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## Argument for the Allocation of Resources to the Development of a Well-Defined System of Real Property Law in the Czech Republic

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# NOTE

## **Argument for the Allocation of Resources to the Development of a Well-Defined System of Real Property Law in the Czech Republic**

### ABSTRACT

*This Note analyzes the enormous burden that the Czech Republic faces in its transition from a command to a market economy. Part of the burden is the privatization of real property. Toward privatization, the government of the Czech Republic has thus far focused its resources on allocating real property to private parties through the process of restitution. Technically, title to real property in the Czech Republic has always been held by private parties, but such ownership was meaningless because the state had virtually limitless power to use the property. The author recognizes that unless the Czech government develops substantive real property law, it will remain unclear whether privatization is really being accomplished or whether restitution merely achieves the transfer of the same hollow ownership rights. The author concludes that the Czech government should allocate resources to the development of a relatively well-defined system of real property law to ensure genuine privatization of real property and to encourage foreign investment in the Czech Republic.*

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## I. INTRODUCTION

The fall of communism in Eastern Europe is accurately described as cataclysmic and without historical precedent.<sup>1</sup> The creation of clear and reliable real property rights—indeed, more

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1. Paul H. Brietzke, *Designing the Legal Frameworks for Markets in Eastern Europe*, 7 TRANSNAT'L LAW 35, 35 (1994). The new democracies face the enormous burden of attempting to simultaneously accomplish three steps, which the Western-style democracies performed consecutively over the course of a century or more: "[T]he generation of a market economy, the establishment of the rule of law . . . and the institutionalization of democratic rule." *Id.* at 36 (quoting Ulrich K. Preuss, *The Politics of Constitution-Making*, 13 LAW & POLY 107, 111-12 (1991)).

accurately the creation of a "private property regime"<sup>2</sup>—is a precondition of the transition from a command to a market economy.<sup>3</sup>

Over the past six years, at least eleven Eastern European countries have considered major legislation regarding the privatization or reprivatization<sup>4</sup> of nationalized property.<sup>5</sup> Most of this legislation addresses the allocation of nationalized property, with a varying emphasis on the reservation of some property to compensate citizens who had been deprived of property by the previous regime.<sup>6</sup> Legislation in the Czech Republic establishes rules regarding the allocation of real property and eligibility to hold title to real property, but fails to address more detailed considerations, such as the rights and responsibilities associated with ownership.<sup>7</sup> The debates over property distribution measures and the related questions concerning restitution distract governments from reforms that will be more important in the long run, including the creation of appropriate property laws.<sup>8</sup>

For example, other than programs of privatization or reprivatization, Czech government reforms have not addressed the general liberalization of real property, and the government has

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2. Alan Aisbett, *European Property Law in Hungary and Czechoslovakia*, ESTATES GAZETTE, Aug. 3, 1991, available in LEXIS, World Library, Reuters Textline File.

3. See, e.g., Richard W. Crowder, Comment, *Restitution in the Czech Republic: Problems and Prague-Nosts*, 5 IND. INT'L & COMP. L. REV. 237, 252 (1994); ROMAN FRYDMAN & ANDRZEJ RAPACZYNSKI, PRIVATIZATION IN EASTERN EUROPE: IS THE STATE WITHERING AWAY? 170 (1994).

In the context of Eastern Europe, privatization was inherently tied to a systemic transition and the creation of what may be called a "private property regime," i.e. a social and economic order defining a new set of expectations that individuals may have with respect to their ability to dispose of the assets recognized as "theirs" by the legal system.

*Id.* at 169; see also Aisbett, *supra* note 2.

4. Anne Gelpern, *The Laws and Politics of Reprivatization in East-Central Europe: A Comparison*, 14 U. PA. J. INT'L BUS. L. 315, 315 (using the term "reprivatization" to include concepts of compensation and restitution).

5. *Id.*

6. Brietzke, *supra* note 1, at 41. One of the prominent issues to be resolved is the question of restitution or compensation to owners of land expropriated or confiscated by the socialist states at the end of the Second World War. *Id.*

7. In the absence of an established system of property rights, the property allocated through the privatization programs implemented in Eastern Europe may fail to convey "the vested type of entitlements they are intended to transfer." FRYDMAN & RAPALZYNSKI, *supra* note 3, at 174.

8. Richard S. Gruner, *Of Czechoslovakia and Ourselves: Essential Legal Supports for a Free Market Economy*, 15 HASTINGS INT'L & COMP. L. REV. 33, 51 n.102 (1991).

assigned a low priority to the creation of real property law.<sup>9</sup> The desire of the Czech government,<sup>10</sup> as may be reflected in the legislation described above, "seems to be to establish the rightfulness and sanctity of broad private property rights rather than getting mired in the details that will take years to elaborate fully."<sup>11</sup> However, as one commentator has observed, "the soul of the law is in the details."<sup>12</sup>

Part II of this Note outlines the history of nationalization of property in Czechoslovakia and describes the details of existing real property law provided in the Czech Civil Code. Part III focuses on developments in real property law after the fall of communism in Czechoslovakia, including reforms in the Constitution of the Czech Republic, the Czech Commercial Code, and the Law on Land Ownership. Part IV of this Note comments on the sufficiency of those laws and concludes that it is worth allocating resources to the establishment of a well-defined system of real property law. Part V explores why the Czech government should undertake the challenge of creating a system of well-defined property rights. And, Part VI of this Note addresses the considerations that should prevail in the formulation of new law. Part V will further present some options for the process of creating new law. Specifically, Part VI stresses the importance of uniformity of real property law across national borders in order to encourage foreign investment, and suggests how such uniformity might be achieved.

## II. THE HISTORY OF LAND OWNERSHIP RIGHTS IN CZECHOSLOVAKIA: FROM FORMATION TO THE VELVET REVOLUTION

Soon after the Second World War, the Communist Party seized power in Czechoslovakia and began aggressively

9. Aisbett, *supra* note 2.

10. The Czech reforms emphasize allocation of real property, but fail to address specific issues with regard to real property law that will be critical in the long run.

11. Brietzke, *supra* note 1, at 36 (citing Paul H. Brietzke, *Law, Democratization and Markets*, in *LAW AND ECONOMICS: NEW AND CRITICAL PERSPECTIVES* (Christopher K. Braun & Robin P. Malloy eds., 1995)). Almost all of the influential foreign consultants in Eastern Europe have been neoclassical economists. Professor Brietzke describes neoclassical economists as those "who adhere to the tenets of the Chicago school of law and economics." *Id.* He elaborates that such economists generally reason that constitutions should establish broad and absolute property rights that would narrowly constrain government activities and give free play to private initiatives under private law. *Id.* at 38.

