors (rather than a two-tier board, as in Germany) whose members are elected solely by the shareholders (and not in part by employees, as in former Yugoslav law and in German law); it requires a complete and accurate register of shareholders; it guarantees some basic shareholder rights including the right to information and the right to attend shareholder meetings; it requires annual shareholder meetings; and it distinguishes clearly between the respective competences of the shareholders, the board of directors and the officers of a company. In many of these respects the current Kosovo company law is more “advanced” than the company laws of the newly-independent former Yugoslav republics.

As indicated above, however, the law needs revision and expansion. It is lacking, for example, in the detail found in other laws on shareholder and director meeting procedures, including notice, voting, quorum requirements, proxy restrictions and protections, and rules for dividends, distributions and share buy-backs; it does not have provisions for merger and change of corporate form (for example, conversion from an LLC to a JSC); it does not have detailed procedures for approval or ratification (or voiding) of director conflict-of-interest transactions; and it does not have provisions for treatment of foreign companies doing business in Kosovo.

Replacement of the current company law. Under the circumstances it is generally acknowledged that the current company law needs revision and perhaps replacement in its entirety. To that end, a comprehensive new draft law was submitted to the Assembly of Kosovo in February 2004. The draft passed a first reading in the Assembly in April 2004, but the draft was widely criticized and is now generally acknowledged as un-adoptable in its current form. The draft now resides in the legal department of the Offices of the Prime Minister and the Assembly to be re-drafted and resubmitted to the Assembly at an undetermined future date.

The criticism of the rejected draft law is instructive for purposes of the next effort. One of the principal criticisms was that it largely copied socialist-era provisions and concepts of the existing (1996) Republic of Yugoslavia (now Serbian) Enterprise Law. This was considered undesirable not only because of the implied connection with Serbia but, more importantly, because it made the draft actually backward-looking compared with the current law that it would replace. Moreover, most or all of the copied provisions of the Serbian law have been rejected in Serbia

itself where a modern, market-oriented law has been proposed and drafted (with the assistance of USAID) and is currently posted on the Serbian Government website.

The rejected draft law has the following provisions which, among others, are contrary to international corporate governance best-practice standards and would not be acceptable to foreign investors and their advisers and lawyers:

- It retains throughout the unclear and indirect drafting style of the 1996 Yugoslav law, which is unfamiliar internationally;
- It retains complex and inflexible rules for forming new companies;
- It imposes mandatory capital maintenance rules which are impracticable under Kosovo accounting practice and which go far beyond the requirements of EU Directives – and which would not protect creditors in any event;
- It explicitly permits a JSC to issue anonymously-held bearer shares, which is especially bad policy in transition countries because it enables hidden ownership and tax evasion;
- It explicitly permits a JSC to cap the voting rights of a shareholder's shares, violating the modern corporate governance principle of one-share = one-vote;
- It permits a company to have two boards of directors rather than one board elected by and directly accountable to the shareholders as in the current company law;
- It requires that in a JSC with more than 50 employees, an “assembly of enterprise employees” (a term which is not defined) shall elect a member of the board of directors, regardless of whether that “assembly” or any of its members is a shareholder of the company;
- It states that shareholder decisions will be made by a majority of shareholders rather than by a majority of shares or a majority of votes held by shares (both of the latter are familiar corporate governance concepts);
- It permits directors to have terms up to five years, contrary to modern corporate governance principles that directors should be accountable to shareholders and always up for re-election or rejection at every annual shareholder meeting;
- It permits a JSC to provide in its charter that particular directors may be elected by a minority of shareholders, violating the corporate governance objective of shareholder democracy;
- It prescribes legal duties of a company director to shareholder-investors which are weaker than under Western company laws, and at the same time it imposes a legal duty on a director to the “company as a whole which includes environmental sustainability of its operations” – for the violation of which the director would have personal liability; and
- It imposes a legal duty on all shareholders (regardless of whether they are directors or employees or have any other connection to the company except share-owning) to “take into account” the interests of all other shareholders – a concept which is contrary to all modern corporate governance principles, which fiduciary duties on directors and managers but not on shareholders/investors as such.

3. IMPLEMENTING INSTITUTIONS

The Business Register, located in the *Ministry of Trade and Industry*, oversees the registration in Kosovo of the five types of companies listed in the current Law of Business Organizations, as well as International Companies, Socially Owned Companies (SOEs), and Publicly Owned

Companies (POEs). SOEs and POEs may be registered with KTA authorization only; accordingly, registration statistics do not reflect how many are actually operating in Kosovo. The following table shows the number of companies registered in each category. By showing registration statistics from both May 2004 and September 2004, the table reflects recent trends in registration:

Type of Company	May 2004	September 2004
Personal Business	35,450	40,990
General Partnership	1,364	1,599
Limited Partnership	33	34
Limited Liability Company	862	1,231
Joint Stock Company	71	84
Foreign-Owned Company	48	75
Socially Owned Enterprise	5	7
Publicly Owned Enterprise	2	10

The presence of the Business Register in the Ministry of Trade and Industry is not itself a problem; however, representatives of the Commercial Court, which handles lawsuits between companies other than personal businesses, complain of difficulties with respect to accessing information from the Register.

In August 2004, the European Agency for Reconstruction launched a program to support the Ministry of Trade and Industry. The program will assist in developing legislation relevant to small businesses that conforms to EU standards; build capacity within the MTI through training programs and technical assistance; and support schemes that assist small businesses generally. This program would clearly benefit from closer coordination with other donor projects that relate to CLIR and competitiveness.

Courts. Legal disputes between individuals (including personal business enterprises) and “legal persons” – that is, all forms of companies *other* than the personal business enterprises – are resolved through Kosovo’s 24 Municipal Courts at the first instance and 5 District Courts for most appeals. The 10-member District Economic Court (the **Commercial Court**), based in Prishtina, is the principal implementing institution with respect to disputes between “legal persons.” This system and structure are described in detail in Section II.D below.

4. SUPPORTING INSTITUTIONS

Business Associations, including the *Chamber of Commerce*, the *Alliance of Kosovo Businesses*, and various recently established sector-based business associations, can each be regarded as resources in the overall effort to improve access to and understanding of commercial law in Kosovo, including company law. In particular, these associations should be advising their membership about the advantages of limited liability and developing programs that underscore the importance of corporate governance.

Professional Associations and training institutions, including the *Kosovo Judges Association*, the *Kosovo Judicial Institute*, and the *Chamber of Advocats* should be consulted and evaluated

for their ability to contribute to the effort to train judges and lawyers and public employees in the principles and details of company law.

The **Kosovo Trust Agency (KTA)** is charged with overseeing the transformation of nearly 500 Socially Owned Enterprises and, eventually, some Publicly Owned Enterprises into private companies over the next few years. As noted by one observer,

Privatization in Kosovo is necessary to remove obstacles to successful development of new private-sector institutions . . . The problem with the status quo is that defunct SOEs are informally controlling property and leasing it to those having political or personal ties with the SOE, while not accounting for the lease revenue or paying taxes on it. This behavior blocks access to real assets needed by investors, undermines certainty needed to attract investment, and erodes the tax base.¹⁴

After a long and, according to many observers, reprehensible delay in the privatization process,¹⁵ the KTA launched a “third wave” of opportunities in September 2004 for private investors to purchase SOEs. Although 75 percent of SOEs are classified by KTA as “operating,” this is a very broad definition that, according to a KTA memorandum prepared in Spring 2004, “fails to capture how moribund the sector is.” Thus, those privatized enterprises that seek to remain or become viable will need an enormous amount of support with respect to the entire scope of commercial operations, including assistance setting up structures of corporate governance and complying with all aspects of commercial law. KTA’s plans include providing for the companies’ institutional development and human resources capacity-building.

The **Banking and Payment Authority of Kosovo (BPK)** licenses and supervises Kosovo’s seven banks and 16 insurance companies and through its authority has been able to enforce certain expectations of corporate governance, including requirements for business plans, record-keeping, monthly reports, and adherence to by-laws.

Prishtina University should be educating its students in law and economics in the contemporary principles of company law. At this time, as discussed in Section I of this Report, the University is not ready to do so.

5. SOCIAL DYNAMICS

Legal Framework. As indicated above, the UNMIK Business Organization Regulation 2001/6 has been basically adequate but it needs to be replaced, and the one major effort so far to replace it was unsuccessful. There is a consensus that, for future economic success, Kosovo needs a comprehensive and modern company law which is clear and consistent with international business practices and which includes current concepts for corporate governance and protection of investors. A primary aim in drafting such a new law should be to help attract investment, both foreign and domestic.

¹⁴ Henry H. Perritt, Jr., *Economic Sustainability and Final Status for Kosovo*, *supra* note 8 at 292.

¹⁵ See Andrew Higgins, *Could the U.N. Fix Iraq? Experience of Kosovo Inspires No Confidence*, *supra* note 13.

Needless to say, such a law cannot in itself create economic success but it should be considered a precondition for progress and – considering the current receptivity in Kosovo – it should be given the most urgent priority. Specifically, this means giving priority to the task of re-doing, and probably completely replacing, the draft which failed in the Assembly earlier this year, and then resubmitting the redone product to the Assembly.

Company formation. As noted by one donor-sponsored representative who has worked with many small and mid-sized enterprises, businesses in Kosovo do not “look to the law as a source of protection.” Rather, the law is “something to be gotten around.” Accordingly, as illustrated by the earlier table, businesses typically register in the fashion that involves the least amount of up-front paperwork and the fewest reporting requirements – namely, the personal business enterprise. Various lawyers reported that the registration process for a personal business enterprise takes about two days, while forming a limited liability company takes closer to thirty days, and a joint stock company even longer.

This personal business enterprise model does not provide protections that are afforded through the other structures, which transform the enterprise into a “legal person.” The benefits of “legal person” status include: (a) the advantages of limited liability, ranging from protection of personal assets to an increased willingness to take risks; (b) the ability to resolve conflicts with other corporations in the Commercial Court, rather than in the less sophisticated and slower Municipal or general jurisdiction District Courts; and (c) the right to enter into bankruptcy, which includes the possibility of protection from creditors while attempts are made at reorganization.

Why do businesses avoid incorporating as legal persons? Reasons include the fact that personal business enterprises are family-owned and thus thoroughly entangled in the finances and property of the family; that the process of incorporation is time-consuming and the reporting requirements may be perceived as burdensome; and that, perhaps most importantly, personal businesses are not subject to corporate tax. Yet the disinclination of businesses to become legal persons can be said to ultimately limit their growth and potential. The concept of limited liability encourages business owners to take more risk and to engage in more arms-length transactions.

Corporate governance. Although a clear “causal link” between systems of corporate governance and traditional measures of economic improvement is difficult to show, practitioners generally agree that strengthening investor confidence in a country’s own companies and capital markets may contribute to business competitiveness and to the overall growth of a national economy. In Kosovo, it seems that the principles of corporate governance are not embraced as an opportunity, but rather begrudgingly engaged in a limited and sloppy fashion for the purpose of satisfying the demands of regulators or donors. As noted in Section I of this Report, achieving a good environment for domestic and foreign investment in Kosovo will take an enormous commitment at all levels to the foundations of a welcoming investment environment, including the rule of law, efficient judicial and regulatory systems, low corruption, and a commitment to competitiveness. Good corporate governance is a critically important part of this.

6. RECOMMENDATIONS

- A new company law should include the following features, many of which are especially appropriate in developing and transition countries such as Kosovo, and many of which are

recommended in the OECD Statement of Principles of Company Law for Transition Countries:

- Fuller statements of the business judgment rule and director fiduciary duties;
 - Detailed rules for director or officer conflict-of-interest transactions, including requirements covering approval, ratification, family members and other related persons and possibly void ability of such transactions;
 - A statement that all directors are up for election or reelection at each annual meeting, and no director may be elected for a term longer than one year;
 - A statement that the shareholders may remove a director at any time, without having to prove cause, if they believe that removal is in the best interest of the company;
 - A requirement that there be some independent directors in companies with widely-held shareholding.
 - Rules for both direct and derivative lawsuits by shareholder/investors against misbehaving directors;
 - A clear requirement that there may be only one class of common stock, always with one vote per share, and that preferred stock be non-voting except in exceptional circumstances;
 - A rule limiting the life of proxies and stating that a proxy may be revoked at any time including at the shareholder meeting itself (and possible restricting company directors from acting as proxies; and
 - Procedures for shareholders to add items to a management-set agenda for a shareholder meeting.
- All donor-sponsored business assistance programs, including those that assist Micro-Enterprises, Small and Medium-Sized Enterprise, State Owned Enterprises, and Publicly Owned Enterprises, should include a practical component in company law, which includes sustained training of management in the following topics, among others: (a) the purpose of and protections afforded by corporate structures that provide for limited liability; (b) the importance of enlisting legal counsel to assist with business formation; contracts and other transactions; disclosure requirements; enforcement of debts; and, if necessary, dissolution; and (c) the principles and practices of corporate governance.
 - Certain improvements might be made to the Business Register, currently housed at the Ministry of Trade and Industry. Bureaucratic inefficiencies that might discourage business owners from adopting a limited liability structure should be evaluated and corrected. Better communications with the courts and a greater willingness to provide information about companies to the public is also advisable.
 - The new library sponsored by the World Bank for the Commercial Court should be evaluated for its current usefulness and additional needs. Additional resources might be provided in this forum, so long as they are accessible not only to judges, but also to practitioners.

B. CONTRACT LAW

1. OVERVIEW

Contracts law governs and regulates the formation, operation, and conclusion of commercial relationships. Our review of this area of law, better known as the law on obligations in Kosovo, indicated that, in many respects, it is reasonably up-to-date. Most importantly, a new Law on Obligations recently passed the Kosovo Assembly that, while not without its deficiencies, is comprehensive, suitable for a modern commercial environment and compatible with European Union directives. Furthermore, contracting standards were also strengthened by the passage of a new Law on Public Procurement by Kosovo Assembly and its promulgation by the SRSJ early in 2004.

Despite this, discussions with several leading commercial lawyers indicated that, in practice, contracts are not widely used by the business community in Kosovo. Most transactions and commercial arrangements, typically involving other family members, are based on oral agreements and there is very little appreciation for written contracts. Furthermore, most local lawyers have limited experience with regard to drafting and negotiating commercial contracts. It is not unusual to find a poorly drafted contract document that fails to contain one or more basic elements, such as a date, description of subject, etc.

This situation is beginning to change, however. Foreign investors and business people generally operate on the basis of written agreements and their presence in Kosovo has already increased, and will continue to do so, the use of contracts documents. Furthermore, the new Law on Obligations, as well as the Law on Public Procurement, will put greater impetus behind the development of good contracting practice. However, as in several other legal areas in Kosovo, there is a real lack of information and continuing legal education on contract law to enable practitioners to understand the new laws and take advantage of the improvements they present.

2. LEGAL FRAMEWORK¹⁶

The Law on Obligations. At present, the fundamental sources of contract law in Kosovo are the 1978 Yugoslav Law on Obligations and the UNMIK Regulation on Contracts for the Sale of Goods.¹⁷ However, these two laws are about to be replaced by a completely revised and expanded Law on Obligations¹⁸ drafted with the assistance of European lawyers supported by the European Agency for Reconstruction. As of this writing, the new law has passed the Kosovo

¹⁶ Many of the observations in this section regarding the new Law on Obligations result from our comparison of this legislation with the *Principles of European Contract Law, Parts I, II and III*. The text of these principles can be found at http://web.cbs.dk/departments/law/staff/ol/commission_on_ecl/index.html. These principles have been drawn up by an independent body of experts, known as the Commission on European Contract Law, representing the Member States of the European Union under a project supported by the European Commission and other organizations.

¹⁷ UNMIK Regulation 2000/68 on Contracts for the Sale of Goods, promulgated 29 December 2000.

¹⁸ Law 2004/25, Kosovo Law on Obligations, passed by the Kosovo Assembly on 28 July 2004.

Assembly and been sent to UNMIK for the SRSG's for signature. Given that it is to become the "law of the land", the following discussion focuses on this new legislation.¹⁹

While the existing Yugoslav Law on Obligations was generally viewed as being progressive in its day and the Law on Contracts for the Sale of Goods mirrored the international convention by that name, there was nonetheless ample rationale for preparing a new law covering both. The Yugoslav law was almost 25 years old and not adequate for a modern commercial environment. Furthermore, there was a need for a comprehensive commercial contracts law, particularly one meeting the standards set out by various directives of the European Union.²⁰

The scope of this new law is remarkably broad; its 42 chapters run to 350 pages and contain the laws governing all types of obligations, not only contractual obligations, but also liabilities arising from torts, unjust enrichment, doing business without authorization, and unilateral transactions. The law is divided into two books: Book One outlines general provisions relevant to all obligations (Chapter 1), covers the creation of obligations by the various means already mentioned (Chapter 2); defines the effects of those obligations in terms of the creditor's and debtor's rights and obligations (Chapter 3); determines how obligations can be terminated (Chapter 4) through fulfillment, operation of the Statute of Limitations, or through other legally provided means (e.g., impossibility, novation); describes certain types of obligations (Chapter 5) such as guarantees, monetary obligations, obligations involving more than one subject, obligations involving several debtors or creditors; and provides for the substitution of creditors and debtors (Chapter 6).