12. *Id.* at 43.

nationalizing property.<sup>13</sup> In 1947 and 1948, laws were adopted whereby the state confiscated from citizens any private landholdings of more than fifty hectares.<sup>14</sup> Technically, the state did not retain these lands, but rather allocated them to other citizens, who held title.<sup>15</sup> The state granted to citizens to whom the land was allocated "[a] certain 'fiction' of retained ownership"<sup>16</sup> under additional legal regulations, which, for the most part, established conditions for the collectivization of agriculture. The regulations aimed to increase the size of farm production entities at the cost of eliminating small- and medium-sized farming operations.<sup>17</sup>

By 1950, the Czechoslovakian government had confiscated large amounts of property from private citizens, and had retransferred it to other private citizens who, in theory only, retained ownership. This transfer alone, of course, did not accomplish the state's goal of forming large, cooperative farms. The state enacted laws to further drive the agricultural cooperative movement.<sup>18</sup> Under these laws, three major rights vested in the state by which the state could appropriate "privately owned" land for its use. These rights included the right to impose

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13. Prior to its seizure, Czechoslovakia was a democratic state, although it had only recently been liberated from Nazi Germany. Czechoslovakia was formed following the collapse of the Austro-Hungarian empire at the end of the First World War. Coopers & Lybrand, *Eastern Europe Business & Investment Guides: The Czech Republic* § 2.1, March 24, 1994, available in LEXIS, Europe Library, EEBIG File. After formation, Czechoslovakia consisted of Czech lands (Bohemia, Moravia, and Silesia), Upper Hungary (Slovakia) and part of what is now the Ukraine (Ruthenia). From the end of the First World War until 1938, the country existed as a progressive liberal democracy. *Id.* The country was subsequently dismembered under the Munich Agreement, by which Hitler was allowed to annex the then Sudetenland region of Czechoslovakia. *Id.* Less than six months later, Nazi troops marched into Prague. Crowder, *supra* note 3, at 238. During the Second World War, Ruthenia and the territories now part of the Czech Republic were swallowed by the Third Reich, while the territory that is now Slovakia was established as a separate state. Coopers & Lybrand, *supra*, § 2.1. After the Second World War, Ruthenia joined the Ukraine and Czechoslovakia was restored as a democratic state. *Id.*

14. Czechoslovak Law No. 229 on Land Ownership of 5/91, introduction, available in Westlaw, 1991 WL 501332 ("text" of land ownership law with elucidations by Peter Liska) (citing Law No. 142/1947 Sb., enacted July, 1947, and Law No. 46/1948 Sb., enacted March 1948) [hereinafter LLO].

15. *Id.*

16. *Id.*

17. *Id.*

18. *Id.* (citing Law No. 69/1949 Sb. on agricultural cooperatives, and the Sample Statutes for Individual Agricultural Cooperatives (No. 40/1953 UL [Official Gazette], Law No. 49/1959 Sb. on individual agricultural cooperatives, and Law No. 122/1975 Sb. on the agricultural cooperative movement)).

cooperative utilization, the right of utilization in support of production, and the right to impose substitute utilization.

The imposition of cooperative utilization by the state generally obligated members of individual agricultural cooperatives to combine their landholdings and to transfer the ownership of production facilities other than land, including buildings, structures, livestock, inventory, and supplies, to the cooperative.<sup>19</sup> While citizen members of the cooperatives retained ownership of the land plots, the state so restricted the rights of ownership as to make them virtually meaningless.<sup>20</sup> The state stripped landowner members of a cooperative of their ownership of the nonland resources on their land plots and forced them to combine their land plots in the interest of agricultural production.<sup>21</sup> The Law of Land Ownership (LLO)<sup>22</sup> provides that such rights are vested in the state, and describes them as "rights of cooperative utilization."<sup>23</sup>

Landowners who did not join cooperatives were regulated under different laws.<sup>24</sup> These laws allowed the state, in the interest of securing agricultural production, to commandeer a citizen's land for use by a state agricultural enterprise. Subsequently, the state enacted legislation granting the agricultural organizations extensive rights to the land assigned.<sup>25</sup> The right of the state to commandeer land in the interest of furthering agriculture was termed the "right of utilization in support of production."<sup>26</sup>

In addition to the rights of cooperative utilization and utilization in support of production, the state created the right of substitute utilization.<sup>27</sup> The right of substitute utilization served the interests of centralizing agricultural land into major holdings and reorganizing the land fund of cooperatives and other

19. *Id.*

20. *Id.*

21. *Id.*

22. LLO, *supra* note 14.

23. *Id.*

24. For example, Law No. 55/1947 Sb., on assistance to farmers in meeting their agricultural production plan, was replaced by Government Regulation No. 50/1955 Sb., regarding provisions to secure agricultural production. *Id.*

25. Law No. 123/1975 Sb. (which rescinded Government Regulation No. 50/1955) granted these rights pursuant to the state-created right of utilization in the interest of production. Thus, the state used the "right" it created specifically to commandeer land in the interest of production and as a bootstrap with which to grant the agricultural cooperatives extensive rights over property that was assigned to them to use.

26. *Id.*

27. *Id.*

agricultural organizations.<sup>28</sup> The law combined noncontiguous land plots and rights to related terrain (such as water rights) toward more efficient land preservation and management.<sup>29</sup> Again, while private ownership of land was retained, the institution of substitute utilization provided that landowners would be assigned plots of land to use as substitutes for their plots of land designated for utilization by cooperatives or other agricultural enterprises.<sup>30</sup>

In the late 1950s and 1960s, the liberalization of the Soviet Union and Czechoslovakia's economic crisis spurred the emergence of more liberal communists in Czechoslovakia, but invading Soviet troops crushed this movement in August 1968.<sup>31</sup> While a dissident movement remained alive, Czechoslovakia was one of the most authoritarian of the Eastern European countries until the democratic revolution of 1989, the "Velvet Revolution."<sup>32</sup> After the Velvet Revolution, the legislation regarding the state's right to acquire use of land remained in place, but acquisition was no longer conducted in accordance with such legislation.<sup>33</sup> Recognition of the separation of ownership of land and the right to use land emphasized in the above-described legislation is most important to understand legislation regarding ownership of property subsequent to the Velvet Revolution.<sup>34</sup> With this in mind, the following sections examine the mechanics of real property law as it existed at the time of the Velvet Revolution, and post-revolution legislation addressing land ownership rights.

### III. REAL PROPERTY LAW AS IT EXISTED AT THE TIME OF THE VELVET REVOLUTION: THE CZECHOSLOVAK CIVIL CODE

At the time of the Velvet Revolution, land ownership rights were for the most part embodied in the Czechoslovak Civil Code (the Civil Code).<sup>35</sup> The Civil Code sets forth the law regarding

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28. *Id.*

29. *Id.*

30. *Id.* (citing Government Regulation No. 47/1955 Sb.).

31. Coopers & Lybrand, *supra* note 13, § 2.1.

32. Jon D. Van Gorp, *Collateral in Eastern Europe: Problems and Solutions*, 28 INT'L LAW. 83, 84 (1994).

33. LLO, *supra* note 14.

34. *Id.*

35. Czechoslovak Constitutional Law of Jan. 1, 1991 Enacting the Bill of Basic Rights and Freedoms, ch. 2, § 1, art. 11, *available in* Westlaw, 1991 WL 501315 (unofficial embassy translation) [hereinafter Bill of Basic Rights and Freedoms].



ownership rights and the mechanics of transactions involving the transfer of real property.<sup>36</sup>

Section 46 of the Civil Code provides that a contract for transfer of real property must be in writing;<sup>37</sup> moreover, the parties must express their intent in the same document.<sup>38</sup> Section 134 provides that if an immovable object is transferred pursuant to a contract, ownership is acquired when the contract becomes effective.<sup>39</sup> A contract for real property between private parties (as opposed to between a private party and the state, or between state organs) comes into effect through registration with the State Notariat.<sup>40</sup> Thus, in contrast to the U.S. system, a contract for the sale of land does not take effect until it is entered into the land register.<sup>41</sup> While the United States uses recording systems, the Czech Civil Code envisions a more active role for the land registry, as evidenced by the land recording scheme.<sup>42</sup>

All changes in ownership of real property must be recorded in the Cadastre of Real Property of the district in which the property is located.<sup>43</sup> There are three categories of registration: "(1) non-discretionary registration (*zaznam*), which encompasses real-estate transferred under the direction of a court or other state authority, is registered without specific review by the land registry office; (2) registration by note (*poznámka*), which occurs when a debt has been enforced by the sale of the debtor's real estate and is recorded by the land registry office; and (3) discretionary registration (*vkład*), which this covers all other property transfers.<sup>44</sup> Registration proceedings commence as soon as the parties to a transaction submit an application and the land

36. *Id.*

37. CODE CIVIL [C. CIV.] § 46(1) (Czech.), reprinted in TH. J. VONDRACEK, COMMENTARY ON THE CZECHOSLOVAK CIVIL CODE 66 (1988).

38. When there is a transfer of property other than real property, the requirement that the contract be in written form is satisfied by a written offer and a written acceptance. If the contract contemplates the transfer of real property, the contract must be comprised of one instrument or sheets laced or glued together. VONDRACEK, *supra* note 37, at 67. Generally speaking, the principles in the Code are common to personal and real property unless specific provisions are made (e.g., mortgages apply only to real property and pledges apply only to personal property). Aisbett, *supra* note 2.

39. C. CIV. § 134(2) reprinted in VONDRACEK, *supra* note 37, at 147.

40. C. CIV. §§ 47(2), 134(2) reprinted in VONDRACEK, *supra* note 37, at 67, 147. State Notariats are administrative personnel in the Cadastre of Real Property.

41. *Id.*

42. "Cadastre of Real Property" is the formal name of the land registry. Coopers & Lybrand, *supra* note 13, § 4.2.

43. *Id.*

44. *Id.*

registry reviews the proposed transaction to ensure it complies with the law. . . ."<sup>45</sup>

Registration of a transfer of real property between private parties falls within the third category and requires review by the land registry. Contracts for the transfer of privately owned real property also require the approval of local authorities.<sup>46</sup> In determining whether a contract for the transfer of real property is valid, the notary investigates

whether the contract does not infringe upon the law or is inconsistent with the interests of society, whether the contracting parties have the capacity to act, whether they are entitled to dispose of the property (title examination), whether the contracted price does not violate the price regulations, whether the required consent of the relevant authorities has been obtained, and other essentials of the contract.<sup>47</sup>

If the notary makes an unfavorable decision, an interested party may appeal within fifteen days.<sup>48</sup> If there is no appeal, the contract is invalidated *ab initio*.<sup>49</sup> There is no appeal from a favorable decision, upon which the contract is registered and becomes effective.<sup>50</sup>

These prerequisites to a valid contract for the transfer of real property give rise to a period between application and notaries decision. During this period, the status of the contract is undetermined. A commentator on the Code cryptically described the contract's legal status during this period as follows:

If parties *validly* enter into a contract needing the approval of the competent authorities and/or notaries registration, *the contract remains inoperative, but the parties are bound by it*. This means that they cannot retract from it by cancellation or otherwise. The contract becomes effective only after the authorities' approval . . . and/or the notaries decision.<sup>51</sup>

The phrase "the contract remains inoperative, but the parties are bound by it" might mean that no performance on the contract may be required during the period of investigation, and, at the same time, neither party may act contrary to its terms. What is truly puzzling is that this explanation of the rights and responsibilities of the parties during this period is predicated on

45. *Id.*

46. VONDRACEK, *supra* note 37, at 68 (citing C. CIV. § 490(2)); *see also* C. CIV. § 134(2) reprinted in VONDRACEK, *supra* note 37, at 147.

47. VONDRACEK, *supra* note 37, at 68 (citing § 63 of the Notary Rules).

48. *Id.*

49. *Id.*

50. *Id.* (citing §§ 21 *et seq.* of the Notary Rules).

51. *Id.* at 69 (emphasis added).

the parties entering into a *valid* contract, an issue that is necessarily not decided until the authorities or notary make a decision.<sup>52</sup>

The Civil Code also provides for "hypotheses," which essentially are the civil law counterpart of mortgages at common law.<sup>53</sup> A hypothec serves as security for a claim and its accessories, and encumbers the hypothecated property, its accruals, and the accessories.<sup>54</sup> Satisfaction out of the hypothecated property may be claimed by the creditor after the claim becomes due and owing.<sup>55</sup>

The main difference between the hypothec and a mortgage at common law is that a hypothec does not create an estate for years.<sup>56</sup> There is no transfer of title or of title deeds.<sup>57</sup> Also, if the debtor defaults there can be no "foreclosure."<sup>58</sup> However, the hypothecary creditor, like the mortgagee, can satisfy his or her claim out of the property through a public sale.<sup>59</sup> Until April 1, 1964, a hypothec could be created by contract or agreement; however, after the Civil Code came into force, hypotheses could only be created by operation of law.<sup>60</sup>

Under the most recent (pre-revolution) version of the Civil Code, the hypothec has been "replaced by 'restraint on the transfer of real property.'"<sup>61</sup> A contract of restraint on the transfer of real

52. *Id.*

53. *Id.* at 445.

54. C. CIV. § 495(2) reprinted in VONDRACEK, *supra* note 37, at 445.

55. *Id.* Section 495(2) also provides that "[w]ith respect to a hypothec encumbering jointly and severally two or more hypothecated things, the creditor is entitled to claim satisfaction of [the creditor's] entire claim or a part thereof out of any item." *Id.*

56. VONDRACEK, *supra* note 37, at 446.

57. *Id.*

58. *Id.*

59. *Id.* The procedure for public sale of hypothecated property upon the debtor's default is governed by the Czechoslovak Code of Civil Procedure of 1961, as amended. §§ 251 *et seq.* and 371, and the Law No. 95/1963 Sb, as amended §§ 79 *et seq.* Vondracek, *supra* note 37, at 446.

60. C. CIV. § 495(1) reprinted in VONDRACEK, *supra* note 37, at 445. An example of a hypothec created by operation of law is a hypothec to secure payment of house taxes. VONDRACEK, *supra* note 37, at 81 (citing Law No. 143/1961 Sb.).

61. VONDRACEK, *supra* note 37, at 78.

The present Code has abolished the old institution of mortgage on real property and chattel mortgage . . . .

. . . .