Book Two regulates 41 specific types of contracts covering a wide range of commercial relationships: sales of goods, exchanges, timesharing, loan and credit agreements, donations, leases, bailment, leasing, supply of services, construction, partnerships, transport and carriage, licensing agreements, franchising, deposits, warehousing, orders, commission business, commercial agency contracts, mediation, forwarding (shipping), contracts for the control of goods and services, organization of travel, mediation of travel, contracting hotel facilities, insurance, lifelong sustenance contracts, warranty and guaranty, assignment, a variety of bank activities (including banking transactions, bank money deposits, money transfers, bank accounts, deposits of securities, safe deposit boxes, credit agreements, letters of credit, and bank guarantees), settlement of claims, and confirmative contracts.

The Law on Public Procurement. While not specifically part of this assessment on commercial contract law, the new Law on Public Procurement in Kosovo²¹ will be an important part of creating a new contract environment in Kosovo. As part of its central role in improving public procurement, it will pressure lawyers and the business community away from the current atmosphere of informal, oral contracting towards the use of written contract documents based on a code of contract law. Just like the Law on Obligations in the commercial arena, the Law on Public Procurement sets out a specific set of rules for contract formation, negotiations, operation,

¹⁹ It can take 4-6 months for UNMIK to promulgate a law. The expectation is that the new Law on Obligations will be approved by UNMIK.

²⁰ Excerpted from an *Explanatory Memorandum on Drafting the Obligation Law in Kosovo* transmitting the draft law from the Prime Minister's Office to the Assembly.

²¹ Law on Public Procurement in Kosovo, Law No. 2003/17, promulgated by SRSG in UNMIK Regulation No. 2004/3 dated 9 February 2004, amended by UNMIK Regulation No. 2004/3 Addendum dated 28 July 2004.

interpretation, fulfillment and termination. Thus, the Law on Public Procurement will complement the Law on Obligations and help to raise the standard of contracting in Kosovo.²²

a. Contract Formation

Like its counterparts in most civil law countries, the Kosovo Law on Obligations defines the elements of an enforceable contract and the remedies available for breach. The basic principles of contracts, outlined in Book One, are applicable to all types of contracts (Art. 13), except where specific rules exist for particular contracts (e.g., the particular contracts covered in Book Two). Government and its various organs are not specifically mentioned, either by way of inclusion or exclusion, from the effect of the law. However, Government contracts would seem to be excluded, as they are “otherwise provided for” in the Law on Public Procurement. The contractual relationships of Socially-Owned Enterprises and Publicly-Owned Enterprises are governed by the Law on Obligations.

The general principles of contract conclusion, offer and acceptance (Art. 16 – 41) are supplemented by more explicit requirements for specific contracts found in Book Two. Parties are free to choose the form of their agreements, again except insofar as a specific form is mandated elsewhere (Art. 85). The rules on formation allow for the conclusion of a contract by electronic (including digital) means. Examples of contracts required to be in writing, as outlined in Book Two, include: time-sharing (Art. 678), consumer credit agreements (Art. 690), credit mediation (Art. 701), real property leases (Art. 742), equipment leases (Art. 773), construction contracts (Art. 809), licensing agreements (Art. 909), franchising (Art. 939), commercial agency (Art. 1028), contracting hotel facilities (Art. 1124), insurance (Art. 1139), lifelong sustenance (Art. 1205), and contracts for current accounts (Art. 1291).

As a general principle, contracting parties have equal status (Art. 7). There are protections for individuals with limited or diminished capacity to act (Art. 67 – 77). While the Law on Obligations does not provide a clear distinction between commercial contracts and contracts involving non-merchants, different treatments are given to “entrepreneurs”/business professionals and “consumers” in a number of instances. For example, where obligations arise between parties as a result of their professional activities, they have a duty to act with enhanced diligence according to the practices of their profession (Art. 12). Several additional burdens are placed on entrepreneurs where they seek to conclude contracts by electronic means (Art. 31). Likewise, there are restrictions on entrepreneurs seeking to conclude contracts with consumers by means of “distance communications” and consumers have a right to revoke such contracts (Art. 44). Consumers also have a right to revoke their contracts with entrepreneurs within 15 days in certain cases (Art. 188) and are given special protections in other situations such as consumer credit agreements (Art. 688 – 699), housing tenancies (Art. 749 – 760), and organizing travel (Art. 1096 – 1117). On the other hand, certain contract types are only available to business persons: franchise agreements can only be between two businessmen (Art. 934), commercial agents must be business persons (Art. 1027), and the obligor in a construction must be an entrepreneur (Art. 809).

²² In addition to the Law on Public Procurement, UNMIK Regulation No. 2001/27, dated 8 October 2001, on Essential Labour Law in Kosovo outlines the requirements for employment contracts. This code will also help to advance the use of written contracts and a modern contract environment in Kosovo.

There is not a wide-ranging requirement that contracts be notarized in order to be valid. Examples of those required to be notarized (and thus made in writing) include undertakings to assign or acquire real property, other contracts requiring entry in the land register, and contracts to assign or encumber all or an ideal part of a party's present property (Art. 95). Notarization is an administrative function of the courts and not a service provided by independent professionals.

b. Interpretation and Freedom to Determine Content

Parties are free to contract with regard to any subject matter, as long as it is feasible, determinable, and does not conflict with "provisions of the Constitutional Framework of Kosovo and other compulsory provisions, public order or good practices." (Art. 59 - 62). In general parties are free to agree on customized terms in their contracts (Art. 9). However, many of the special contracts provided for in Book 2 of the law require or preclude certain clauses and these cannot be negotiated away (Art. 17). For instance, Article 1140 prescribes the content of an insurance contract. General conditions of standard form contracts receive special attention. They become an integral part of a contract only when (i) the party proposing them brings them to the attention of the other contracting party, (ii) the other party has an opportunity to familiarize itself with the terms, and (iii) the other party agrees to their application (Art. 57). Furthermore, general conditions will be invalid if they violate the requirement of good faith in contracting and place the contracting party of the user at an unreasonable disadvantage (Art. 168). Certain types of general conditions are not allowed as a matter of policy (Art. 169).

In interpreting contract provisions, priority should be given to the "joint intent of the contractors" and their purpose at the time of contracting (Art. 147). This joint intent should not be defeated by a literal reading of the terms. The Law on Obligations explicitly recognizes customs of commerce and usual trade meanings as evidentiary sources for determining how to interpret contracts, as well as the circumstances surrounding the contracting and the conduct of the parties (Art. 149). Where the joint will of the parties is impossible to decipher, consideration can be given to what a reasonable person would have understood in the circumstances.

Using the *Principles of European Contract Law* as a model, one can identify some deficiencies in Kosovo's Law on Obligations which, if addressed, could improve the overall "user-friendliness" of the law.²³ With regard to contract interpretation, it would be helpful if the Law on Obligations included a section on terminology. For instance, there is no definition of "reasonableness"; one can construct a definition, but this requires consideration of five or six different articles. Furthermore, the Law should give more explicit and direct coverage to a number of points; examples include what constitutes valid notice, extent of knowledge and intent imputed to a contracting party from someone acting on his behalf, the validity of a written merger clause stating that the contract is the entire agreement, and what constitutes "fundamental" non-performance. Finally, there are two other basic rules of contract interpretation that should be included: i) terms are to be interpreted in the light of the whole contract in which they appear; and ii) an interpretation which renders the terms of the contract lawful, or effective, is to be preferred to one that would not.

²³ Having said that, these deficiencies do not significantly detract from the great benefit this new law represents for Kosovo.

Given its lack of sovereign status, Kosovo is not a formal signatory to the UN Convention on Contracts for the International Sale of Goods. However, since the UN has confirmed in its Security Council Resolution 1244 that Kosovo remains a part of the Federal Republic of Yugoslavia (FRY) and since the Convention was effective for FRY, the argument has been made that Kosovo is subject to the Convention.²⁴ Such a conclusion is far from clear, particularly given the dissolution of FRY and its succession by the union between Serbia & Montenegro.

c. Remedies and Enforcement

The Law on Obligations allows enforcement of all valid contracts by individuals and businesses to the extent that they do not contradict compulsory regulations, public policy or good practice (Art 153). The law provides for range of the usual contractual remedies, including the right to withhold performance (Art. 173, 174), to terminate (Art. 175), to claim monetary damages (Art. 333), to claim liquidated damages (Art. 343), to claim default interest (Art. 350), to take action to protect property that might be used to satisfy claims (Art. 353), and to seek specific performance (Art. 366, 367).

While providing for damages, the Law on Obligations fails to state the basic objective of such monetary awards, which is to put the aggrieved party in the position he would have been in had the contract been performed as expected. Although it would be better to have this overriding concept clearly stated, it can be inferred from the Law's defining damages to include all foreseeable costs and lost profits (Art. 339). Claimants must take steps to reduce their losses (Art. 339).

The right to specific performance is not explicitly provided for by name, but this right can be inferred from the articles noted above.²⁵ However, the Law on Obligations is deficient in that it does not include the usual limitations on specific performance: i) performance would be unlawful or impossible; ii) performance would cause the obligor unreasonable effort or expense; iii) performance consists in the provision of services or work of a personal character or depends on a personal relationship; or iv) the aggrieved party may obtain performance from another source.

Again using the *Principles of European Contract Law* as the model, one can see that the Law on Obligations leaves something to be desired in its presentation of the remedies available to aggrieved parties. In fact, the term "remedies" is not used in the Law. Furthermore, the various remedies are located in two different sections of the Law. A more unified and better organized presentation of the range of remedies would be an improvement.

There is no arbitration law in Kosovo. Article 152 of the Law on Obligations states that "contracting parties may provide that a third party shall interpret the contract in case of a disagreement concerning the meaning and scope of terms in the contract." If this language was

²⁴ The Socialist Federal Republic of Yugoslavia signed and ratified the Convention on 11 April 1980 and 27 March 1985, respectively. Following a decision of the UN Secretary General on 12 March 2001, the Convention became applicable to the successor Federal Republic of Yugoslavia; this was effective for FRY on 27 April 1992, the date on which FRY succeeded the Socialist Republic.

²⁵ Our analysis identified only one use of the term "specific performance" in the Law on Obligations and this was only a passing reference in Art. 512.

intended to provide for arbitration as an alternative means of dispute resolution, one wonders why the drafters did not call it that specifically. This language could be much more robust in terms of speaking to issues of the arbitration rules to be applied or the location of the arbitration. In addition, the terms of Article 152 do not make an arbitral award final and binding and preclude the filing of a court proceeding. It only provides that the parties shall seek a third party interpretation prior to going to court.

Foreign arbitral awards and court judgments are enforceable in Kosovo under the still-applicable laws of the former Yugoslavia. With regard to the UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards, it is unclear as to whether or not this is binding on Kosovo.²⁶

A monetary judgment awarded to an aggrieved contracting party is of little value if it cannot be collected, if necessary through an execution procedure. In Kosovo, major problems have been identified with regard to the execution of civil judgments. In a recent study conducted by the National Center for State Courts (NCSC),²⁷ a number of deficiencies were identified in the existing execution law,²⁸ as well as in other laws that form part of the framework for executing on civil judgments.²⁹

3. IMPLEMENTING INSTITUTIONS

a. Courts

The courts system is the key implementing institution for contract enforcement in Kosovo. The Code of Civil Procedure provides for Commercial Courts where disputes are heard only in cases where the litigants are legal entities. Otherwise, where one or more of the parties is not a legal entity, commercial disputes are heard in either the District or Municipal Courts depending on the amount at issue.

In general, the one operating Commercial Court is viewed as more efficient and having judges with more specialized knowledge of commercial matters. Overall, though, the courts are underfunded and under-staffed, while judges and court officials appear to be under-trained and under-paid. Our interviews elicited comments from legal practitioners that judges are not well versed in the law, either due to lack of information with regard to new legislation or an unwillingness to put in the time required to stay up-to-date. There are complaints that older judges operated too long in a different system, tend to fall back on the old Yugoslav laws they know, and feel little

²⁶ The same argument applies here as was outlined above for the UN Convention on Contracts for the International Sale of Goods. The Socialist Federal Republic of Yugoslavia acceded to the UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards on 26 February 1982. Following the break-up of the Socialist Republic, the Convention became applicable to the successor Federal Republic of Yugoslavia as a result of a decision by the UN Secretary General on 12 March 2001.

²⁷ “The Execution of Civil Judgments in Kosovo,” a report prepared by the National Center for States Courts with support from USAID, was presented in August 2004 and provides the basis for the comments made above.

²⁸ The execution of civil judgments is regulated by legislation of the former Yugoslavia, the 1978 Law on Execution Procedure, as amended in 1982 and 1987.

²⁹ These include the UNMIK regulations on pledge and mortgage, banking law, immovable property register law, business registration law, and the civil procedure code.

motivation to follow new laws and regulations. And there are clear suggestions that corruption plays a part in court decisions.

Given this, it is not surprising that courts do not have the public's confidence and are not viewed as institutions capable of defending contract rights. Parties see no reason to sue to defend their rights because of the extended time commitment and unpredictable outcome. This, coupled with the lack of a tradition of using written contract documents, means that Kosovo has a ways to go before contract law takes its rightful place at the core of commercial relationships.

b. Public Procurement Implementing Bodies

As noted, the new Law on Public Procurement will be influential in raising the standards of contracting and contract law in Kosovo. That law calls for the creation of several implementing bodies:

- ***Public Procurement Regulatory Commission*** - to oversee the development and operation of the public procurement system and ensure its efficient and transparent operation;
- ***Public Procurement Agency*** - to conduct tenders in special circumstances and maintain a public procurement register;
- ***Public Procurement Rules Committee*** - to develop and promulgate detailed rules for implementation of the current law.

To date, seven months after the law was passed, none of these bodies has been established. It goes without saying that, until these are formed, the direct benefits to be derived from the new Law on Public Procurement and the indirect benefits to improving the overall standards of contracting cannot begin to be achieved.

The confusion in recent months with regard to the bidding for a second mobile phone franchise provides a prime example of the need for clear procedures for government tendering and contract award, as well as rigorous enforcement and oversight. In that case, there appears to have been, at best, confusion over the tender procedures or their application and, at worst, suggestions of corruption in the process. And, despite the recommendation of an independent auditor to re-tender, there was no agreement between the Telecommunications Regulatory Authority and the relevant Ministry as to the appropriate way forward.

4. SUPPORTING INSTITUTIONS

a. Professional Associations

As a practical matter, it appears that few lawyers in Kosovo have much experience with commercial contracts or well developed contract drafting skills. Judges also appear to lack an in-depth knowledge of contract law or commercial transactions. This situation is exacerbated by the fact that both lawyers and judges must now adjust to a new Law on Obligations; this is a law whose drafting had little input from either the bar or judiciary.

A common issue for both lawyers and judges is the abysmal lack of legal research materials and resources available to them. The Internet provides the quickest access to regulations and legislation promulgated by the SRSJ and is otherwise a key tool for legal research. However, only a few lawyers have Internet access in their offices. There simply does not exist a well-stocked law library providing all local legislation, opinions issued by the Kosovo courts, academic treatises on different legal specialties, examples of key legislation from other countries, form books, computer terminals with Internet access for further research – all under the direction of a knowledgeable law librarian who can assist lawyers in solving their research issues.³⁰ One further limitation on the ability of Kosovar lawyers to utilize foreign legal materials is that very few of them speak foreign languages; as a result, key texts need to be translated and published in Albanian and Serbian.

Both lawyers and judges have organized professional associations, but these groups are doing little to support their members in developing better contract law skills.

Chamber of Advocats. The Chamber is the bar association for lawyers in Kosovo. Membership is mandatory and at present there are approximately 280 members. There is no section of the chamber that is specialized on contract law or commercial transactions. There are plans for a continuing legal education program, but these have not yet been broadly implemented.³¹ The chamber receives institutional-building support from ABA/CEELI which has helped the chamber establish a “praktikant” or apprenticeship program for young lawyers in the year leading up to their sitting for the bar exam. Although the ABA/CEELI support has benefited the Chamber, it is still viewed as a rather passive organization, lacking in funds, a poor advocate for the profession or with regard to critical legislation, and not supportive of the profession in terms of much-needed legal training.