The reason for its abolishment, as stated in *Nove obcanske pravo* (a book by an authors' collective), was the general aversion of socialist jurists to the traditional "cleavage" of rights *in rem* and rights *in personam*, professed to be typical for a society where private ownership is supposed to serve as a basis for exploitative appropriation. From the legal point of

property must be in writing and requires registration by the State Notariat.<sup>62</sup> Upon registration, the contract operates against everyone.<sup>63</sup> Under such a contract, the debtor assumes a duty not to transfer the debtor's real property to a third party without the consent of the creditor, until the claim is satisfied.<sup>64</sup> Ironically, the institution creates a right *in rem*.<sup>65</sup>

The contract strengthens a creditor's position in two ways. First, the debtor cannot sell the real estate without the creditor's permission.<sup>66</sup> Second, when the debt has matured, the creditor may apply to the court to have the property sold.<sup>67</sup>

When the property is sold, the money received from the sale is applied, in order, to five classes of claims. The first class is comprised of statutory mortgages.<sup>68</sup> The second includes claims secured by a restraint on transfer of real property, claims secured by a contractual mortgage,<sup>69</sup> and rights resulting from easements.<sup>70</sup> The third class consists of claims for support of dependents; the fourth comprehends taxes and levies not secured by a statutory mortgage.<sup>71</sup> Finally, the fifth class embraces all claims not falling into any of the first four classes.<sup>72</sup> Where there is not enough money to cover the debt secured by the first class, the debt in that class is satisfied proportionately.<sup>73</sup> The debt in

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view, objections were raised against the "slivering" of a legal relation *in rem* into a "real component" and a "personal component," said to be indigestible to the legal consciousness of the ordinary working people. For instance, the buyer of a mortgaged house was forced to endure the fact that the creditor could satisfy [the creditor's] claim from the house of the new owner although the latter was in no way the creditor's real debtor; [the new owner's] only "sin" was . . . [the purchase of] a mortgaged house.

*Id.*

62. C. CIV. § 58(2) reprinted in VONDRACEK, *supra* note 37, at 78; see also *supra* text accompanying notes 48-53.

63. VONDRACEK, *supra* note 37, at 78.

64. C. CIV. § 58(1) reprinted in VONDRACEK, *supra* note 37, at 77-78.

65. VONDRACEK, *supra* note 37, at 78; see also *supra* note 61. *Contra* J. DVORAK, OMEZENI PREVODU NEMOVITOSTI 242-54 (1983).

66. VONDRACEK, *supra* note 37, at 79. Vondracek does not explain, however, how the mere ability to prevent a sale protects the creditor's right to receive payment of the loan.

67. The sale by the court is executed by the notary public. *Id.*

68. See *supra* note 60 (referring to a statutory mortgage as a hypothec created by the operation of law).

69. VONDRACEK, *supra* note 37, at 81. "Contractual mortgage" refers to a hypothec created by contract or agreement before such device was abolished. See also *supra* text accompanying notes 53-60.

70. VONDRACEK, *supra* note 37, at 81.

71. *Id.*

72. *Id.*

73. *Id.*

the second class, including debt secured by restraint on transfer of real property, is satisfied in the order in which the instruments were registered. If the proceeds exceed all claims, then the balance is paid to the debtor.<sup>74</sup>

The foregoing discussion of the mechanisms of real property law in the Czech Republic as it existed at the time of the Velvet Revolution is not comprehensive. It covers some basic areas of property law, such as formation of land contracts, recordation, and nonownership interests that could be taken in land, and is included to allow the reader to compare the Czech system, generally, with other systems of real property law. In many ways, in theory, the pre-Revolution real property law in the Czech Republic is surprisingly similar to real property systems in market economies.<sup>75</sup> However, because real property law often operated only in theory and since other state-vested rights rendered ownership of property meaningless, the mechanics remained largely untested. This may explain why some apparently ambiguous and inefficient procedures remained in place.<sup>76</sup> In any case, the general description of real property law in the Czech Republic at the time of the Velvet Revolution shows the starting point from which the law must develop if a market economy is to be achieved.

#### IV. POST-REVOLUTION REFORMS OF REAL PROPERTY LAW

##### A. *A Preliminary Matter: The Dissolution of Czechoslovakia*

After the Velvet Revolution, Vaclav Havel was elected president of the new Czech and Slovak Federal Republic (CSFR).<sup>77</sup> Under then Finance Minister Vaclav Klaus, the CSFR moved rapidly to introduce market reforms and dismantle the institutions of the communist era.<sup>78</sup> In 1991, however, the pace

74. *Id.* In the execution of the public sale, the highest bid does not necessarily prevail. "A price higher or lower than the one determined beforehand by the notary's official estimate would be contrary to the auction rules." *Id.*

75. Concepts of private ownership, recordation, and the possibility of borrowing against land, for example, closely approximate their counterparts in market systems.

76. The registration system is one example.

77. *Doing Business in the Czech Republic and Slovakia*, § 1.1, available in Westlaw, 1991 WL 222449.

78. The principal elements of reform adopted by the CSFR include the following:

(1) [R]estrictive monetary and fiscal policies; (2) price and trade liberalization; (3) development of a legal framework appropriate to a market economy; (4)

momentarily slowed when the political groups that had participated in the Velvet Revolution fractured.<sup>79</sup> The Civic Democratic Party (ODS), a Czech party led by Vaclav Klaus, supported rapid economic transformation and continuation of the federation of the Czech Republic and Slovakia (the Federation).<sup>80</sup> The movement for a Democratic Slovakia (HZDS), a Slovak party led by Vladimir Meciar, advocated slower reform and a loose confederation of two quasi-autonomous republics.<sup>81</sup>

Klaus initially pushed continuation of the Federation, but when it became clear that division between the Czech and Slovak parties would threaten the pace of economic reforms, he agreed that division of the Federation was essential.<sup>82</sup> On December 31, 1992, Czechoslovakia was dissolved and superseded by the two independent republics.<sup>83</sup>

The significance of this substantially abbreviated history leading up to the divorce of the two republics is at least two-fold. The single most influential factor causing the dissolution of Czechoslovakia was the different emphasis that the republics placed on the speed of reform.<sup>84</sup> While it bears mentioning that since the separation Slovakia has continued to implement major aspects of the federal reform program,<sup>85</sup> clearly the history predating the dissolution speaks to the relative speeds with which the two republics will tackle future reform, and therefore property law reform.

More importantly, this split does *not* necessarily portend the creation of vastly different legal frameworks governing the private ownership of real property. Prior to Czechoslovakia's dissolution, property ownership by individuals was governed by the Civil Code, and property ownership by commercial entities was

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privatisation of state-owned property; (5) introduction of internal currency convertibility; (6) reform of the financial sector; and (7) creation of an appropriate social security safety net to offset the social costs of reform.

Coopers & Lybrand, *supra* note 13, § 3.1 (emphasis added).

79. *Id.* § 2.2. The Civic Forum (OM, a Czech party) divided into the Civic Democratic Party (ODS), Civic Democratic Alliance (ODA), and Civic Movement (OH). Within the Public Against Violence (VPN), the Movement for a Democratic Slovakia (HZDS) faction arose. *Id.*

80. *Id.*

81. *Id.*

82. *Id.*

83. *Id.*

84. Vaclav Havel considered it essential to maintain the momentum of the theretofore rapid pace of reforms. *Id.*

85. Gelpert, *supra* note 4, at 323-28 (focusing on the federal programs of privatization of state-owned property).

governed by the Economic Code.<sup>86</sup> In the interim between the Velvet Revolution and the dissolution, certain provisions under the Civil Code and under the Economic Code were modified by federal legislation.<sup>87</sup> The Czech Republic and Slovakia have both passed legislation stipulating that Czechoslovak federal law will apply until superseded by new legislation.<sup>88</sup> Thus, while the two countries are distinct, at least presently, their laws with respect to the mechanics of private ownership of real property are the same.

### B. Constitutional Reforms

Constitutional reforms have accompanied the establishment of meaningful real property rights. In Act 100/1990, the Federal Assembly re-established the rights of private ownership.<sup>89</sup> Subsequently, the Constitution of the Czech Republic was amended to include the changes.<sup>90</sup> The amendments establish the following: the equality of private property with state and cooperative property (formerly there was a hierarchy of state, cooperative, personal, and private ownership);<sup>91</sup> that all property rights are equivalent and equally protected by the Constitution and civil law;<sup>92</sup> and that foreign individuals and companies are

86. Aisbett, *supra* note 2.

87. The Commercial Code replaces much of the former company and commercial legislation including: (1) the Economic Code (Act 109/64), which was amended in 1990 and regulates the following types of companies: limited liability company, general partnership, limited partnership, and partnership limited by shares; (2) the 1990 Act on Joint Stock Companies; and (3) the 1988 Law on Companies with Foreign Participation (Joint-Venture Law). *Doing Business in the Czech Republic and Slovakia*, *supra* note 77, § 3.1.2.

88. Coopers & Lybrand, *supra* note 13, § 3.1.

89. *Czechoslovakia: The Growth Towards Active Commitment to Economic Reform and Foreign Investment*, EUROMONEY SUPPLEMENT, July 7, 1991, available in LEXIS, World Library, Reuter Textline File.

90. CZECH REPUBLIC CONST. (Dec. 21, 1992) ch. 1, art. 3 & ch. 8, art. 112, para. 1; *see also* Coopers & Lybrand, *supra* note 13, § 3.3. Chapter 1, article 3 of the Constitution provides: "The Charter of Fundamental Rights and Freedoms is part of the constitutional order of the Czech Republic." Chapter 8, article 112, paragraph 1 provides:

The constitutional order of the Czech Republic consists of this Constitution, the Charter on Basic Human Rights and Freedoms, constitutional laws of the National Council of the Czechoslovak Republic, the Federal Assembly of the Czechoslovak Socialist Republic, and the Czech National Council law dealing with the borders of the Czech Republic, and constitutional laws of the Czech National Council adopted after 6 June 1992.

91. Bill of Basic Rights & Freedoms, *supra* note 35, ch. 2, art. 11, ch. 2, § 1; *see also* Coopers & Lybrand, *supra* note 13, § 3.3.

92. Cooper & Lybrand, *supra* note 13, § 3.3.

guaranteed the same property rights as Czech citizens and entities.<sup>93</sup>

Article I of the Bill of Basic Rights and Freedoms provides that constitutional laws, legislation, and legal regulations, as well as their interpretation and use, must be in accordance with the Bill of Basic Rights and Freedoms, and that the Constitutional Court protects the basic rights and freedoms listed.<sup>94</sup> Article 11 of the Listing of Basic Rights and Freedoms contains the fundamental modification of rights of ownership generally.<sup>95</sup> Article 11 provides, *inter alia*, that every person has a right to own property, and that ownership rights of all owners have the same validity and are equally protected.<sup>96</sup>

### C. The Czechoslovak Law on Land Ownership

The Czechoslovak Law on Land Ownership,<sup>97</sup> passed by the Federal Assembly on May 21, 1991, is essentially another in the series of reprivatization programs. The LLO modifies restitution in the context of agricultural and forestry land, as well as in the context of related property.<sup>98</sup>

93. *Id.*

94. Bill of Basic Rights & Freedoms, *supra* note 35, art. 1.

95. *Id.* art. 11.

96. (1) Everybody has a right to own property. Ownership rights of all owners have the same content and are equally protected. Inheritance is guaranteed.

(2) The law determines which property necessary to secure the needs of the whole society, development of national economy, and public interest may be possessed only by the state, community, or legally designated persons; the law may also determine which specific things may be possessed only by citizens or legally designated persons based in the CSFR.

(3) Ownership is a commitment. It must not be used at the expense of other peoples' rights or contrary to common interests protected by law. Its exercise must not damage human health, nature, and the environment beyond the measure determined by law.

(4) Expropriation or forced curtailment of ownership rights is possible only in public interest; and only on the basis of law and for compensation.

(5) Taxes and levies can be imposed only on the basis of law.

*Id.* ch. 2, § 1, art. 11.

97. LLO, *supra* note 14.

98. Specifically, the law applies to:

(a) [L]and which makes up the agricultural land fund or belongs to it and to the extent stipulated by [the] law, also to land which makes up the forestry land fund (hereinafter referred to as "land"); (b) residential buildings, economic structures, and other buildings belonging to the original agricultural settlement, including built-on land plots; (c) economic



In addition to providing for the restitution of the land, however, the law modifies the rights and obligations of owners, original owners, users, and renters of land, as well as defining the jurisdiction of the state in regulating ownership and utilization rights with respect to land.<sup>99</sup> As such, it is the most relevant legislation to date with respect to the creation of a well-defined system of real property rights. Perhaps most significantly, considering the long history in Czechoslovakia of separating ownership rights and rights of use,<sup>100</sup> the LLO provides that apart from the owner, other persons may only use the land on the basis of a contract with the owner or the land fund.<sup>101</sup> While it is not clear how far this provision goes toward protecting the owners' right to use the land, it does seem to preclude forced substitution of alternate land for the land of the owner.<sup>102</sup> The question of the future of substitute utilization, however, will be the subject of further legislation.<sup>103</sup>

While the future of substitute utilization is unclear, the other rights of the state to utilize property (cooperative utilization and the right to utilize to support production) are expressly extinguished.<sup>104</sup> As for properties being used by a party other

structures and buildings serving agricultural and forestry production or related water management projects, including built-on land plots; and (d) other agricultural property [as listed in § 20 of the law].

*Id.* §§ 1(a)-(d).

99. *Id.* § 1(2).

100. See *supra* text accompanying note 34.

101. LLO, *supra* note 14, § 2(1). Another aspect of § 2 is that crops on the land, not covered by regulations governing the agricultural cooperative movement, are owned by the owner of the land. *Id.* part 1, § 2(2).