Kosovo Judicial Institute. The institute is a spin-off from an earlier training program supported by the Organization for Security & Cooperation in Europe (OSCE). With continuing support from OSCE, it is intended to become a magistrates school focused on training prosecutors and judges. However, at present the KJI’s effectiveness is limited as it has no national coordinator and no curriculum director. Curriculum development has started, but needs further support.

Kosovo Judges Association. This association for the judiciary is even less well developed than the Chamber of Advocats. Again the ABA/CEELI program is providing support, but considerable development is required before it will be truly effective.

b. Specialized Services

Commercial arbitration of the kind used for resolving contract disputes seems almost unknown in Kosovo at present. Although parties can include an arbitration clause in their contract if they so choose, this is not a wide-spread practice. There is no arbitration law which would help to

³⁰ Very limited law libraries exist at the Kosovo Law Center (compilations of the laws – criminal, civil, administrative, tax --- in English, Albanian, and Serbian), at the law faculty (not up to date; primarily human rights materials), and at the Supreme Court (new created; contains the Official Gazettes, some law books).

³¹ Continuing legal education would be made mandatory under a Law on Advocates that is making its way through the legislative process.

facilitate implementation of such a procedure and we could not identify any commercial arbitration services or commercial arbitrators.

There are opportunities for legal publishers in Kosovo. For instance, the few contract forms books that can be found in Kosovo are out-of-date and do not cover modern commercial situations (e.g., e-business, information technology). Furthermore, most forms books are not available in the Albanian language.

c. Trade and Industry Associations

Although there are a number of trade and industry associations in Kosovo, at present they do not play any significant role in improving contracting standards. They certainly could do so by providing training or seminars to their members on a variety of contract-related topics including, for example: the benefits of written contracts, general contract principles and requirements under the Law on Obligations, specific contract types provided for in the Law, how to enforce contract rights, techniques of contract negotiations, etc. In addition, trade and industry associations could be prime movers for the development of standard contract documents of use to their membership, the passage of legislation on alternative dispute resolution in Kosovo and the training of arbitrators and mediators, and improvements in the ability of the courts to protect contract rights. Trade and industry associations also have a role to play in commenting on and influencing the legislative process when laws affecting contract rights are under consideration.

The *American Chamber of Commerce* (AmCham) has only been in existence for several months, but, given that its membership is more internationally oriented, it could be a real force for improved contract standards. The Chamber is just beginning to develop an agenda that will likely focus on economic development in Kosovo, push for greater consistency in the implementation of the customs and tax laws, encourage the enforcement of existing legislation with particular emphasis on intellectual property laws and permitting, and seek to influence the legislative drafting process. Lack of clarity among its members as to what are the applicable commercial laws is also viewed as a real problem, one which it will seek to overcome by putting together a compilation of the most relevant business legislation.

There are several domestic trade and industry groups, including the long-established *Kosovo Chamber of Commerce*, the *Kosovo Export Association*, the *Alliance of Kosovo Business*, and the *Society of Certified Accountants and Auditors*. Although they are well placed to have an influence on improving the use of contract law, we are not aware that any of them has shown any particular interest in doing so.

5. SOCIAL DYNAMICS

The drafting and passage of the new Law on Obligations was championed by a professor at the law faculty, who also happens to be a Member of the Assembly. In addition, the international community, particularly donors, has also been a key driving force behind the creation of a more modern contract legal environment in Kosovo. The European Agency for Reconstruction provided the necessary financial support and technical assistance that supported the drafting of the new Law on Obligations. Furthermore, USAID has provided international lawyers in the

Office of the Prime Minister and at the Kosovo Assembly to facilitate the drafting, review, and passage of new commercial legislation.

We observed little demand for improved contract law in Kosovo among the business and legal communities. As already noted, there is no real tradition of using written contracts among the vast majority of Kosovar business people; they tend to transact business in a much more informal manner that relies on relationships and oral agreements. Foreign investors and other foreign business persons do insist on proper contract documents for their business activities in Kosovo and are seeking enforcement in the courts. Over time this will help to improve contracting standards and increase the use of written agreements.

The legal profession and judicial system have done little to promote reform of the contract law environment. Few lawyers have the essential skills necessary – drafting, negotiating, transacting – to make a modern system of contracting functional. Judges, through incompetence or corruption, prevent the courts from being viewed as an institution that protects contract rights and thus encouraging the greater use of contracts. Both lawyers and judges suffer from a lack of legal research resources and training in contract law.

It is strange that few Kosovar lawyers show an interest in developing their contract drafting, negotiation, and other transactional skills. There is increasing demand for these services from foreign investors and business people wanting to invest or trade in Kosovo but simply not enough qualified lawyers to meet this demand. Given that many lawyers are just able to survive, many more of them should seek to gain the necessary skills to take advantage of this opportunity and otherwise promote a contract law and court system of the highest quality.

The education system does not promote a strong contract law environment. The texts used by the law faculty are outdated – at a minimum, the new Law on Obligations should henceforth form the basis for legal education on this subject matter. And the legal education is focused on theory with little practical education in areas such as legal drafting and negotiation skills. Furthermore, the business and management faculties do not educate future managers on the basics of business law. Until a new generation of business people understand the need for formal contracts, it will be difficult to reverse the tradition of informal, oral agreements.

6. RECOMMENDATIONS

The new Law on Obligations provides modern contract legislation for Kosovo that can support a dynamic commercial environment. The proper implementation of that law will be a challenge and this is the focus of our recommendations:

- **Courts.** For contract law to become truly effective, the courts must become effective protectors of contract rights. Judges need more training on commercial law, particularly the Law on Obligations. The organization of courts and their procedures need evaluation so that contract disputes receive timely resolution; for example, a small claims court could provide quick and cost-effective relief where the amount at issue is small. Finally, and perhaps most importantly, more aggressive measures must be taken against corruption in the judicial system.

- **Implementing bodies for the Law on Public Procurement.** Effective implementation of the new Law on Public Procurement can raise the standards of contracting, not only in public contracts, but also in private commercial contracts. Implementation will not begin until the Public Procurement Regulatory Commission, the Public Procurement Agency, and the Public Procurement Rules Committee are established. This should be done as soon as possible.
- **Alternative Dispute Resolution.** All modern systems of commercial law include provisions for extra-judicial dispute resolution. While Kosovars can agree to use alternative methods, such as arbitration or mediation, the drafting and passage of appropriate legislation to institutionalize these techniques is needed. Furthermore, there needs to be training for arbitrators and mediators so that these methods of dispute resolution can be implemented locally.
- **Execution of judgments.** The execution of civil judgments is a key element in the enforcement of contract rights. The recommendations set forth in the recent NCSC Execution of Civil Judgments report should be carefully considered and acted upon as part of a comprehensive program to address the commercial law system in general.
- **Legal education.** Training on the new Law on Obligations is needed for judges as well as lawyers. Both the Chamber of Advocats and Judges Association must establish effective programs of continuing legal education that will provide a better grounding in contracts law and modern commercial transactions. Likewise, the law faculty must orient its contracts classes to the new Law on Obligations. For both practitioners and law students, the training needs to include the theory of contract law, but also a strong practical component focused on contract drafting and negotiating skills.
- **Treatises on contract law.** Students, practicing attorneys, and judges would all benefit treatises elaborating on and explaining the new Law on Obligations. Such treatises should, at a minimum, clarify the intent of various sections of the law, provide comparisons with other countries, and include discussion and examples of how the various sections of the law should be applied in a modern commercial environment.
- **Contract forms book.** A form book is a standard feature in the office of any commercial lawyer in the United States and would greatly facilitate the improvement of contract drafting in Kosovo. It should be prepared in line with the requirements of the new Law on Obligations and be available in the Albanian and Serbian languages.
- **Business law courses.** To overcome the traditional reluctance to use written contracts among Kosovars, business and economics curricula at the university level should include business law courses to teach the next generation of managers and entrepreneurs the basic elements of commercial law and benefits of defining contractual relationships through written agreements.
- **Commercial law specialization.** There are significant opportunities for Kosovar lawyers in commercial and transactional law. To capitalize on these, members of the profession need to develop specialties in commercial law areas, particularly in contract law. The

Chamber of Advocats should lead this effort by establishing sections within its membership focused on the various aspects of commercial law. These sections need to be supported with focused training in their area of specialization.

- **Civic society watchdogs.** The business community, through its trade and industry associations, need to take a more active role in monitoring and influencing legislation that affects commercial transaction, contracts, and dispute resolution. AmCham, the Kosovo Chamber of Commerce, and other groups must work individually and collectively to improve the commercial environment in which they operate. In addition to legislation, they must pressure the authorities to improve the operation and independence of the courts.

C. COLLATERAL (FINANCING SECURED WITH PLEDGE OF MOVABLE PROPERTY)

1. OVERVIEW

The goal of Collateral Law is to make credit easier to obtain for individuals and corporations by reducing the risk of default by allowing creditors to have recourse to the property secured. “Secured Transactions” pertains to the laws, procedures and institutions designed to facilitate commerce by promoting transparency, predictability and simplicity in creating, identifying and extinguishing security interests in assets.

2. LEGAL FRAMEWORK

Drafting authority. Collateral (or “pledge”) law, like company law, is an area in which legislative authority was transferred from UNMIK to the Kosovo Government in 2001 pursuant to the Constitutional Framework for Provisional Self-Government in Kosovo (UNMIK Regulation 2001/9).

Thus, while UNMIK acting alone issued the current pledge law (before the Constitutional Framework became effective in May 2001), future amendments or replacements of that law are to be adopted by the Kosovo Assembly – although are although still subject to ultimate approval by UNMIK the under the Constitutional Framework.

As a practical matter this also means that responsibility for drafting a future pledge law lies with the Office of the Prime Minister of Kosovo and the Office of the Assembly of Kosovo, not with the UNMIK Office of the Legal Adviser to the SRSG.

The present pledge law consists of two UNMIK regulations: Regulation 2001/5, entitled “On Pledges,” and Regulation 2001/32, entitled “On the Establishment of a Pledge Filing Office.”

These regulations contain provisions very similar to those found in modern, market-economy pledge and pledge-filing laws (including the U.S. Uniform Commercial Code) and they have been used fairly extensively in Kosovo since their enactment. A comprehensive new law called the “Law on Real Rights of Kosovo” was proposed in 2004 which would consolidate and replace those two regulations and also several other existing Kosovo laws using a model based on Slovenian and German law. That draft law was reviewed and the conclusion was reached that it

did not offer a significant improvement over the current pledge law. It is understood that that draft will not be approved by UNMIK.

The Pledge Law. Regulation 2001/5 can be fairly characterized as a well-drafted, modern law basically adequate for present credit markets. Its preamble recites that it is intended to provide “a simple, uniform and exclusive structure for pledges in Kosovo,” and, among other things, it:

- covers (among other things) accounts, future advances, bulk sales of inventory, contract rights, proceeds of collateral such as sale proceeds, “fruits” of collateral such as accrued interest or dividends, shares of a company, negotiable instruments, and inventory including work in process;
- lists the formal requirements for a pledge agreement to be effective;
- sets out the basic rights of the pledgor and pledgee in the collateral, including rules governing preservation of its value while the pledge is in effect;
- specifies the relative priorities of multiple pledges when those exist;
- specifies rules governing transfer and acquisition of collateral including the rights of transferees of specific types of collateral;
- states rules for perfection including perfection by public filing in the filing office; and
- states rules governing default and enforcement.

The Pledge Filing Office. Regulation 2001/32 supplements Regulation 2001/5 by establishing the Pledge Filing Office within the Department of Trade and Industry. That office is described below.

3. IMPLEMENTING INSTITUTIONS

The Pledge Filing Office. The Pledge Filing Office is located on the ground floor of the building that houses the Banking and Payments Authority of Kosovo (the BPK). The current relative effectiveness of this institution may be reduced because it has just moved from another location and, while diligent creditors know where it is, other stakeholders may not.

The Pledge Filing Office appears efficient in its purpose of maintaining, indexing, searching-retrieving, and providing public access to all filed pledges. To date about 15,000 pledges have been filed there. A typical life history of a filed pledge is as follows:

- most filed pledges are made on standardized contract forms which include the data required by Regulation 2001/5 (name and address of debtor and creditor, description of the collateral including serial numbers where applicable, etc., etc.);
- when the creditor first takes the pledge, it transmits the form by email or fax to the Filing Office;
- the Filing Office retains the information both electronically and in hard copy;
- the data in the pledge is indexed electronically by name of debtor, name of creditor, type of collateral, and serial or other identifying number where applicable; and
- when the debt is paid the filed pledge is terminated by the filing of a termination statement.

The Assessment team conducted some sample searches and were able to find a particular purchase-money pledge of a Fiat van several times by searching under each of several categories, including company name of the debtor, individual first and last names of the responsible debtor officer, name of the creditor, make and model of the van, and serial number of the van; and we were told that any member of the public can come in and do the same. (The clerk in charge was helpful and polite, which is an important requirement for an office of this kind.) Collateral such as inventory and receivables is indexed by category type, although obviously without unique identifying data such as serial number. The fee for filing a pledge is 5 Euros; there is no fee for a search or for filing a termination statement.

The clerk of the Filing Office stated that creditors have “often” come in and requested copies of their pledge filings to enforce their loans. Repossession of collateral is a rarely-used remedy in Kosovo, but that is apparently not because the recording and filing system is inadequate.

The ***Kosovo Credit Information System*** (the KCIS) is similar to a Western-style credit bureau. The KCIS was originally created by banks and microfinance institutions (MFI) as a clearinghouse for information on personal and company credit history, loan defaults and similar information among the members of the KCIS. Its management is currently in the process of being turned over to the by the ***Banking and Payment Authority of Kosovo (BPK)***, which is expected to result in improved administration. Namely, the BPK will require that all banks register their collateral with the pledge registry.

Municipal Courts. Kosovo’s 24 municipal courts are charged with managing the civil execution procedure. This process and its prospects for reform are detailed at length in the recent Execution of Judgments Study sponsored by USAID and the National Center for State Courts.³²

4. SUPPORTING INSTITUTIONS

Users of the system. There are 24 registered lending institutions in Kosovo which use or can use the pledge law and filing system. Almost all pledge lending is done by lending institutions; little is done directly by sellers of pledged goods or other persons.

Of the 24 lenders, seven are banks and 17 are microfinance institutions (MFIs). Two of the banks currently account for about half of all of the institutions’ loans. Those two are ProCredit Bank, a “development bank” whose shareholders include multilateral institutions such as the EBRD and the IFC and also the German commercial bank Commerzbank; and Raiffeisen Bank, a subsidiary of the Austrian commercial bank of that name, which was recently purchased in 2003 from the USAID-sponsored American Bank of Kosovo. The other five banks are headquartered in Kosovo and are generally referred to as “local banks”; they account for about 40% of all the loans. The 17 MFIs account for about 9%. (These figures are kept on a monthly basis by the BPK, which provided them to us.) Raiffeisen Bank, a major creditor which lends chiefly to small and medium-sized enterprises but also to Kosovo’s growing community of larger businesses, is virtually alone among Kosovo’s seven banks in having a practice of enforcing all bad debt through the court system.

³² USAID/National Center for State Courts, *Execution of Civil Judgments in Kosovo*, *supra* note 27.

A *Bankers Association* is in its infancy, with technical support being provided by the European Agency for Reconstruction. In the future, this Association may serve as one vehicle for helping all of Kosovo's banks understand best practices in the field of bankruptcy.

Lawyers. Creditors in Kosovo do not yet have access to the degree of legal and business expertise that they require to effectuate sound lending and collection practices. The small cadre of banking lawyers employed by Pro-Credit and Reiffeisen Bank currently accounts for the vast preponderance of professional capacity with respect to the implementing role of creditors in Kosovo. Training of other lawyers as part of a larger Commercial Law Curriculum may begin to address this problem.

Kosovo's long-established *Chamber of Commerce*, the *Alliance of Kosovo Businesses*, and various recently established sector-based business associations, can each be regarded as resources in the overall effort to improve access to and understanding of commercial law in Kosovo, including the law of collateral.

5. SOCIAL DYNAMICS

Problems with the system. While the legal framework may be adequate for present conditions – and it is definitely used – pledge financing is not widely relied on overall in Kosovo.

There are many reasons for this which are unrelated to the above legal framework. One lending officer who said his institution always uses the filing system also stated, in the next breath, that the pledge filing system is “fine but irrelevant.”

The partly overlapping reasons for this situation include the following:

- **The present Kosovo “business profile.”** The persons interviewed stated that most business activity in Kosovo consists of trading and similar pursuits in which easily identifiable and resalable items of collateral do not play a large part. Typical businesses cited are trading in food, cigarettes, clothing or building materials. There is little large-scale manufacturing or trading in capital equipment activities in which pledge financing is uncomplicated in practice, as it must be in transition economies.
- **Unpredictable government intervention.** Under still-used Yugoslav laws, the Kosovo Government can assert first-priority property liens for unpaid taxes. Such liens have priority over previously-filed pledges of the same property. Since taxes are often unpaid in Kosovo (and the tax rules are unclear) this is a constant threat to lender collateral rights. These potential tax claims cannot be predicted or searched for. These laws have even been used to block bank lenders from seizing cash collateral held in an account at the lending bank under loan agreements in which the seizure by the bank specifically agreed to by the borrower. When governmental officials assert such claims the collateral can be lost or “negotiation” can ensue in which special payments are sought.
- **Difficulty with court enforcement.** The persons interviewed stated that the procedures for court enforcement of collateral pledges are unclear, time-consuming, costly, sometimes unpredictable and variable from region to region. The problem begins with

the far-flung execution system: it would be much easier, bank representatives have argued, to manage collections through a smaller number of courts (3-5) rather than the 24 Municipal Courts. Within the Municipal Court process, situations were described where the court judge went out to view and physically seize the collateral, and others in which police did the job, in some cases successfully and in some unsuccessfully. Often the costs of repossession exceed any realizable value of the collateral.

- **Risks in realizing on and valuing collateral.** Even when collateral is repossessed, resale can be difficult or impossible. Sometimes the only market for resale includes acquaintances or business associates of the debtor who can block resale. There are few if any independent, objective appraisers. There are no rules on whether a lender has a duty to get the best price and there are risks of counterclaims by the debtor if collateral is sold. One lender stated that his institution goes to great lengths to minimize such risks, including sending serial demand letters over several weeks before beginning repossession. One lender described cases where collateral, when finally repossessed, consisted of unmarketable, out-of-fashion clothes, unusable auto parts, and, in one instance, counterfeit gold jewelry that could not have been identified in advance as being counterfeit.
- **Results for the Kosovo Credit Markets.** These problems have resulted in credit market conditions which do not encourage commercial business loan financing in general. Commercial lenders tend to be unwilling to make loans based on “objective” factors like collateral pledges; instead, credit evaluation is based more on “character” assessment – personal reputation, observable historic cash flow rather than future prospects or audited financial statements, etc. Long-term loans are virtually unavailable; typically the maximum available is 12 months, although trusted borrowers can receive terms up to 36 months. Bank loan interest rates for business loans are currently 12-14% per year; for individuals they range from about 9-16%; and rates for microfinance loans are up to 24%.

There is no significant lease financing. There have been no formal bankruptcies.

6. RECOMMENDATIONS

As indicated above, the secured credit market in Kosovo very limited, although aspects of the current framework (the pledge law, the registry and the presence on the ground of sophisticated banks) are very positive factors that could support a much more developed market.

The greatest legal-structural problem at present is the inadequate system for enforcement of collateral rights, which is part of the larger problem of execution of civil judgments. That problem was analyzed in detail and recommendations made in the recent (August, 2003) report of USAID and the National Center for State Courts, which will not be repeated here. The recommendations set forth in that report should be carefully considered and acted upon as part of a comprehensive program to address the commercial law system in general.

D. COURTS (COMMERCIAL DISPUTE RESOLUTION)

1. OVERVIEW

The current structure of the Kosovo court system is largely unchanged from former Yugoslav times. The legal framework under which it functions, of course, is different – the framework now consists of a complex combination of UNMIK Regulations and former Yugoslav laws which have been preserved in force under the UNMIK administration.

There is wide consensus that the court system badly needs reorganization. To that end the SRSG in 2002 initiated a major study which resulted in a comprehensive analysis and set of recommendations for restructuring that was published in 2004.³³ The 2004 Report was sponsored by the Council of Europe and the U.S. Department of Justice and is based on extensive interviews with Kosovo judges and court personnel by European and U.S. judges and court administration officials.

Because of its comprehensiveness and detail, the 2004 Report may be considered the basic resource and a necessary starting point for further analysis of the Kosovo court system.

The 2004 report does not concentrate on commercial law issues; rather, it focuses on the general structure of the current justice system, key issues affecting management of the courts including analysis of and the need for reducing delays and case backlogs, various criminal procedure issues, and proposed staffing levels for all of the courts. From the commercial law standpoint, however, there are important issues concerning Kosovo's only functioning Commercial Court that require more detailed consideration. These issues include the following:

- Whether the Commercial Court should be maintained as a separate court or folded into the general court system (the 2004 Report recommends the latter);
- Whether the Commercial Court's jurisdiction should be expanded to include a broader range of commercial cases than at present;
- Whether some or all of the Commercial Court's former authority relating to deregistration of insolvent companies should be restored; and
- Whether, if the Commercial Court's jurisdiction is indeed expanded, there should be only one such court (as now) or more than one established on a regional basis (as in former Yugoslav times).

There is a great need to resolve those issues promptly so that an agreed Commercial Court structure will be in place when final status is determined. It is argued below that the separate Commercial Court should be retained and expanded, notwithstanding the contrary recommendation of the 2004 Report.

³³ Council of Europe/U.S. Department of Justice, *Kosovo Judicial System: Assessment and Proposed Options* (2003-04) (hereinafter "2004 Report").

2. LEGAL FRAMEWORK

The constitutional status of the courts is stated in Section 1.5 of the Constitutional Framework (UNMIK Regulation 2001/9), which makes the Courts one of four named “Provisional Institutions of Self-Government,” the other three being the Assembly, the President and the Government. The Constitutional Framework states that the courts “are responsible for the administration of justice in accordance with the applicable law,” and that “judges shall be independent and impartial...shall not hold any other public office [and] shall be distinguished jurists of the highest moral character, with adequate qualifications” (Sections 9.4.1 and 9.4.7).

The Constitutional Framework also reserves to the SRSG the power to appoint, promote and dismiss judges. On this subject it states specifically that judges and prosecutors shall be appointed by the SRSG from candidates proposed by the Kosovo Judicial and Prosecutorial Council (the KJPC) and endorsed by the Assembly, and that decisions on promotion, transfer and dismissal shall be made by the SRSG on recommendations by the KJPC “and exceptionally on his own initiative.” The Constitutional Framework also states that “international [meaning non-Kosovar] judges and prosecutors shall serve ...according to rules established by the SRSG (Sections 9.4.7 and 9.4.8).”

A further feature of the Constitutional Framework is that it creates a “Special Chamber of the Supreme Court” with the job of deciding constitutional issues, including issues of whether particular laws adopted by the Assembly are incompatible with the Constitutional Framework, and also including disputes between Provisional Institutions and questions of their respective authority under the Constitutional Framework (Section 9.4.11).

Beyond this, the court system remains largely governed by pre-1989 Yugoslav laws which were preserved in effect by UNMIK Regulations 1999/24 and 2000/50. (Those latter regulations prescribe that certain then-existing Yugoslav laws are to remain in effect to the extent that they do not conflict with UNMIK regulations and are non-discriminatory.) A detailed description of this complex legal situation can be found in the 2004 Report.³⁴

3. IMPLEMENTING INSTITUTIONS

Courts.³⁵ Except for adding the Special Chamber of the Supreme Court, the Constitutional Framework left the court structure essentially the same as it was before. With respect to civil law cases (including commercial disputes), the somewhat complicated structure is as follows:

- **Municipal Courts.** At the first (or lowest) level are 24 municipal courts which are located in municipalities throughout Kosovo. In addition to criminal jurisdiction and jurisdiction over various civil issues, the commercial law-related responsibilities of the Municipal Courts include the following:
 - Disputes concerning property issues;
 - Disputes on labor relations falling within the competence of the regular courts;

³⁴ 2004 Report, *supra* note 36, at 13-15.

³⁵ For a more detailed discussion of the structure of Kosovo’s court system including its criminal courts, *see* 2004 Report, *supra* note 36, at 15-26.

- Disputes concerning suspension of leases, contracts or rent of movable and immovable property, and concerning housing relations, where those fall within the jurisdiction of the regular courts;
 - Civil execution procedure;³⁶
 - Registration of rights in relation to real estate;
 - Division of property and regulation of boundaries;
 - Verification of transcripts, manuscripts and signatures, as well as in other “out of court” issues which are by law assigned to the municipal courts; and
 - Execution of verdicts in cases involving property disputes.
- ***District Courts.*** The five District Courts in Kosovo (located in Prishtina, Prizren, Gjilan, Peja and Mitrovica) hear all appeals from the Municipal Courts. In addition, the District Courts have first-instance jurisdiction for a specific list of criminal offenses (including all offenses carrying a punishment of more than five years’ imprisonment) and have other functions including undertaking investigations concerning cases within their competence and providing international criminal legal aid at the request of international organs.
 - ***Commercial Court.*** The 10-member District Economic Court (**Commercial Court**) is located in Prishtina. In the overall system hierarchy it ranks as a District Court, but it has its own judges and it hears only cases in which all of the private parties are “legal persons” – that is, general or limited partnerships, limited liability companies, or joint stock companies. There was a second such Commercial Court in Gjakova, but that second court has been defunct since 1999. All members of the Commercial Court have received significant training sponsored by the World Bank, including training over the course of three months in Fall 2003 and study tours of the Commercial Courts in Austria and Slovenia during the first quarter of 2004. The World Bank has set up the beginnings of a new law library at the Commercial Court.
 - ***Supreme Court.*** Kosovo’s Supreme Court has compulsory jurisdiction over appeals from the Commercial Court and the regular District Courts. Members of an informal “commercial consortium” on the Supreme Court participated in World Bank-sponsored training pertaining to commercial law issues.

4. SUPPORTING INSTITUTIONS

Kosovo Judicial Institute. As detailed at the Introduction of this Report, the KJI has served since 1999 as the chief source of training for judges and prosecutors in Kosovo. The KJI has sponsored at least 200 training programs, and most judges and prosecutors in Kosovo have attended at least one program. The KJI’s mission is currently being re-focused into service exclusively for judges, with the strong likelihood of the development of a new resource for prosecutors only. Many donors have used the KJI as a vehicle for developing and providing training for judges. For example, USAID has offered professional skills courses through the KJI. The World Bank and Germany’s Icon Institute have arranged training at the KJI for “commercial law judges.”

³⁶ For a detailed discussion of the system of execution of judgments, see USAID/National Center for State Courts, Execution of Civil Judgments in Kosovo, *supra* note 30.

Kosovo Judges Association. Relative to other judicial associations in the region, the KJA is underdeveloped, and it has no activities pertaining specifically to CLIR at this time. ABA/CEELI currently assists in building the KJA's capacities through support of board meetings, membership information efforts, and other activities.

Chamber of Advocats. The Chamber is the bar association for lawyers in Kosovo. Membership is mandatory and at present there are approximately 280 members. There is no section of the chamber that is specialized on contract law or commercial transactions. Although ABA/CEELI support has assisted in building the Chamber's institutional capacities, such as fundraising, it is still viewed as an organization whose capacities in lobbying, professional training, and communicating with the public and the media, need further development.

The Business Register, located in the ***Ministry of Trade and Industry,*** oversees the registration in Kosovo of the five types of companies listed in the current Law of Business Organizations, as well as International Companies, Socially Owned Companies (SOEs), and Publicly Owned Companies (POEs). The presence of the Business Register in the Ministry of Trade and Industry is not itself a problem; however, representatives of the Commercial Court, which handles lawsuits between companies other than personal businesses, have noted serious difficulties with respect to accessing information from the Register.

Prior to the adoption of Kosovo's Law on Business Organizations in 2001, registration of companies took place in the Commercial Courts.

5. SOCIAL DYNAMICS

As stated above, reorganization of the courts is already being actively considered in Kosovo and it can probably be expected that a general court restructuring will take place in the foreseeable future. Any restructuring should be accompanied by an all-new Law on Courts to replace the present jumble of laws.

It is particularly crucial that the right kind of reform take place in the commercial law area because of Kosovo's urgent need for economic growth and for additional investment, both domestic and foreign. To encourage growth and investment Kosovo must have judges who are familiar with and reasonably sophisticated in business and business law matters. Such qualifications, however, are not often found among the judiciary in general (a situation obviously not unique to Kosovo).

With this in mind it is recommended that the present system of having a separate Commercial Court of first instance be retained. This is based on several considerations, including:

- Interviews with six judges and administrators and attendance at a trial at the existing Commercial Court. It was observed that the judges were in fact reasonably knowledgeable in specialized business subjects and accustomed to dealing with them.
- Greater feasibility of specialized training and continuing education when there is a smaller group of judges. Specialized CLE is critical for good business law-making, and can be practical with a group of about ten where it would not be for the judiciary in

general. The study tours to Austria and Slovenia mentioned above were feasible for the Commercial Court but probably would not be for all the general jurisdiction judges.

- Analogous experience in the United States. Several U.S. State court systems have had positive experiences with separate business courts or separate business dockets within courts of general jurisdiction; these include court systems in New York, Cook County, Illinois (Chicago), Philadelphia, Pennsylvania, Rhode Island, and Orange County, Florida.³⁷ Those courts have dealt with, among other practical issues, the tasks of defining the types of cases to be heard and the assignment of specialized judges. Study of their methods and procedures would be helpful in Kosovo. It should also be noted that most major U.S. corporate law is made in only one court system, Delaware's, which is chosen by companies headquartered in other States for its judges' business knowledge and sophistication and the relative predictability of its decisions.
- The fact that business litigation is increasing in Kosovo and can be expected to increase further with economic growth. This could reasonably be expected to produce a caseload sufficient to occupy a separate panel of judges. Following the war there was very little commercial litigation but it has grown each year, with about 1200 cases heard by the Commercial Court in the past year.

6. RECOMMENDATIONS

The 2004 Report proposed to effectively abolish the Commercial Court and transfer its jurisdiction to the regional Municipal Courts, which would become courts of general jurisdiction. In support of this recommendation the 2004 Report cited the need to streamline, simplify and increase the efficiency of the court structure, along with the fact that the Commercial Court's caseload has not been heavy over the past several years. The authors of the 2004 Report could not be interviewed for this report and those reasons should be carefully considered. It is suggested here, however, that the other factors cited above can outweigh the valid considerations cited in the 2004 Report, particularly if the Commercial Court's jurisdiction is expanded as recommended below. On that basis it is recommended that the Commercial Court be retained and its jurisdiction expanded.

A major gap in the Commercial Court's present jurisdiction is that it covers only cases in which all of the non-governmental parties are registered legal entities. The Commercial Court does not hear cases in which individuals or registered personal business entities (sole proprietorships) are parties. This archaic distinction makes no sense, and all of the judges who were interviewed made this point. As investment and business activity grow in Kosovo more and more commercial disputes involving individuals (and needing judicial business expertise) can be expected – to cite one example which is common in the West, suits by investor/shareholders against a company (or its directors) for self-dealing or other misconduct which caused a loss of the investor's investment.

³⁷ See Bach, Applebaum and Schaeffer, "Business Courts," in *Annual Review of Business and Corporate Litigation, 2004 Edition*, at 117-45 (published by and available from the American Bar Association Section of Business Law).

There are two additional areas in which the Commercial Court's jurisdiction should or could be expanded if the court is retained. One is bankruptcy. Currently there are almost no bankruptcy cases in Kosovo but their number will only increase as economic activity increases and they, too, will require judicial business law expertise and experience. Indeed, this is one of two areas (the other being intellectual property) for which the 2004 Report stated that specialized courts would be appropriate in Kosovo. A second is execution of judgments including enforcement of debt, both secured and unsecured. This is currently a very major problem area in Kosovo – so much so that a well-attended conference to discuss its difficulties was held in Pristina in September 2004, sponsored by the National Conference on State Courts (NCSC).³⁸ This also is a specialized area calling for some judicial business law expertise. These areas were discussed with the Commercial Court judges who were interviewed and those judges would support such expansion or clarification of the court's jurisdiction.

Yet another jurisdictional issue concerns registration and deregistration of companies. Under former Yugoslav law this was performed by the Commercial Court but UNMIK moved it from the court to a newly-created non-judicial registry office in the Ministry of Trade and Industry. This was considered a positive reform because the registration-deregistration function is largely ministerial and it is now done more quickly and easily by clerical personnel in the new office. However, it has led to a real problem in the Commercial Court because there have been several cases in which owners of insolvent companies deregistered them to escape litigation against the company. This tactic has been successful because deregistration is more-or-less automatic on payment of a small fee to the new registry, and when a company is deregistered it automatically ceases to exist and thus automatically exits from the jurisdiction of the Commercial Court. This tactic would not have worked in former times because the court had discretionary power to refuse deregistration, and it could and did exercise that power to prevent deregistration of companies which were insolvent or in litigation before the court.