102. See *supra* text accompanying notes 34-40 (describing the institution of substitute utilization). As Peter Liska points out in his commentary on this provision of the law: "[T]he right of substitute utilization . . . is not based on a contractual agreement." LLO, *supra* note 14, commentary on part 1, § 2(1). The commentary by Peter Liska does point out, however, that it is clear that substitution may not be implemented by the state to achieve certain ends, such as land plot modification:

A prerequisite for the realization of the law on land ownership in practice particularly involves the identification of land plots owned by individual owners, as well as the new organization of the land fund. Toward this end, it is no longer possible to implement land modifications in accordance with hitherto valid Government Decree No. 47/1955.

*Id.* commentary on part 3, § 19.

103. See LLO, *supra* note 14, introduction.

104. *Id.* § 22(1) (a)-(b). Other rights of utilization extinguished under § 22 include the following: the former right of the state to use the land to support forestry production and other forestry functions under § 12 of Law No. 61/1977 Sb. on forests; the former right of the state under § 4 of Law No. 102/1966 Sb. on fisheries to the cost-free use of ponds; the former right of the state to permanently utilize real estate owned by the state under § 70 of the Economic Code; and the

than the owner, unless the user and the owner agree to another arrangement, a landlord-tenant relationship is established under the LLO.<sup>105</sup> The LLO also provides that the landlord-tenant arrangement could be cancelled as of October 1, 1991, provided a party gives one year's notice.<sup>106</sup> The user of the property is granted the right of first refusal (a preemptive purchase right) for the duration of the user's tenancy.<sup>107</sup>

What is striking about this provision, other than the apparent abolishment of two significant methods of state utilization of land, is the vagueness of the landlord-tenant relationship, which results in the absence of agreement between the parties. A commentator on the LLO has stated that "[t]he [LLO] regulates at least the fundamental question of the landlord/tenant relationship with regard to the fact that this relationship is not based on an agreement."<sup>108</sup> But beyond addressing this fundamental question, the LLO provides little guidance for determining the rights and obligations under a lease.

The LLO does state that the owner of the land assumes the rights and obligations of the owner's legal predecessors.<sup>109</sup> For public policy reasons, the LLO grants to certain users a right to conclude an agreement with the owner.<sup>110</sup> Also, in the case of such users, the owner cannot terminate the lease agreement prior to May 21, 2001, which is ten years from the date on which the LLO went into effect.<sup>111</sup> Finally, when the owner fails to reach an agreement with such a tenant, the state, through the "appropriate organ of state administration," will impose an agreement on the parties covering both the extent of the premises subject to the lease and the price of the lease.<sup>112</sup>

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former right of the state to, in effect, appoint as manager of certain realty a person other than the owner under § 64 of the Economic Code. *Id.* § 22(1) (c)-(f).

105. *Id.* § 22(2).

106. *Id.*

107. *Id.* commentary on part 4, § 22.

108. *Id.*

109. *Id.* § 25(1).

110. *Id.* § 25(2)(a)-(e). The following uses give rise to a right to conclude an agreement on using the premises: activities of diplomatic and consular missions; provision of health and social services education; operation of cultural and physical fitness facilities; and work rehabilitation and the employment of handicapped persons. *Id.*

111. *Id.* § 25(2).

112. *Id.*

## D. The Czech Commercial Code

The Czech Commercial Code (Commercial Code) signals commitment to market reform.<sup>113</sup> The Commercial Code merges the Civil, Economic, and International Trade Codes, and eighty-four other laws, into a single body of law.<sup>114</sup> The Commercial Code's provisions regarding the use of mortgages to secure debt are the most relevant to the creation of a well-defined system of property rights.

Contract provisions in the Commercial Code govern mortgage rights with respect to bonds.<sup>115</sup> Under the Commercial Code, mortgage rights can arise on the basis of a bond issued according to special regulations, provided that the bond identifies the manner in which surety is to be provided for any claims resulting from the mortgage rights.<sup>116</sup> The nature of the mortgage is that of the hypothecary mortgage bond.<sup>117</sup>

A mortgage right arises as a result of its registration, on the basis of a proposal submitted by the issuer of the bond and the owner of the real estate involved. The regulations governing the registration of mortgage contracts mandate this process.<sup>118</sup> The Commercial Code also provides that the issuer of hypothecary mortgage bonds list in the real estate record the total number of secured claims that are based on the issuance of the bonds. Issuers may not place them in circulation until they have complied.<sup>119</sup>

An individual authorized to assert rights based on a hypothecary mortgage bond has the standing of a mortgage creditor.<sup>120</sup> Such rights can be established to run for a specific period of time, at a specific level, and covering a specific type of claim, which may accrue to the mortgage creditor in the future.<sup>121</sup> In exercising mortgage rights, a mortgage creditor may sell the

113. DAVID E. BIRENABAUM & DIMITRI R. RACKLIN, *BUSINESS VENTURES IN EASTERN EUROPE AND THE SOVIET UNION: THE EMERGING LEGAL FRAMEWORK FOR FOREIGN INVESTMENT* § 3.01 (1990).

114. Sarah Andrus, Note, *The Czech Republic and Slovakia: Foreign Participation in Changing Economies*, 17 HASTINGS INT'L & COMP. L. REV. 611, 620 n.68 (citing U.S. DEPT. OF COMMERCE, CSFR COMMERCIAL CODE § 772(1)-(84)).

115. U.S. DEPT. OF COMMERCE, CSFR COMMERCIAL CODE § 261(4), also available in Westlaw, Int-EEurope Database) [hereinafter CSFR COM. C.].

116. *Id.* § 297(1).

117. *Id.*; see *supra* text accompanying notes 53-60; see also *supra* note 61 (relating to history of restrictions regarding hypotheses).

118. CSFR COM. C., *supra* note 115, § 297(2). Under the Civil Code, hypotheses were required to be registered in the same manner as transfers of real property. See *supra* text accompanying notes 54-63.

119. CSFR COM. C., *supra* note 115, § 297(2).

120. *Id.* § 298.

121. *Id.* § 299(1).

real property at a public auction, provided the mortgage creditor notifies the mortgagee and debtor in sufficient time of the creditor's intent to enforce the mortgage rights.<sup>122</sup> Also, provided that the mortgage contract so specifies, the mortgage creditor may sell the property by other suitable methods.<sup>123</sup> After execution of the sale, the mortgage creditor must pay the debtor, without undue delay, the amount of the sale price that exceeds the balance of the debt and reasonable costs.<sup>124</sup>

## V. THE UNIQUE CHALLENGE OF FORMULATING PROPERTY LAW IN THE CZECH REPUBLIC

### A. Why Take the Challenge

Before suggesting how property law in the Czech Republic might be reformed, it is worth considering why resources should be expended to formulate detailed property law.<sup>125</sup> The creation of enforceable property rights, while productive, is a costly activity that competes with many other productive activities in Eastern Europe.<sup>126</sup> Clear real property law facilitates the transformation from a command economy to a market economy.<sup>127</sup> In light of this purpose, it is important to recognize that the creation of clear property laws "guarantees neither a relatively free access to markets nor that distortions in the incentives to produce and to invest will disappear."<sup>128</sup>

Czech leaders regard the speed of reform as critical.<sup>129</sup> Quick privatization is more important than finalizing all the details of a market economy.<sup>130</sup> While political exigencies<sup>131</sup> demand quick

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122. *Id.* § 299(3).