This unintended consequence of reform should be dealt with promptly. One solution is to restore the company registration function to the court (which the Commercial Court judges stated they would favor) but this is undoubtedly impracticable. Another solution is to expand the responsibilities of the registry office to include verifying (perhaps after investigation and making findings) that a company is not insolvent or a party to certain types of litigation as a condition to permitting it to deregister. This, however, is contrary to the (laudable) principle that the registry office should be fast-acting and ministerial only.

The problem could also be solved by expanding the Commercial Court's jurisdiction to include individuals and amending the company law to state that shareholders of a fraudulently deregistered company are personally liable for all of the company's obligations after it has been deregistered. Also, a provision could be added to the company law that a shareholder of any dissolved company is liable to company creditors to the extent of the amount that the shareholder received from the company as a distribution in liquidation. The current Serbian company law has such a provision and so, also, do some US state corporation laws including those of Delaware and Pennsylvania. Such changes in the Kosovo law are strongly recommended.

³⁸ The agenda for this conference was the report cited *supra*, note 30.

A final issue concerning the Commercial Court is whether there should be only one court or more than one based regionally. At this time only one court is warranted given the present and immediately foreseeable caseload. For the future, as the caseload grows, it is strongly suggested that one court would still be best in view of the small size of Kosovo and the expertise that the judges of that one court will develop. It would seem better for the expert judges of the single court to sit periodically in other regions than to have separate Commercial Courts each with separate judges.

E. BANKRUPTCY

1. OVERVIEW

The goal of bankruptcy law is to allow for the fair and efficient dissolution of businesses that are not viable and, for those businesses that have a chance at achieving viability, the opportunity to extend, reduce, or wipe-out debt and protect themselves from pursuit by Creditors. A modern, credit-based economy requires predictable, transparent and affordable methods of enforcing debt, and a clear and efficient bankruptcy regime is central to such a system.³⁹

In Kosovo, a sound foundation for a workable bankruptcy regime has been laid through UNMIK Regulation 2003/7, which pertains to the Liquidation and Reorganization of Legal Persons in Bankruptcy (hereinafter “Bankruptcy Law”). Several issues, however, conspire to render this foundation inoperable to date.

First, although the Bankruptcy Law states that implementing rules would be enacted within 90 days of its promulgation on July 14, 2003, these rules have not been disseminated.

Second, the Bankruptcy Law applies *only* to “legal persons” – defined as general partnerships, limited partnerships, limited liability companies, and joint stock companies – but *not* to personal businesses, even those that are properly registered pursuant to the Law on Business Organizations (UNMIK Regulation 2001/6). Thus, until there is a vast shift in the way that enterprises understand the significance of limited liability and become registered accordingly, an enormous sector of Kosovo’s economy will neither contribute to nor benefit from the potential advantages of a viable bankruptcy system. Moreover, the ease with which all companies may “deregister” under the Law on Business Organizations means that Creditors seeking to enforce debt through the bankruptcy process may find that their Debtors have simply ceased to exist as “legal persons,” and therefore are not subject to the Bankruptcy Law.

Third, although the previously discussed Commercial Court seems generally prepared to assume jurisdiction over bankruptcy cases, the legal community is ill-equipped to provide adequate representation to either Debtors or Creditors. Not only are most lawyers uninformed about bankruptcy, but also there is not yet a pool of trained, experienced professionals in Kosovo who would qualify to serve in the vital role of bankruptcy Administrator.

Fourth, there is no apparent demand for a more viable bankruptcy system at this time. Major secured Creditors, chiefly the banks and especially the foreign-owned Reiffeisen Bank, typically

³⁹ See World Bank, *Removing Obstacles to Growth: An Overview* (2004).

use the existing pledge laws to enforce debt and thus have the ability to effect liquidation of a business at the expense of virtually all other Creditors, who tend to be less aggressive in collection efforts. In the category of unsecured credit, Kosovo's public utilities reportedly clog the civil docket of the Municipal Courts with actions arising from unpaid bills and indeed use the courts as a first resort for enforcement, rather than making serious internal attempts at collection.⁴⁰ Other unsecured Creditors, given the virtual absence of written contracts among smaller enterprises, can rarely provide sufficient proof of debt and, in any case, do not appear to consider bankruptcy as among their enforcement options.

An effort to build capacities now would have a direct effect on the long-term usefulness of the Bankruptcy Law. A plan to implement and support Kosovo's bankruptcy regime must necessarily encompass: (a) the dissemination of implementing rules; (b) reform of the "deregistration" process, such that it cannot be used by Debtors as a simple tool to avoid bankruptcy; (c) the training of judges, lawyers, and businesses about the details of the Bankruptcy Law, with an emphasis on the significance of business registration options, the importance of secured debt, and opportunities presented through business reorganization; (d) special training for persons who seek to serve as Administrators and Appraisers; and (e) better resources in the area of commercial law generally.

2. LEGAL FRAMEWORK

The topic of bankruptcy tends to attract interest only when enterprises face difficult times or even certain failure; however, the very existence of a clear and enforceable legal framework for insolvency has an important role to play in fostering economic growth. Where Creditors can reasonably anticipate that their investments are protected when an indebted enterprise falters or fails and they will be able to seek and receive at least partial payment on the enterprise's debt, they are more likely to loan money or provide goods on credit in the first place. In addition, the opportunity to restructure or "workout" debt means that some companies may return to viability and even profitability, so that they can contribute to an economy's overall development, competitiveness, and employment level. A viable framework for business insolvency, coupled in particular with a Law of Secured Transactions and other regimes for enforcement of pledges, enables market participants to more accurately price, manage and control risks of default or enterprise failure.

UNMIK Regulation No. 2003/7 was entered into force in July 2003 and establishes the basic legal framework for Liquidation and Reorganization of Legal Persons in Bankruptcy in Kosovo. Although the substance of the law is sound, a fundamental problem is revealed at first glance: The English-language version is replete with minor errors of English-language usage and form. Although the intent of the language is basically clear, the errors throughout the document send a message of poor attention to detail and suggest problems of interpretation in the future that cannot yet be anticipated. The difference between "the" or "a" or "and" and "or" can be critical; the fact of imperfect translation in what might be regarded as the controlling version of the Bankruptcy Law undermines its potential effectiveness from the outset.

⁴⁰ See USAID/National Center for State Courts, Justice System Reform Activity in Kosovo, *The Execution of Civil Judgments in Kosovo*, *supra* note 27 at 2.

Scope. Article I of the Bankruptcy Law mandates that the legal framework for liquidation and reorganization of insolvent entities shall apply to “legal persons” only, namely, only to those enterprises that have become incorporated under the Law on Business Organizations as general partnerships, limited partnerships, joint stock companies, or limited liability companies. Specifically excluded from the Law’s jurisdiction are “private businesses, insurance companies, financial institutions, pension providers, and the enterprises in public and social ownership which are not yet transformed into legal entities.” With the exception of private businesses, the liquidation or reorganization of each of these excluded entities are regulated by other UNMIK regulations. In addition, individuals are not eligible for the protections afforded by the Bankruptcy Law.

The exclusion of private businesses from the Bankruptcy Law is not inappropriate or in error. Nor is it unusual that the Law does not incorporate a personal bankruptcy option in the fashion of, say, the U.S. Bankruptcy Law. Rather, the very fact that most enterprises in Kosovo are registered as personal businesses is indicative of a larger weakness in the economy. Namely, entrepreneurs clearly do not understand the advantages of forming their enterprises in a fashion that permits limited liability, which includes the ability to seek and receive bankruptcy protection.

Commencement of proceedings. Article 7 of Kosovo’s Bankruptcy Law sets forth the various bases for initiation of a bankruptcy case. Article 7.3 provides that Debtors may access the protections afforded by the bankruptcy system upon showing proof of insolvency or financial difficulty. Article 12 (Opposition to a Petition) discourages Debtors from using bankruptcy as a shield against a single Creditor.

Article 7 further provides that the ability of one or more Creditors to place a Debtor enterprise into bankruptcy is conditioned on a showing of the Debtor’s insolvency. Kosovo’s Law in fact adopts the preferred test for insolvency, which is the Debtor’s inability to pay debts as they come due, or the “liquidity test.” This test is generally preferred over the “balance sheet test,” which determines whether an enterprise’s liabilities exceed the fair market value of its assets. (The balance sheet approach is generally considered more costly and difficult to administer because it requires a valuation professional to review books, records and financial data to determine the enterprise’s fair market value, or reasonable value that can be obtained between a buyer and a seller.) It has been observed by many sources that most businesses in Kosovo would in fact fail the liquidity test.

Pursuant to Article 28, commencement of a bankruptcy action means that (1) the Debtor may not dispose of its assets without court authorization; and (2) Creditors, even secured Creditors, may not seek to enforce their rights or remedies against a Debtor or the Debtor’s assets through such means as collection, adjudication, or execution.

The role of the courts. The legal framework provides for active engagement of the Commercial Court, which currently consists of 10 judges stationed in Prishtina, in all phases of the Bankruptcy procedure. The Court’s role includes the acceptance or rejection of a bankruptcy petition (Articles 11 and 12); the appointment, supervision, compensation and discharge of the Administrator (*see, e.g.*, Articles 17, 20, 23, and 73); the responsibility to protect secured property (Article 34); the oversight of reorganization or liquidation plans (*see, e.g.*, Articles 58,

59, and 60); and various notification requirements (*see* Articles 14, 61, and 71). Given the breath of Court oversight, it is essential that the Commercial Court judges who will hold these responsibilities are well versed in these numerous and varied responsibilities. Although the Court has already received significant training, it may be desirable for a subject-matter expert to be made available to them as the first cases proceed in the future.

Appointment of the Administrator. Administrators, also referred to as “trustees,” are individuals who are designated in place of a Debtor’s management to handle either the liquidation or reorganization of an enterprise and who are accountable to the Commercial Court judge who is overseeing the bankruptcy case. Articles 17-25 of Kosovo’s Bankruptcy Law pertain to the appointment, qualifications, compensation and expenses, authority, reporting responsibilities, status, liability and bond requirements of a Bankruptcy Administrator. Regarding the qualifications of Administrators, Article 18 states that “particular qualifications and licensing procedures may be established by implementing rules.” Although this language is elective rather than mandatory, lawyers interviewed for this Assessment stated that the bankruptcy regime would generate greater trust in the long run if the Administrators are in fact licensed according to a formal and transparent procedure.

Creditor’s involvement and treatment. Article 26 of the Bankruptcy Law provides for the general safeguarding of Creditor interests through the establishment of a Creditor’s Committee that enables Creditors to participate in the insolvency procedure and monitor the process to ensure fairness and integrity. Through the voting and confirmation procedure set forth at Article 56, the Law anticipates possibly conflicting views of secured Creditors and unsecured Creditors. Namely, unsecured Creditors will have a greater interest in sustaining the life of the business through reorganization, which would increase the chances of their collecting on their debts. Secured Creditors will almost always favor quick sale of their collateral, rather than the more laborious and uncertain process of reviving the business. Administrators have the challenging role of reconciling the often opposing viewpoints in the course of a bankruptcy.

Liquidation. Liquidation, the more common form of bankruptcy, is the process of assembling and selling a Debtor’s assets in an orderly and expeditious fashion in order to dissolve the enterprise and distribute the proceeds to Creditors according to established law. In liquidation, the Administrator collects the non-exempt property of the Debtor, arranges for its proper and supportable valuation, sells it, and distributes the proceeds to the Creditors. Liquidation can include a piecemeal sale of the Debtor’s assets *or* a sale of all or most of the Debtor’s assets in productive operating units or as a going concern.

Chapter IX (Articles 60-68) of the Bankruptcy Law competently sets forth the general procedures for liquidation of a bankrupt enterprise in Kosovo, although details about sales of property and payment of Creditors are awaiting the promulgation of implementing rules.

Reorganization. Companies that have some chance of rehabilitation can benefit from the reorganization protections provided by a bankruptcy law. The opportunity to restructure or “workout” debt means that some companies will return to viability and even profitability, so that they can contribute to an economy’s overall development, competitiveness, and employment level.

Chapter VIII (Articles 51-59) of the Bankruptcy Law sets forth the procedures for reorganization, referencing in part a set of “implementing rules” that detail procedures. As previously noted, the implementing rules have not yet been disseminated. One possible weakness in this Chapter is the absence of specific reference to the difficult question of who actually controls the enterprise during the process of rehabilitation. A more comprehensive framework would provide for two approaches: (1) control by an independent Administrator; or (2) supervision of management by an independent Administrator or supervisor. The decision to displace the enterprise’s management entirely should not be taken lightly, because such a radical step may undermine the enterprise’s ability to regain solvency. Specifically, the existing management’s understanding of the details of the business may be crucial to rehabilitation, just as their support may be necessary for complete turnaround. Moreover, from a practical perspective, Kosovo simply does not have a pool of management expertise from which to choose a supervisor. On the other hand, where fraud, gross negligence or other severe abuses are at issue, the law should provide for transfer of control of the enterprise into the hands of new management.

Criminal Provisions. The Bankruptcy Law properly identifies the penalties for certain criminal acts, including submission of false claims or documents (Article 74); false oath or testimony (Article 76); concealment of assets (Article 77); bribery during the course of a bankruptcy action (Article 78); knowing disregard of the provisions of the Bankruptcy Law (Article 79); and Misappropriation of Assets (Article 80).

Implementing Rules. Throughout the Bankruptcy Law, reference is made to implementing rules to be enacted within 90 days of the Law’s entry into force. Nearly a year later, rules have reportedly been drafted by the Office of Legal Services Support of the Office of the Prime Minister,⁴¹ but they have not been publicly disseminated. According the Bankruptcy Law, the rules should cover the following:

- Form and content of the Petition (Article 8).
- Documents required with a Debtor’s Petition (Article 9).
- Procedures for notifying the business registry and the pledge registry of the opening and closing of a case (Article 10).
- Particular qualifications and licensing procedures for Administrators (Article 18).
- Procedures for meetings of Creditors or of a Creditor’s Committee (Article 26).
- Treatment of unperformed contracts (Article 39).
- Minimum required information for proof of claim, the procedures for acceptance and recordation by the Court, and creation of the claims register (Article 42).
- Procedures for hearing on plan of reorganization (Article 55).
- Procedures for sales of the property of the estate (Article 60).
- Procedures for paying claims to Creditors upon liquidation (Article 66).
- Contents, distribution, and procedures for resolving objections to the final report of the Administrator (Article 69).

3. IMPLEMENTING INSTITUTIONS

⁴¹ See Checchi and Company Consulting/Louis Berger, *Evaluation of the USAID/Kosovo Economic Reconstruction Project*, at 43 (November 2003).

The Commercial Court. As discussed previously, the 10-member Commercial Court is the Bankruptcy Law's principal implementing institution. All members of the Court, along with three judges from the Supreme Court, received significant training sponsored by the World Bank on the topic of bankruptcy, including training over the course of three months in Fall 2003 and study tours of the Commercial Courts in Austria and Slovenia during the first quarter of 2004. In addition, USAID provided bankruptcy training for Commercial Court judges, lawyers, and other interested parties, including economists. The Commercial Court is ready and willing to assume its obligations under the Bankruptcy Law. To date, however, no bankruptcy actions have been filed in the Commercial Court. The World Bank has set up the beginnings of a new law library at the Commercial Court.

Administrators. A corps of professionals who are qualified to serve as bankruptcy Administrators does not yet exist in Kosovo. Administrators charged with rehabilitation of a company must be capable of restoring the enterprise's financial well being, which may include restructuring debt, changing business practices, improving methods of corporate governance, or even selling the enterprise as a going concern. Administrators handling the liquidation of an insolvent enterprise should have knowledge of the law and adequate experience in commercial and financial matters. Administrators should understand that a crucial aspect of their role is to maximize the value of assets returned to Creditors. They also should be impartial. A program that specifically pertains to the implementation of the Bankruptcy Law must necessarily encompass the training and licensing of Administrators.

Creditors in Kosovo do not yet have access to the degree of legal and business expertise that would allow them to, pursuant to the Bankruptcy Law, serve as decision-makers in a number of key areas. The small cadre of banking lawyers employed by Pro-Credit and Reiffeisen Bank currently accounts for the vast preponderance of professional capacity with respect to the implementing role of Creditors in Kosovo. Training of other lawyers as part of a larger Commercial Law Curriculum may begin to address this problem.

4. SUPPORTING INSTITUTIONS

Lawyers. Although the community of lawyers that currently practices before the Commercial Court is said to have significant experience litigating cases of relatively high value, the fact that no bankruptcy cases have yet taken place means that no lawyer in Kosovo has any direct experience in the field. Clearly, continuing legal education in bankruptcy – through a class with no fewer than 40 hours of training time, preferably with an anonymously graded exam at the end – is necessary. In addition, the fact that bankruptcy has such a significant relationship to other areas of the law, including Company Law and Collateral Law, suggests that a 40-hour bankruptcy course should be part of a larger Commercial Law curriculum sponsored by an institution that is committed and capable of serving this field. One possible forum for an intensive Commercial Law curriculum for lawyers might be the **Chamber of Advocats**, Kosovo's professional association for lawyers.

Banks. Reiffeisen Bank, a major Creditor which lends chiefly to small and medium-sized enterprises but also to Kosovo's growing community of larger businesses, is virtually alone among Kosovo's seven banks in its determination to enforce all bad debt through the court system. Given the virtual absence of competition among secured Creditors, Reiffeisen has not

found a particular need for bankruptcy; rather, through seizing of collateral after a debt has gone bad, the bank essentially liquidates the firm through asset sales procedures that are in line with those set forth in the Bankruptcy Law. A **Bankers Association** is in its infancy, with technical support being provided by the European Agency for Reconstruction. In the future, this Association may serve as one vehicle for helping all of Kosovo's banks understand best practices in the field of bankruptcy. Banks in Kosovo are supervised by the **Banking and Payment Authority of Kosovo (BPK)**.

Appraisers. Although Kosovo has a number of court-appointed "experts" in valuation of property, a formal and professional appraisal system does not yet exist in Kosovo. A program that pertains to the implementation of the Bankruptcy Law would benefit from a component pertaining to the training and licensing of Appraisers.

Various Business Associations, including the long-established **Chamber of Commerce**, the newer **Alliance of Kosovo Businesses**, and various recently established **sector-based business associations**, can each be regarded as resources in the overall effort to improve access to and understanding of commercial law in Kosovo, including bankruptcy. One longstanding Kosovo observer, Harry Perritt, has asserted that business associations play a major role in promoting the overall economic development agenda. Specific activities proposed by Perritt include the following:

An effective business advocacy organization would consult regularly with business constituents, listening carefully to understand the problems they face. Such an organization would fight for easy access to business laws and other legal systems through some form of electronic database. It would have the capacity to do legal analysis aimed at explaining how best the practices from other legal systems can be adapted to the needs of Kosovo businesses. Its staff would possess exemplary communication skills so they could develop materials persuading people of the merits of the association's position. Effective business advocacy for Kosovo must reach not only UNMIK, other international organizations playing a governmental role, and the indigenous institutions of provisional government; it must also include foreign governments and NGOs capable of applying pressure to domestic decision makers. Certain business advocacy associations also may wish to become involved in channeling campaign contributions to responsive political parties and candidates.⁴²

The Business Register oversees the registration in Kosovo of eight types of companies, as detailed in the chapter on Company Law. The presence of the Business Register in the Ministry of Trade and Industry is not itself a problem, but representatives of the Commercial Court did note serious difficulties with respect to accessing information from the Register. The central problem cited was the fact that the Register can "deregister" businesses at their request without the knowledge of the Court, or without even checking with the any court regarding outstanding enforcement actions. Moreover, the Business Register may "deregister" a Limited Liability Company or Joint Stock Company for failure to file an annual report or financial statement.

⁴² Henry H. Perritt, Jr., *Economic Sustainability and Final Status for Kosovo*, *supra* note 8, at 299; *see also* Henry H. Perritt, Jr., *Stabilizing Kosovo: Enterprise Formation and Financial Markets*, 2 J. Global Fin. Markets 28, 37-38 (2001).

The ***Kosovo Trust Agency (KTA)*** is a supporting institution insofar as it is charged with overseeing the transformation of Socially Owned Enterprises and, eventually, Publicly Owned Enterprises into private enterprises over the next few years. Those enterprises that seek to remain or become viable will need an enormous amount of support with respect to the entire scope of commercial operations, including assistance setting up structures of corporate governance and complying with the commercial law. Moreover, although the KTA is responsible for liquidation of certain SOEs at this time, eventually the privatized entities will be treated like all other companies, including joint stock companies and limited liability companies. These companies and their lawyers must be not only be aware of how to function in the event that a Creditor seeks to open bankruptcy proceedings against them, but also how to enforce debts that are owed to them, including through the bankruptcy process.

Certain non-government organizations may be engaged as resources in educating the commercial law community about how and why the ultimate success of a bankruptcy regime is critical to the long-term economic future of Kosovo. ***Riinvest*** is a local economic think tank that has established credibility among both local actors and the donor community. The ***Kosovo Law Center***, though focused chiefly on matters of criminal and humanitarian law, has set a strong example in how a legal NGO might function, through the development of a resource center and publication of laws and Supreme Court cases. Perhaps the KLC could serve as a model for a future Commercial Law Resource Center in Kosovo.

5. SOCIAL DYNAMICS

As noted earlier in this chapter, there is no particular demand specifically for a more viable bankruptcy system at this time. Formal liquidations that are likely to take place in the near future will do so under the authority of the KTA (which oversees SOEs and POEs) or the BPK (which oversees banks and insurance companies). The problem lies, however, where liquidation take place *informally* as the effective action by just a single secured creditor (such as a bank collecting on a debt) or by a creditor who is trying to escape paying his or her debts (such as through mere “deregistration”). Bankruptcy law is intended to bring order and fairness to the liquidation process, attributes that do not generally exist at this time.

One past experience in formal liquidation proceedings took place under the supervision of BPK, when it placed an insolvent insurance company into receivership. When the insurance company failed to qualify for licensure under the UNMIK regulation on insurance companies, BPK appointed a special receiver, removed the company’s management, sold the company’s real estate, and tendered off its portfolio, which was purchased by another insurance company. Ultimately, the staff for the liquidated company was employed by the purchasing company. Although Kosovo’s law specifically excludes insurance companies, a study of this experience may be instructive for bankruptcy lawyers and Administrators in the future.

Although there is not a clear demand for bankruptcy reform in particular, there is an enormous demand for knowledge and services to support economic development generally, and how Kosovo intends to protect both debtors and creditors through its bankruptcy system is an important part of this body of knowledge. As Henry Perritt has remarked, what is missing in the economic development arena is a corps of knowledgeable transactional lawyers to assist businesses:

One useful addition to [donor assistance provided in Kosovo] would be a small business assistance clinic operated jointly by certain local consulting firms, drawing on support from the law and economics faculties of the University of Prishtina, the Kosovo Chamber of Commerce, and the Ministry of Trade and Industry. Such a clinic would permit law and economics students, under appropriate supervision by professors and experienced practitioners, to assist would-be proprietors of SMEs in refining their business models, executing marketing research, developing business plans, determining the most important legal forum for their business, registering the business, and writing contracts for employees, customers, and suppliers. The clinic also would maintain close contacts with diaspora groups and with assistance obtaining capital for startups.⁴³

6. RECOMMENDATIONS

- In consultation with the Commercial Court and the Office of the Prime Minister, a clear plan for the dissemination of bankruptcy implementation rules should be devised. Although it has been reported that such rules have been drafted and even adopted by the government, they remain unseen by and unknown to the community of interested professionals.
- The system of “deregistration” of businesses in Kosovo needs to be reformed, most likely through the next draft of the Company Law. At this time, the only documentation required by the Business Register prior to deregistration of an enterprise is a certificate of good standing with the tax authority. As recommended by the recent study on Execution of Civil Judgments in Kosovo prepared by the National Center for State Courts, a similar notification mechanism should be set up with the courts, either requesting the courts to notify the Register of initiated lawsuits, including bankruptcy actions, or requesting the Register to ask for a certificate of good standing with the courts before registration.
- Other improvements might be made to the Business Register, currently housed at the Ministry of Trade and Industry, which would affect the long-term viability of the bankruptcy regime. Specifically, better communications with the courts and a greater willingness to provide information about companies to the public is advisable.
- All donor-sponsored business assistance programs, including those that assist Micro-Enterprises, Small and Medium-Sized Enterprise, State Owned Enterprises, and Publicly Owned Enterprises, should include a practical component in commercial law, which includes sustained training of management in the following topics, among others: (a) the principles and practices of corporate governance; (b) the importance of enlisting legal counsel to assist with business formation; contracts and other transactions; enforcement of debts; and, if necessary, dissolution; and (c) the purpose of and protections afforded by corporate structures that provide for limited liability.
- When a bankruptcy action is finally brought before the Commercial Court, provisions might be made for the mentoring of the judge who will oversee the case. One resource for *pro bono*

⁴³ See Perritt 2004, *supra* note 8, at 303.

judicial assistance is the Committee on International Judicial Relations of the United State Judicial Conference (*see* www.uscourts.gov).

- In considering resources that would assist the further development of a bankruptcy practice, the new library sponsored by the World Bank for the Commercial Court should be evaluated for its current usefulness and additional needs. Additional resources might be provided in this forum, so long as they are accessible not only to judges, but also to practitioners.
- Bankruptcy should be a part of any over-arching Commercial Law curriculum that is developed through future programs. Like other commercial law topics, a substantial foundation must be provided, preferably through a certificate-granting program of no fewer than 40 hours of training time, conducted with an anonymously graded exam at the end.

F. COMPETITION

1. OVERVIEW

The goal of Competition Law is to foster a culture of competition that ultimately benefits consumers – in short, more and better goods at the best prices. A comprehensive competition regime typically encompasses a set of laws crafted for the purpose of ensuring open and free markets, preventing conduct that impedes fair competition among businesses, protecting consumers, and stimulating enterprise innovation and efficiency. Competition Law can be quite complex, and, particularly for countries that are desperate for substantial economic growth in a short amount of time, the rules it sets down against collusive activity can seem counter-intuitive.

Is Kosovo ready for a formal Competition Law? In Western democracies, the laws restricting monopolies and other unfair competition resulted from sustained public outcry over the business practices of powerful “robber barons” who monopolized certain markets or conspired to fix prices. Resulting legislation specifically disallowed price-fixing; schemes that constrained access to specific customers or geographic areas; insurmountable barriers to entry; restraints on production or sale, including quotas; and other practices which ultimately discouraged businesses from producing “more and better goods at the best prices.”

In Kosovo, there is not yet a similar demand for a Competition Law. Rather, concerns over anti-competitive practices generally arise from the unfair advantages held by Kosovo’s “gray economy.”⁴⁴ Specifically, the fact that many firms in Kosovo operate without registering, paying taxes, or observing labor, environmental or other regulations represents “a significant competitive barrier for firms operating legally.”⁴⁵ One other potential source of anti-competitive activity has been addressed through legislative action: the pending UNMIK Regulation on the Chamber of Commerce specifically ends the Chamber’s history of mandatory membership of registered enterprises, thereby facilitating creation of new business associations and, in effect, promoting genuine competition among groups formed for the purpose of supporting businesses.

⁴⁴ *See* Stuart Bell, Kosovo’s Business Environment: Constraints to Growth at 9 (World Bank, June 2004).

⁴⁵ *Id.*

The impending enactment of a Competition Law in Kosovo will generate new attention to anti-competitive practices. It may be assumed, however, that the Law's underlying principles and specific restrictions will not be immediately understood. The Law also will create a new administering agency – the Kosovo Competition Board – to be charged with enforcing the new rules. Given Kosovo's dearth of qualified professionals capable of addressing sophisticated new market-oriented initiatives, the creation of a new enforcement and policy-setting body seems on the verge of self-defeating. Assuming there is no turning back, any program in support of commercial law should anticipate that, immediately following the enactment of a Competition Law, significant training and capacity-building for the KCB and other affected constituencies will be critical.

2. LEGAL FRAMEWORK

a. The core Competition Law

Since 1990, as more than 50 developing countries have completed legislation for Competition Laws and over 25 more have launched the process for doing so, a general consensus has emerged over the necessary components of a classic Competition Law which is best suited to support a developing country's emergence into the world economy. The Model Competition Law prepared in 2003 by the United Nations Conference on Trade and Development⁴⁶ sets forth the following components:

- Objectives or purpose of the Law;
- Definitions and scope of application;
- Restrictive agreements or arrangements;
- Acts or behavior constituting an abuse of a dominant position of market power;
- Notification, examination and prohibition of mergers affecting concentrated markets;
- Notifications by enterprises;
- The relationship between the Administering Authority and regulatory bodies including sectoral regulators;
- Possible aspects of Consumer Protection;
- The Administering Authority and its organization;
- Functions and powers of the Administering Authority;
- Sanctions and relief;
- Appeals; and
- Actions for damages.

In Kosovo, the Office of the Prime Minister drafted a Competition Law in 2003, which is largely drawn from the German Law against Restraints on Competition. Enactment of the Law awaits action by the Legislative Assembly and will likely take place, reportedly, by the end of 2004. As stated in its introductory language, the draft Law seeks to “bring the regulation of anti-competitive practices in Kosovo generally into compliance with European Union requirements and internationally recognized best standards and practices.”

⁴⁶ UNCTAD, Model Law on Competition – Substantive Possible Elements for a Competition Law, Commentaries and Alternative Approaches in Existing Legislations (2003) (http://www.unctad.org/en/docs/tdrbpconf5d7rev1_en.pdf).

The draft of the Competition Law intends to apply to all “undertakings” in Kosovo – in effect, all enterprises or organizations that are engaged in economic activity. The definition of “undertakings” is very broad, and will encompass all personal businesses, all forms of corporations, all associations, and even all Socially Owned and Publicly Owned Enterprises. Although certainly not all collaborative acts among undertakings are prohibited, the mandate of the Competition Law is very broad.

The draft Law focuses on “horizontal restraints” – that is, unlawful agreements among businesses to fix prices, limit supply or otherwise drive prices up or limit competition – and abuse of dominant power in a market. The draft Law does not address mergers and acquisitions (M&A) of businesses. The sensible explanation for excluding M&A at this time is that, in an economy as small as Kosovo’s, with so few large businesses, legislating issues that might arise in the M&A context is premature.

The draft Law specifically contemplates the establishment of a five-member, highly independent competition regulatory body called the Kosovo Competition Board (KCB). The Board will be charged with investigating and enforcing alleged violations of the Competition Law, as well as with a rule-making function. The draft Law indicates that all members of the Board are expected to have a university degree, at least one member of the Board must possess “the same qualifications as those required under the applicable law for a judicial appointment,” and at least three others will likely be required to be professional economists. KCB members must be highly independent in that they may have no formal or even informal relationships with enterprises that would be within the scope of the Law. Board members will be empowered to compel testimony and, with the permission of a District Court of proper jurisdiction, seize evidence. The draft Law does not appear to require the same independence of KCB staff; additional wording expanding this expectation might be useful.

The draft Law also provides for a private right of action in court, although it seems that there is some debate at this time over whether the court with jurisdiction over KCB actions and private suits under the Competition Law will be the sole Commercial Court, located in Prishtina, or the five general-jurisdiction District Courts, located in various cities in Kosovo. In addition, although the draft Law indicates that appeals of KCB decisions may be taken, it might benefit from a clearer statement of the appeal procedure.

b. Related Laws

i. Law of Consumer Protection

As of October 2004, a Law on Consumer Protection has been enacted by the Legislative Assembly, but has not yet been promulgated by UNMIK. In general, the purpose of the Consumer Protection Law is to support the availability of truthful information about products and the reliability of express or implied promises. The Consumer Protection Law will also include prohibitions against false advertising, provisions pertaining to product safety, and the general rights to return defective items for a refund or enforce warranties.

ii. Intellectual Property protections

There are appropriate exceptions to the principles underlying a Competition Law, and the most important, perhaps, is Intellectual Property (IP). In effect, IP regulations provide that the authors, inventors, musicians and other creators have or may assign a right to profit from their creativity. As of October 2004, the anticipated Copyright Law in Kosovo was recently adopted by the Assembly. The proposed Patent Law is before the Assembly. The Trademark Law is the drafting stage with the Government.

iii. Other relevant laws and administrative rules

In many emerging markets, anti-competitive practices are disguised as legally sanctioned entry restrictions to a given area of economic activity. Thus, a Competition Law's prohibitions against restraints on trade may be subverted by a licensing authority's practice of effectively keeping newcomers out. Restrictive strategies may include overly burdensome requirements for property ownership, lengthy and cumbersome permitting processes, or inappropriate fees or deposits. Although Kosovo has the advantage of having a substantially new legal regime, the new Kosovo Competition Board should anticipate that complaints and issues pertaining to anti-competitive conduct arise from ministries and agencies that are charged with enforcing Kosovo's host of new laws.