123. *Id.*

124. *Id.* § 299(3).

125. Other than laws providing for privatization or reprivatization, and amendments to laws allowing universal ownership, "liberalisation of real property law has not been high on the legislative agenda, perhaps understandably when bearing in mind other priorities." Aisbett, *supra* note 2.

126. Brietzke, *supra* note 1, at 43.

127. *See supra* note 3.

128. *Id.*

129. *See, e.g.,* Gruner, *supra* note 8, at 34; *see also supra* text accompanying note 11. As Czech Economics Minister Karel Dyba stated, "Speed is crucial. Speed matters more than perfection." R.C. Longworth, *Economic Tigers Begin to Growl in East Europe*, CHI. TRIB., Oct. 14, 1994, §1, at 1.

130. *See, e.g.,* Michele Balfour & Cameron Crise, *A Privatization Test: The Czech Republic, Slovakia and Poland*, 17 FORDHAM INT'L L.J. 84, 95-96 (1993).

privatization despite a lack of clearly defined ownership rights, such an approach, when considered from a legal perspective, appears to put the cart in front of the horse.

In the absence of an established system of property rights, the privatization policies may fail to convey the full range of entitlements intended.<sup>132</sup> At the very least, it is not certain what package of rights is conveyed. There is nothing to indicate that the pace of reform would necessarily be slowed by simultaneous formulation of property law. Of course, if resources are such that costs of property law reform would impact the speed of privatization, the relative merits of the two activities would have to be assessed.<sup>133</sup>

Furthermore, the benefits of allocating resources to the establishment of a system of property rights must be weighed against those of other activities, including privatization programs with a focus on allocation of property. Finally, it must be conceded that the establishment of property rights does not guarantee a significant move toward a market economy.<sup>134</sup> It is beyond the scope of this Note to assess the costs of the establishment of a system of property rights; nevertheless, some observations about the benefits that would accrue from clear rights follow.

First, it should be noted "that the government is always both a player and a rulemaker on the economic scene, [and that] the borderline between these two roles is significantly more fluid in a society without a stable private property regime."<sup>135</sup> When a government has a near monopoly on an asset such as real property (or the right to use real property), which is indispensable to the private sector, the government necessarily has a high degree of control over the conditions of transfer of such rights.<sup>136</sup> This condition may make it difficult for the government to genuinely commit to its program of privatization, and may tempt its representatives to so restrict the nature and scope of the transferred rights so that the transferees remain insecure in their entitlements.<sup>137</sup>

This might be particularly true in the case of the Czech Republic's privatization of real property. As the history of private

131. Longworth, *supra* note 129 (quoting Czech Economics Minister Karel Dyba as stating that the purpose of the speed of reform is to build political consensus).

132. See *supra* text accompanying note 6.

133. See *supra* notes 129-31.

134. See *supra* text accompanying note 128.

135. FRYDMAN & RAPACZYNSKI, *supra* note 3, at 174.

136. *Id.*

137. *Id.*

ownership of land in Czechoslovakia indicates, relinquishment of ownership of land may be meaningless unless founded on certain firmly established rights inherent in ownership.<sup>138</sup>

Secondly, in a system in which property rights are firmly rooted, such rights are only marginally enforced by the formal legal system.<sup>139</sup> It has been suggested that in an advanced economy, the bulk of enforcement is achieved informally through cultural norms and self-enforcing mechanisms developed through a long evolution of property rights.<sup>140</sup> In a less developed economy, such as the Czech Republic, this "background of self-enforcement may be absent from the privatization policies in the period of transition, with the result of precluding an effective establishment of the property rights intended by the policymakers."<sup>141</sup>

Regardless of whether clear laws are in place for the judiciary to enforce, it would be unrealistic to expect the Czech judicial system to make up for the lack of enforcement due to the nonexistence of self-enforcement mechanisms.<sup>142</sup> Certainly a system of well-defined property law might aid them in such an effort. Assuming, however, that the judiciary was yet unable to make a significant contribution with respect to resolving the great number of current disputes, it nevertheless would, by settling some disputes, play an integral role in the evolution of a system of well-defined property rights.<sup>143</sup> Thus, in the long run, the judiciary would contribute greatly to the creation of a "background of self-enforcement."<sup>144</sup>

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138. See *supra* text accompanying note 16.

139. FRYDMAN & RAPACZYNSKI, *supra* note 3, at 175.

140. *Id.*

141. *Id.*

142. See, e.g., Crowder, *supra* note 3, at 252-253. Professor Gruner states:

Even without the additional caseload of new legal controversies arising from private business ownership and from heightened levels of commercial activity, there are clear signs that Czechoslovakia's judiciary is already overburdened. The extent of this problem was revealed in the summer of 1990 when judges in Prague and other parts of Czechoslovakia staged a work slowdown to protest the Government's inadequate provision for new courts. That the judges felt such extreme action was necessary suggests judicial staffing may pose a serious problem that could undercut the significance of the country's new commercial law standards.

Gruner, *supra* note 8, at 52.

143. "Whether property is a creature of law and derives from the state. . . or the law merely enforces some more fundamental principles, without legal recognition no entitlement to the exclusive use of valuable resources is fully defined." FRYDMAN & RAPACZYNSKI, *supra* note 3, at 170.

144. *Id.* at 175.

These more specific arguments for the formulation of well-defined property rights aside, it must be conceded that laws promulgated to define property rights are meaningless unless the government respects the rule of law.<sup>145</sup> In order for a rule of law to have any meaning, there must be a powerful judiciary capable of interpreting and enforcing new legal standards.<sup>146</sup> If a judiciary is to interpret and enforce legal standards, it follows that legal standards must be adopted. A precondition of successful economic development is that the state establish entitlements with precision and enforce them impartially and promptly.<sup>147</sup> This is easier said than done, but the challenge should be met.<sup>148</sup>

### B. *The Significance of the Existing Real Property Law in Responding to the Challenge*

In Czechoslovakia, the right of ownership of land and the right to use land historically have been kept separate. While ownership technically remained with individuals, the right of use vested in the state often rendered "ownership" meaningless. Because ownership was often meaningless, the rights and obligations of land owners were considered unimportant. This would explain why, prior to the Velvet Revolution, the details of those rights and obligations never evolved.

In light of the history of land ownership, and the separation of that status and the right to use land in particular, restoration of the right to own land may mean little. More significantly, at least until the ramifications of the constitutional reforms are clear, the LLO appears to put some restraints on the state's former ability to use privately owned property. Nevertheless, the post-revolution legislation focuses on figuring out *who* should be given land, and leaves the question of what rights are vested in the land owner to future resolution.<sup>149</sup>

Because ownership was largely meaningless, Czechoslovak law, with regard to real property ownership rights and obligations, did not evolve prior to the Velvet Revolution. Likewise, the law did not develop, and is not developing, subsequent to the Velvet

145. See Gruner, *supra* note 8.

146. *Id.*

147. FRYDMAN & RAPACZYNSKI, *supra* note 3, at 170.

148. *Id.*

149. See Aisbett, *supra* note 2. The LLO, for example, provides that certain parties using land are entitled to a tenancy agreement with the rightful owner of the land established under the LLO. The provision states that when no agreement is reached, an agreement will be fashioned for the parties. See LLO, *supra* note 14, § 25. This is a basic example of the fact that definite rights and obligations are of secondary concern to allocation.