3. IMPLEMENTING INSTITUTIONS

Kosovo Competition Board. The five-member KCB will have a broad mandate to both enforce the Competition Law and promote competition among undertakings and consumer welfare in Kosovo. The KCB is intended to be staffed with a sufficient number of support personnel to enable it to efficiently and professionally carry out its investigative, enforcement, rule-making, advisory, reporting, and educational functions. KCB members will be expected to be highly independent. Among other restrictions, members will not be allowed to have an ownership interest in, employment relationship with, or contractual relationship with any undertaking that is engaged in economic activity that has effects within Kosovo. The KCB will be comprised chiefly of lawyers and economists.

Although the design and expectations of the KCB are entirely consistent with the principles of Competition Law, the creation of a new administrative body with broad and complex new powers has the potential to be self-defeating at this time. Throughout the community engaged in Kosovo's economic reconstruction, there is a reported dearth of qualified local professionals; those who would qualify for KCB membership and could effectively operate within its mandate are likely otherwise engaged. Is it worth pulling these individuals (plus individuals who qualify as staff) away from their present obligations to investigate and enforce anti-competitive practices? This question should be seriously considered before the Competition Law is enacted and its implementation begins.

Assuming the Competition Law is enacted and the KCB is established, immediate efforts at training and capacity-building will be critical. One observer suggests that no fewer than six months of formal education in market-oriented microeconomics and principles of competition is a desirable prerequisite for not only the KCB, but also its staff.

Courts and judges. A significant point of discussion in the process of reviewing and enacting the draft Law must necessarily be the judicial authority to which the KCB will report, and the court to which appeals from KCB actions will be taken. Indeed, a major barrier to the effective implementation of a Competition Law can be that of the court system: Even if the judiciary is essentially independent, judges may have no meaningful training or experience in the application of commercial law, the use of economic analysis, or the principles of competition; or the judicial system, including the system of court administration, may harbor significant corruption. In Kosovo, training and support of those judges who are expected to enforce the Competition Law is essential. The *Kosovo Judicial Institute* is the obvious resource for training in this area.

Lawyers. Concerns about competency and conduct extend into the legal community in general, which may be called upon to serve as an implementing force through private means of redress under the Competition Law *and* to defend entities that are prosecuted under the new Law. Continuing legal education in Competition Law – preferably through a certificate-granting class with no fewer than 40 hours of training time, with an anonymously graded exam at the end – is necessary. The *Chamber of Advocats* should be evaluated specifically for its capacity to serve as a resource.

4. SUPPORTING INSTITUTIONS

Various Business Associations, including the long-established *Chamber of Commerce*, the newer *Alliance of Kosovo Businesses*, and various recently established *sector-based business associations*, can each be regarded as resources in the overall effort to improve access to and understanding of commercial law in Kosovo, including competition.

Professional associations and training institutions, including the *Kosovo Judges Association*, the *Kosovo Judicial Institute*, the *Chamber of Advocats*, and the *Kosovo Institute for Public Administrators*, should be consulted and evaluated for their ability to contribute to the effort to train judges, lawyers and public employees in the principles and details of Competition Law. A Continuing Legal Education program should not only focus on the Competition Law itself, but also on related aspects of Kosovo’s legal regime, including Kosovo’s laws of consumer protection and intellectual property, along with the competition-related aspects of the regulatory regime pertaining to specific sectors of the economy, such as pharmaceuticals, mining, and tobacco.

The *Kosovo Trust Agency (KTA)* is a supporting institution insofar as it is charged with overseeing the activities of Kosovo’s various Publicly Owned Enterprises, which are, in effect, monopolies. The KTA is overwhelmingly concerned at this time with simply getting the POEs to function. Most POEs, within the next year, will be registered as joint stock companies and operating with formal board and shareholder structures. The challenges before the POEs are monstrous and they involve reform of all tasks that permeate their operations: executive management, financial management, human resources management, facilities recovery and rehabilitation, environmental concerns, and more. Nonetheless, insofar as the POEs are covered by the Competition Law – and they do fit the draft Law’s definition of “undertaking” – the KTA must serve as a monitor of anti-competitive practices – chiefly, the abuse of dominant position in the market. Of course, such monitoring is consistent with KTA’s role in developing sound corporate governance practices within the POEs.

The ***Banking and Payment Authority of Kosovo (BPK)*** might be an appropriate resource to assist in teaching banks in Kosovo about the fundamentals of Competition Law.

Prishtina University should be educating its students in law and economics in the contemporary principles of Competition Law and the professors who are teaching the courses themselves should be supported in their efforts to become up-to-date.

5. SOCIAL DYNAMICS

To repeat the question asked at the outset of this chapter: Is Kosovo ready for a formal Competition Law? Very little demand for the Law exists. In fact, a promising anecdote suggests that market forces are up to the challenge of combating anti-competitive behavior: In or about 2001, when a consortium of bakeries conspired to fix bread prices in Kosovo, the combined forces of public outcry, media attention, and individual seller defiance resulted in a quick and efficient ending to the scheme. Whether a new administrative body could do a better job at fixing the problem is far from certain.

Moreover, as noted, the supply of professionals and resources that are capable of implementing a new Competition Law is virtually non-existent at this time. Frank discussion about Kosovo's readiness for a competition regime, and the willingness of donors to support it, is necessary. There must be serious consideration of the likelihood that investment in a Competition Law, including the development of requisite policies and institutions, may take place at the cost of other approaches to eliminating restrictive business practices and may even amount to a detraction of resources from Kosovo's more fundamental needs of economic reconstruction.⁴⁷

Prior to enacting the Law, decision-makers should consider other approaches to encouraging increased competitiveness in Kosovo, and whether those approaches afford more "bang for the buck." Other approaches may include the following:

- Capital improvements to transportation or telecommunications capacities, thereby increasing the ability of enterprises located in different geographic regions to compete with each other;
- Legal reforms that eliminate licensing-related barriers to entry, deregulate prices, or discourage collusive business habits; or
- Increased enforcement of laws that are intended to limit the anti-competitive influence of the gray economy, including laws of business registration, labor and employment, environmental practices, taxes, or trade.

⁴⁷ See Cynthia L. Clement, Andrew Gavil, Georges Korsum and William Kovacic, *Competition Policies for Growth: Legal and Regulatory Framework for SSA Countries* 3-4 (2001). See also Ioannis Lianos, *Report of the Workshop: Competition Policy and Economic Development: The Costs and Benefits of Multilateral Principles on Competition for Developing Economies* (Institute for International Law and Justice, New York University Law School, November 2, 2002).

On the other hand, the reality of ever-increasing integration of world economic activity suggests that a common set of rules pertaining to collusive business practices, market domination, and competition in general is unavoidable, and that Kosovo might as well go forward with launching its own program. Clearly, governments that support culture of competition through legal means signal a genuine interest in their citizens' quality of life, which is itself an indicator of greater economic improvements to come.

6. RECOMMENDATIONS

- Whether Kosovo is ready for a new regime in Competition Law is a question that must be seriously considered by all interested actors, including the Legislative Assembly, UNMIK, and the community of donors. Assuming that the need for a Competition Law is agreed upon, a detailed long-term plan for effective implementation should coincide with its enactment.
- Support for a newly established Kosovo Competition Board should encompass such approaches as short and long-term technical assistance, resident advisors and mentoring, training curriculum development and execution, public information programs, and assistance in sharing information with the Board's sister agencies in other countries. Failure to provide the KCB with sufficient resources will undermine its ability to establish credibility and garner public support from the outset.
- The KCB's public outreach and education efforts should necessarily involve Kosovo's prominent business and banking associations so that their constituencies can be fairly apprised of new rules affecting business practices.
- Competition should be a part of any over-arching Commercial Law curriculum that is developed for judges and lawyers. Like other commercial law topics, a substantial foundation must be provided, preferably through a certificate-granting program of no fewer than 40 hours of training time, with an anonymously graded exam at the end.
- The law and economics faculties at Prishtina University should be included in substantive discussions and curriculum development efforts pertaining to Competition Law so that students may be sufficiently prepared in this area.

G. FOREIGN DIRECT INVESTMENT

1. OVERVIEW

It would be an understatement to say that Kosovo is somewhat unique in the world of investment opportunities. Its undecided political status creates considerable uncertainty, anathema to investors, which is only exacerbated by its poor economic performance, all-too-often troubled relationships with its regional neighbors, and its landlocked geographic position. However, the changes that are underway in Kosovo create opportunities that could encourage foreign investors provided that the return is attractive when compared to their other options and the risks they are taking.

The need for increased foreign investment in Kosovo requires no elaboration. Furthermore, there has been little debate in Kosovo about the utility of a foreign investment law aimed at making Kosovo more attractive to outside investors.⁴⁸ UNMIK promulgated the current investment legislation in early 2001 and the Government is now drafting its own law which will provide certain incentives to investors. Despite this, better foreign investment laws are unlikely to have much impact on the quality or quantity of foreign investment in Kosovo. Political resolution of Kosovo's status, improved economic outlook, and better promotion of Kosovo's investment opportunities will.

2. LEGAL FRAMEWORK

UNMIK Regulation 2001/3 provides the existing legal framework regulating foreign investment in Kosovo. As discussed below, it is generally in keeping with international standards for such legislation. In addition to the protections currently offered by this regulation, it is useful to note that UNMIK, on behalf of Kosovo, has signed an investment protection agreement with its regional neighbor Albania and the Provisional Government is drafting a new foreign investment law – in several ways, each of these documents improves upon some of the deficiencies in the UNMIK regulation.

a. UNMIK Regulation on Foreign Investment⁴⁹

Since January 2001, this UNMIK regulation has provided the basis for foreign investments in Kosovo, although there is no indication that having such a regulation has had any major impact on attracting investors to Kosovo. Its 18 sections outline a rather streamlined regime which includes the following principle protections:

- national treatment - that is, treatment with respect to all laws, regulations, instructions, etc. that is not less favorable than that accorded to similar domestic business organizations (Sections 2 and 3);
- non-discriminatory - prohibition on discrimination against investors from a particular countries (Section 13);
- no *ex post factor* laws - prohibition on legislation that imposes less favorable conditions on investments from being applied retroactively (Section 12);
- no expropriation – no such “taking” is permitted, except for an overriding public purpose; in such event, there will be a prompt hearing based on due process and timely payment of fair market value compensation (Section 7);

⁴⁸ There is an ongoing debate in legal development circles whether foreign direct investment (FDI) laws are actually needed. Opponents of such laws argue that they are unnecessary, add no particular value, and can distract from the real issue, which is the overall climate for investment of any sort, not just foreign investment. Proponents insist that a foreign investment law is a useful tool for identifying those issues that are important to foreign investors, and, by putting them all in one place, sends a message that foreign investment is welcome.

⁴⁹ UNMIK Regulation 2001/13 on Foreign Investment in Kosovo, 12 January 2001.

- right of repatriation, conversion – unrestricted right to use the investment and any incomes; that is, all lawful proceeds may be retained or disposed of in any manner, including repatriation or conversion to another currency (Section 9);
- protection against extraordinary events - same rights and protections as domestic businesses where losses accrue due to war, revolution, civil disturbances, etc. (Section 8);
- right to employ expatriate personnel (Section 16);
- alternative dispute resolution - right to utilize arbitration or other procedures and to make the judgment binding and final (Section 17).

The International Center for Settlement of Investment Disputes (ICSID) has published a set of well-regarded international standards for foreign investment laws.⁵⁰ Accepting that this model investment law presents a “best case” scenario that most developing countries cannot fully meet, it is nonetheless a useful baseline against which to compare the UNMIK regulation. Such a comparison reveals the following main deficiencies in the current Kosovo legislation:

- Guiding principles – fails to guaranty to foreign investors and investments “fair and equitable treatment” and “full and constant protection and security”, as well as treatment no less favorable than that required by *international law*; such broad language would encourage investors and provide a backdrop against which other specific provisions are implemented and tools for interpreting and applying the law;
- Non-interference and respect of rights – lacks an explicit statement that there will be no interference by Kosovo with the lawful activities, rights, and recognized interests of the investor; similarly it lacks an explicit statement that Kosovo shall recognize all rights of foreign investors regarding ownership or use of land, intellectual property, or other assets or rights;
- Extent of national treatment – confusingly, the definition of national treatment extends protection only to “foreign investments” and not explicitly to “foreign investors”, but some of the examples provided refer to foreign investors also; in any event, an investors’ right to own property does not include agricultural lands under the UNMIK regulation;
- Compliance with obligations - fails to provide an explicit statement that the Host State will comply with all obligations it has towards foreign investors;
- Liability of local officials – no provision that officials who do not comply with the investment law will be held liable; no specific right to compensation for losses incurred due to good faith reliance on unauthorized actions by officials or due to actions or inactions by officials that violate domestic or international law;

⁵⁰ *Basic Elements for Foreign Investment Legislation in the NIS*, Foreign Investment Law Journal, International Centre for Settlement of Investment Disputes (ICSID), Volume 16, Number 1, Spring 2001.

- Stabilization – does not provide protections / compensation against prospective changes, that are detrimental, in the foreign investment law (at least for some defined period of time);
- Conflicting provisions - no provision giving investors the most favorable treatment where there are conflicting provisions among clauses in the foreign investment law or between the investment law and other legislation;
- Expropriation - the limitation on expropriation does not include UNMIK’s own administration of property;
- Expatriate personnel - the UNMIK regulation is more restrictive than the model law in providing for expatriate personnel; for example, there is no reference to freedom of movement, transferability of expat salaries, etc.;
- Guaranteed transfers – the UNMIK regulation refers only to “unrestricted right to use investments and incomes”, including repatriation or conversion, but does not explicitly state (as does the model law) that this right includes initial capital and additions thereto, returns, contract payments, proceeds from liquidation, payments from dispute settlements, and earnings and other remuneration of personnel; the model law provides an explicit right to liquidate or terminate an investment and repatriate the assets;
- Foreign investment agency – lacks provisions for an agency to promote investment, assist investors, provide clarifications of the investment law or other legislation.

It is arguable that certain sections of the UNMIK regulation could be read broadly so as to include or address some of the deficiencies and issues raised above. However, investors, particularly those new to a foreign region and its laws, want clarity and it would behoove Kosovo to make the language of its foreign investment legislation as robust, expansive, and well defined as possible. Only in this way will investors understand the protections, be able to better evaluate their risks, and view Kosovo as a more attractive location.

The model investment law also calls for the Host State to make provision for investment guarantee programs. Such a provision is not specifically included in the UNMIK investment regulation. However, a separate agreement was signed in May 2002 between UNMIK and the Overseas Private Investment Corporation, an arm of the United States Government, which provides such investment insurance.⁵¹

⁵¹ Agreement for Investment Support for Projects in Kosovo between the Government of the United States of America and the United Nations Interim Administration Mission in Kosovo, 30 May 2002.

b. Foreign Investment Agreement with Albania

On behalf of Kosovo, UNMIK concluded an investment agreement with Albania in February 2004.⁵² While of limited application in that it only applies to Albania and Kosovo, the language of the agreement is an improvement over the existing UNMIK regulation, suggesting that some of the deficiencies of the regulation have been recognized. Although not all elements of the ICSID model law have been incorporated, it is obvious that the drafters of the agreement made use of the ICSID document.

The text of the Albanian agreement is more expansive and clear with regard to a number of issues. Of particular note are the following improvements (over the terms in the UNMIK regulation): i) a broad definition of what types of “investments” are subject to the agreement; ii) inclusion of basic protections such as “fair and equitable treatment”, “full legal protection and security”, and no “treatment less favorable than that required by international law”; iii) an explicit statement of non-interference in the lawful activities of investors; iv) an explicit statement of the right to liquidate an investment; v) a detailed list of the types of property that can be repatriated or converted (including earnings and remuneration of expat employees), vi) most favorable treatment where the agreement conflicts with domestic legislation or international obligations of either Party; vii) no limitation on the right to own agricultural land.

c. Draft Law on Foreign Investments

The Government is preparing a new law on foreign investment. The document was originally drafted by the Ministry of Trade & Industry which has responsibility for overseeing and attracting foreign investment to Kosovo.⁵³ At the time of this writing, the Cabinet had sent the draft law back to an inter-ministerial working group for further clarifications, particularly with regard to its incentives provisions. Even after the law is adopted by the Government, it may face changes in the Assembly over the coming months, and we cannot be sure of its final form. For this reasons, and also due to the translation problem raised below, our comments on this draft are limited.

At the outset, it has to be said that the English translation of the official draft of this law is extremely poor. This has greatly hindered our ability to comment; too frequently we simply could not understand what particular provisions were trying to convey. In some cases, the Albanian language text was also confusing to a local Kosovar lawyer whom we consulted. It is absolutely essential that this law be properly translated so that potential investors can understand what protections are being offered through this legislation. A poor translation will only tend to put potential investors off.

⁵² Agreement between the United Nations Interim Administration Mission in Kosovo Acting for the Provisional Institutions of Self-Government in Kosovo and the Council of Ministers of the Republic of Albania on the Reciprocal Promotion and Protection of Investments, 19 February 2004.

⁵³ UNMIK Regulation 2000/63 on the Establishment of the Administrative Department of Trade & Industry, 7 December 2000.

In summary, the draft law is a mixed result – in some places it improves on the existing UNMIK regulation, in others it takes a step backwards. The drafters do not appear to have considered the text of the ICSID model law. Our key observations:

- Basic protections – many of the basic protections are provided for: national treatment; right to repatriate profits and convert to other currencies; right to liquidate; right to fully participate in the management of the investment; no expropriation; a right to compensation where there are losses due to “extraordinary events” (but that term is not defined). It seems to protect against retroactive legislation, but the text is very convoluted. However, unlike the UNMIK regulation, there is no specific non-discrimination clause as regards the treatment of investors;
- Real property – investors can buy all types of real estate under the draft law; there is no limitation to non-agricultural land as in the UNMIK regulation;
- Responsibility of officials – in an improvement on the UNMIK regulation, the draft legislation makes government officials, who violate the investment law, legally responsible for their actions;
- Definitions – there are two different definitions of “foreign investor” in the draft; they are similar, but not the same and this is sure to cause confusion;
- Employment contracts – those working for foreign investors have the protections not only of local laws, but also of rights defined by the International Labor Organization and “other international standards”; these are unclear criteria and raise the question as to whether foreign investors are being held to a higher standard than local employers;
- Foreign investment agency – the draft mentions an investment agency in several articles, but strangely does not actually provide for its establishment;
- Conflict resolution – although parties can elect to use arbitration, the draft law would require them to apply UNICTRAL rules; some investors may prefer to use rules defined by other organizations (e.g., International Chamber of Commerce);
- Investment data – investors must provide (undefined) data to the investment agency and this may be disclosed to the public based upon a decision of the agency’s managing board; this needs clarification, as some investors may object to certain information being made public;
- Investment contracts – one article purports to define the contents of such contracts; these terms would only apply where there are several shareholders in an investment; it is not clear why these specifications of the contract terms in this particular situation are required.

In perhaps the biggest change from the current UNMIK Regulation, the new draft investment law provides incentives to potential investors in terms of tax holidays and reductions in customs duties. These provisions are being re-written at the request of the Cabinet, and without knowing

their final form, we cannot comment on the specifics of the incentives. However, these investment incentives raise a number of issues:

- First, it is not clear on the face of the draft law that the incentives are available only foreign investors. If they are available to domestic and foreign investors alike, one has to wonder why these provisions are included in a foreign investment law. There are many who would argue that tax and customs incentives belong in laws that deal with those specific topics and not in investment legislation.
- If the incentives are intended to apply only to foreign investors, domestic investors with sufficient capital might seek to obtain foreign citizenship or create foreign companies in order to meet the definition of a “foreign investor.” This would put domestic investors at a competitive disadvantage vis a vis “true” foreigners by virtue of the extra costs incurred in “becoming foreign.”
- As a policy matter, why should the incentives apply only to foreigners? Investment legislation should seek to encourage all investors, domestic and foreign, to place their funds in Kosovo.
- As a practical matter, does Kosovo have adequate fiscal resources so that it can afford to provide these incentives?

d. Regional and International Trade & Investment Initiatives⁵⁴

Kosovo participates in a limited number of regional and international initiatives and agreements that, collectively, provide a positive indication that Kosovo desires to move toward international standards in its foreign business and economic relationships. Perhaps most importantly, UNMIK and PISG representatives take part in a number of the activities and task forces established by the Stability Pact for Southeast Europe.⁵⁵

i. Trade

With regard to the Stability Pact, Kosovo has participated officially since February 2003 as an observer in the Trade Working Group. Importantly, in May 2003 UNMIK indicated its commitment to the obligations of the “Memorandum of Understanding on Trade Liberalization and Facilitation” signed by regional countries in June 2001. In line with this memorandum, UNMIK has launched trade negotiations with neighboring countries. However, to date, only a bilateral trade agreement has been signed with Albania. Discussions with Macedonia have been

⁵⁴ This section has been drawn from the website of the Stability Pact for Southeast Europe (www.stabilitypact.org) and a June 2004 paper entitled *Trade Policy for Kosovo* prepared by the Ministry of Trade & Industry and the UNMIK European Union Pillar.

⁵⁵ Given its non-sovereign status, Kosovo participates in these initiatives through UNMIK, but this has been endorsed and supported by Kosovars through the participation of PISG. UNMIK’s competence to engage in international agreements on Kosovo’s behalf is derived at a fundamental level from United Nations Security Council Resolution 1244.

ongoing, but have not resulted in any agreement.⁵⁶ Trade with Serbia & Montenegro is not subject to customs duties.

Since 2003, a Kosovo businessman has been a member of the Business Advisory Council, a Stability Pact body which aims to build viable partnerships between governments and the private sector in the region. In September 2003 a Council mission brought international business people to Kosovo to discuss the investment environment.

Kosovo participates in the Regional Electricity Market initiative sponsored by the Stability Pact and European Union and has signed the “Memorandum of Understanding on Regional Electricity Market in South East Europe.”⁵⁷ Kosovo also enjoys customs-free access to the European Union market as provided for in the EU’s Autonomous Trade Preference Regime.⁵⁸ However the poor quality of Kosovar products means that little advantage has been taken of this opportunity.

ii. Investment

Kosovo participates in the Stability Pact’s Investment Compact for Southeast Europe which aims to develop country specific policy recommendations, as well as monitor progress in regional policy implementation, improvement of investment conditions, and investment performance.

Importantly, the countries participating in the Investment Pact agreed to a set of common principles and best practices with regard to attracting investment.⁵⁹ While not a formal signatory of this agreement, Kosovo would do well to observe its obligations as it drafts a new foreign investment law. The principles and best practices reflect the key components set out in ICSID’s model law.

3. IMPLEMENTING INSTITUTIONS

a. Ministry of Trade & Industry

There is no true implementing institution in existence at the moment. The Ministry of Trade & Industry is responsible within the Government for foreign investment, but the relevant department poorly staffed and minimally resourced. Its director is not an English-speaker and was unable to provide more than the barest minimum of data on foreign investment in Kosovo. Other staff members, while enthusiastic, are at a junior level. The department is hidden away in the basement of the Ministry and, in general, does not exhibit the high profile, focus, and level of energy that will be necessary to make an investment program successful.

⁵⁶ With regard to Macedonia, UNMIK has agreed to follow the 1996 Trade Agreement between the former Yugoslavia and Macedonia. This agreement allows the duty-free import of goods from Macedonia and thus provides little incentive for Macedonia to sign a free trade agreement with Kosovo under which it would have to provide reciprocal trade privileges.

⁵⁷ Kosovo became integrated into the European Union Internal Electricity Market in November 2002 in Athens.

⁵⁸ Council Resolution (EU) 2007/2000.

⁵⁹ Ministerial Declaration on Attracting Investment to South East Europe: Common Principles and Best Practices, adopted at the Ministerial Conference held in Vienna on 18 July 2002.

The Ministries activities with investors appear to be sporadic and are not driven by any strategy. There is an upcoming investment conference which the Ministry will co-host along with the U.S. Office in Pristina and the American Chamber of Commerce, but otherwise there was no other schedule of promotional activities with investors. We are not aware of other major drives to attract investors and inform them about opportunities other than several “Invest in Kosovo” conferences presented by the Kosovo Trust Authority (KTA) in Frankfurt, London, and New York in October 2003.

b. Foreign Investment Agency (proposed)

The Foreign Investment Agency proposed under the draft Foreign Investment Law could provide the needed focus, but the Agency is still on the drawing boards and it will take time to be established even after the law is passed. The Agency will have an uphill battle to promote investment in a land-locked country with a small market, an unsettled political status, and beset by problems of corruption and bureaucratic incompetence. Some serious strategic thinking of the role and mission of the Agency will be essential to its success.

First and foremost, the new Agency must get in touch with, and constantly stay in touch with, its customers, potential foreign investors. There will be a big premium on understanding their needs and decision-making processes and being responsive to those.

At a bare minimum, the Foreign Investment Agency will need:

- clear mandate and objectives – the Agency should be designated the focal point for contacts and negotiations with investors so that a consistent message is being delivered;
- adequate resources and research capabilities – an investment agency is often the first contact that potential investors have with a country and is significant in creating an investor’s first impression; therefore, it should not be hampered with constant budget problems or lack of information that hamper its preparedness or responsiveness;
- proper management and staff – the agency should focus on hiring individuals who can present an enthusiastic and positive image; they must be born marketers and speak foreign languages; political appointments should be avoided; adequate training is essential to ensure that they are knowledgeable about Kosovo;
- cooperation throughout the government – investors will come in contact with a variety of government offices; these in turn must understand that their cooperation is essential to convincing an investor to select Kosovo;
- clear strategy: the agency needs a clear strategy and targeted groups of investors where it is likely to achieve success; using a “shotgun” approach will waste time and resources; there must be a disciplined plan for contact and follow-up.

In particular, we note that no statistics on foreign investment are being collected at present. It is essential that the Government, and especially the proposed Foreign Investment Agency, collect

and analyze data on the level of investment, where the investment is going, and the sources of the investment funds.

4. SUPPORTING INSTITUTIONS

Any institution with which foreign investors come into contact can influence, positively or negatively, their experience in Kosovo and their willingness to invest there. Below we outline observations regarding government institutions, professional associations, specialized services and trade associations and their impact on foreign investment.

a. Government entities

Our limited discussions with investors have not indicated any particular discrimination against them. However, there are issues or perceptions that have arisen as a result of investor experiences with various Government entities.⁶⁰ The most pervasive issue is corruption; it was found to be the primary barrier to foreign investment in the Riinvest study and was consistently raised in our interviews. Other issues concerning Government entities include:

- Courts and legal system - lack of clarity as to what is the applicable law; not viewed as capable of protecting rights; existing laws and regulations are not being enforced (e.g., building permits);
- Customs – there is a new law that is EU compliant, but there are complaints that implementation is inconsistent; individuals with “friends” among customs officers received special treatment;
- Taxation – there are comments regarding inconsistent assessments, as well as of harassment by tax officials;
- Property rights – the primary concern here is that one cannot get clear title to land;
- Intellectual property - existing IP laws are adequate and new ones are currently in the drafting/approval stage, but the laws currently on the books are simply not being enforced.
- Municipalities – lack the knowledge or motivation to operate efficiently.

Government needs to appreciate that these are issues keeping investors away. They need to be evaluated and aggressively acted upon if foreign investment is to be increased.

⁶⁰ The results of our interviews were consistent with an extensive report entitled *Foreign Direct Investment in Kosovo – Policy Environment and Promotional Strategy*, prepared by the Riinvest Institute for Development Research in cooperation with the Center for International Private Enterprise, dated 19 September 2002. In turn, that report and our interviews were also consistent with a more recent article published by Henry Perritt entitled *Economic Sustainability and Final Status for Kosovo*, *supra* note 8.

b. Professional associations

Commercial Lawyers. The Chamber of Advocats has no specialized section dealing with foreign investment law issues. At present only two or three law firms are getting most of the business with foreign investors. This would indicate that the law faculty and the Chamber need to place more emphasis and training on international business issues, the legal needs of foreign investors, transactions and how to develop legal services with foreign investors. As with other areas of law, the situation is compounded by a lack of continuing legal education and other training and outreach initiatives to explain the recent and future changes in foreign investment laws.

Accountants and auditors. While international accounting standards are now the law in Kosovo, we understand that they are not being widely implemented. Furthermore, there are apparently only a handful of qualified auditors in Kosovo. Investors will demand international standards, both in terms of the accounting rules being applied and the quality of auditing and accounting services available. Business and economics faculties, as well as the Association of Independent Auditors and the Society for Certification of Accountants & Auditors in Kosovo, need to take note of this and support the development of greater numbers of qualified accountants.

c. Specialized services

A credit bureau, the Kosovo Credit Information System, was originally established by two local banks, but this service will soon be taken over by the Banking & Payments Authority.

Commercial arbitration of the kind used for resolving commercial disputes is almost unknown in Kosovo at present. Although parties can include an arbitration clause in a contract if they so choose, this is not a wide-spread practice. There is no arbitration law which would help to facilitate implementation of such a procedure and we could not identify any commercial arbitration services or commercial arbitrators.

d. Trade associations

Although there are a number of trade and industry associations in Kosovo, at present they do not play any significant role in supporting foreign investment. However, they could do so by taking a leading role in improving the general business environment and promoting investment opportunities to their contacts abroad.

American Chamber of Commerce. The American Chamber of Commerce in Kosovo (AmCham) has only been recently established, but will undoubtedly become the primary organization representing foreign investors in Kosovo. Although in its infancy, this organization is quickly moving to promote investment and raise issues of importance to foreign investors. It will be a key sponsor, along with the U.S. Office in Pristina and the Ministry of Trade & Industry, of a trade and investment conference in Pristina from September 26 – 29. The Chamber is just beginning to develop an agenda that will likely focus on economic development in Kosovo, push for greater consistency in the implementation of the customs and tax laws,

encourage the enforcement of existing legislation with particular emphasis on intellectual property laws and permitting – all of these are issues of importance to foreign investors. In addition, AmCham intends to take seriously its civic society role in monitoring and influencing legislation that is important to investors.

Kosovo Chamber of Commerce. The Chamber is in transition as it moves to non-mandatory membership and explores ways to provide value-added services that will attract members. At present it is not having any particular role in promoting foreign investment, despite having been encouraged to do so.

5. SOCIAL DYNAMICS

The market for reform in this area is somewhat complicated. So many entities (e.g., government ministries and agencies, the courts, municipalities, financial institutions, lawyers, accountants, other service providers, etc.) influence foreign investment, affect the experience that investors have in Kosovo, and have a stake in whether foreign investment is successful or not. At present, without a Foreign Investment Agency, it is difficult, if not impossible, to find a locus of demand for positive change in the relevant laws and the other action necessary to improve the investment climate.

Leaving aside the critical issue of Kosovo's final status, most demand is not for a change in the foreign investment law, but for improvement in the underlying economic situation as well as and consistent and more aggressive enforcement of existing laws (e.g., protections of intellectual property).

Kosovo is simply not an attractive investment location at this time for most forms of investment. The risks of failure due to non-market factors such as corruption, administrative barriers, and uncertainty in the legal regime are high for all investors, and particularly so for foreign investors who are not yet familiar with doing business here. These frustrations are beginning to be expressed through AmCham and other groups, but Kosovo also needs a better-developed civic society with a capacity for formal complaint and lobbying.

The proposed Foreign Investment Agency can play a key role if properly funded and staffed. As it courts investors, it needs to listen carefully to their needs and to respond as efficiently and effectively as possible. In addition to responding directly, the agency needs to advise Government of investor attitudes and requirements so that policy is not made in a vacuum, but is also responsive to investors.

6. RECOMMENDATIONS

There is little doubt, among our interviewees and other commentators, that the resolution of Kosovo's political status is the most important factor in increasing foreign investment. As has been suggested above, there are other important, but secondary, issues that need to be addressed. A summary of our recommendations includes:

- **Foreign investment law.** The deficiencies in the current UNMIK investment regulation need to be addressed. However, the current draft law has its own problems and is not yet

a worthy successor. Significant consideration should be given to incorporating the principles and language outlined in the ICSID model law and the best practices adopted by the Investment Pact;

- **Foreign investment agency.** The Agency needs to be created to provide a focal point and facilitator for investors. But as noted above, its success will depend on having the right leadership and staff, adequate resources, and a well planned strategy. Much more in the way of promotion needs to be done;
- **Commercial lawyers.**⁶¹ More lawyers with commercial and international business transaction skills are needed and the Chamber of Advocats must respond and support its membership in the necessary skills development, including practical elements such as drafting and negotiating. The law faculty also needs to make necessary changes to its curriculum so that students begin to develop the necessary skills.
- **Business environment.** Investors have raised issues with regard to the inconsistent implementation of other laws such as customs, profit tax, and VAT, as well as concerns about getting clear title under the existing property laws. Corruption continues to be a major problem in key areas such as the courts and municipalities. The Government simply must listen to these investor concerns and take whatever action is necessary.
- **Alternative dispute resolution.** There needs to be a law providing for both arbitration and mediation in Kosovo and support for the development of local commercial services that can provide these.

⁶¹ Most of the recommendations in the section on Contract Law are also directly applicable here, as they are aimed at improving the types of skills needed by lawyers serving foreign investors.