Revolution, because it has been eclipsed by the focus on allocation and distribution of real property. The significance of the lack of real property law in the Czech Republic is that in order to respond to the challenge of creating a system of well-defined real property rights the Republic must begin the task basically from scratch. As explored more fully below, because the Czech Republic must create laws basically from scratch, a wider variety of options are therefore possible.

While the Czech Republic will certainly draw on law from countries with more developed systems, the law it creates must become its own, since the law is a factor in the evolution of a larger cultural backdrop of private ownership of property, arguably more important than state enforcement of property rights.<sup>150</sup> This Note offers suggestions as to some facets of ownership of real property that should not be ignored in the process of creating the law, and further recommends a potential method by which to create effective and desirable real property law in the Czech Republic.

## VI. RESPONDING TO THE CHALLENGE OF CREATING A SYSTEM OF WELL-DEFINED PROPERTY RIGHTS IN THE CZECH REPUBLIC

### A. *The Importance of an Accurate System of Recording Title to Land*

Developing an accurate and efficient system of recording the title to real property in the Czech Republic should be of the utmost priority. Czech law envisions an extensive role for the land registry.<sup>151</sup> Not only must this office record transfers and other modifications of title to real property, it is also expected to review the agreements underlying such transfers and modifications to determine whether they are valid.<sup>152</sup> With each new piece of legislation, new responsibilities are delegated to the registries.<sup>153</sup>

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150. The author cannot suggest a comprehensive scheme of real property rights and obligations. First, no country has implemented such a system with unqualified success. Second, what may be desirable in other countries may not suit the Czech Republic.

151. See *supra* text accompanying notes 41-50.

152. *Id.*

153. For example, under the LLO, the land registry will be burdened with fashioning lease agreements between newly established owners and current users of plots of land who are unable to reach agreement on their own.



Without addressing the merits of such an extensive role, it must be recognized that at the very least, the registries must accurately record transactions. Currently, however, the land registries are in terrible disrepair.<sup>154</sup> It has been observed that "[t]itle to real property in the Czech Republic is unclear at best and non-existent at worst."<sup>155</sup> During communist rule, records of title were not accurately maintained.<sup>156</sup> In fact, in 1964 some land registries were not kept at all, and others were deliberately destroyed. Of course, rights of land use were swapped between different agricultural enterprises without regard to ownership, and thus were never recorded. This neglect has rendered title searches virtually useless, and investors in land have had to simply "wait and see" if claims to the land are brought under the reprivatization programs.<sup>157</sup> This uncertainty has given pause to potential investors in land or enterprises with substantial land assets. Thus, lack of clear title has directly slowed the privatization process.

While the land records may not be rehabilitated, the accurate recording of title throughout the privatization process and thereafter will be crucial. Because so much land will be transferred during this process, this period will provide an opportunity for the Czech Republic to establish a base of accurate records, and, as ownership of land is transferred or modified in the future, the base can be maintained and expanded. The method and competency with which such records are kept are critical.

Clear title records will facilitate more transactions between Czech entities and individuals, and will result in ownership of land by owners who will use the land most efficiently.<sup>158</sup> Further, it will play a critical role in the attraction of foreign investment.<sup>159</sup> As Professor Bruce explains, "an element of a congenial atmosphere for transjurisdictional mortgage lending is the existence of a means of assuring lenders that debtors actually own the land taken as security and that the land is not subject to prior encumbrances."<sup>160</sup> Of course, this principle applies not only

154. See Aisbett, *supra* note 2.

155. Crowder, *supra* note 3, at 252.

156. *Id.*

157. *Id.*

158. Balfour & Crise, *supra* note 130, at 87-88.

159. Jon W. Bruce, *The Impact of Diverse Mortgage Law and Other Aspects of the Legal Environment on the Flow of Funds for Mortgage Lending Among States: Lessons Derived from the United States Experience* 14 (1992) (unpublished manuscript prepared for submission to the IX International Registration Law Congress, Torremolinos, Spain, May 25-29, 1992, on file with the author).

160. *Id.* at 2.

to mortgage lenders, but also to potential investors in land or entities with substantial land assets. If a jurisdiction lacks an adequate system of establishing title, investors will look elsewhere.<sup>161</sup>

The lack of a system of accurate recordation represents a significant shortcoming in the Czech Republic. One positive aspect to the neglected and underdeveloped state of the Czech recording system, however, is that it gives the Czech Republic a real choice with regard to the method it will adopt. Because the system is in complete disarray, the costs of adopting a different system will be relatively low.

While the Czech Republic will undoubtedly look to the West for much of its property law, it may have good reason to consider other alternatives. In the United States, for the most part, one determines title by examining the land records.<sup>162</sup> Status of land must be divined from these recorded transactions, which may be numerous and difficult to locate. Also, some types of transactions may not appear in the records.<sup>163</sup> The difficulty of ascertaining title under this system has caused extensive reliance on title insurance.<sup>164</sup>

On the other hand, the Torrens system of registration, originally developed in Australia, involves the maintenance of a public register in which current landowners and encumbrances are listed.<sup>165</sup> The register is updated to reflect the most recent land transactions.<sup>166</sup> This obviates the need to examine the history of recorded documents.

As Professor Bruce points out, if a state does not have a fully developed recording system, implementation of the Torrens system may be desirable.<sup>167</sup> On the other hand, if a state has a long-standing system, the time and expense involved may be prohibitive.<sup>168</sup> In the Czech Republic, the system, which is in such disrepair as to be of little or no use, could certainly not qualify as "fully developed." A cost-benefit analysis may support abandoning the old system and adopting a more efficient method such as the Torrens system. Thus, the dilapidation of the Czech recording system may provide an incentive to adopt a much more

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161. *Id.* at 14. Hungary, for example, has a relatively effective system. Aisbett, *supra* note 2.

162. Bruce, *supra* note 159, at 14.

163. *Id.* at 14-15.

164. *Id.* at 15.

165. *Id.*

166. *Id.*

167. *Id.* at 16.

168. *Id.*

advanced system of recordation, which in the long run may serve to attract more foreign investment than the Czech Republic otherwise would have. Certainly, such a system would help the Republic compete with its neighbors who have more evolved systems.

Such a change appears to place an even greater burden on the already overburdened land registries. As remarked earlier, however, whatever else the registries accomplish, they must at least accurately and efficiently record title. Perhaps the organ responsible for approving transactions could be separate from the body recording transactions.<sup>169</sup> In any case, accurate recordation should be a high priority.

Because the Czech recording system is completely inadequate, a new system must be developed. This gives the Czech Republic the opportunity to choose a method that it considers the most efficient. This should be an immediate priority, so as to accurately capture the vast transfers that will occur as a result of reprivatization. While in the short run this may be difficult, it will ultimately make investment in land and lending on land in the Czech Republic more attractive and give the Republic an advantage over its neighbors with respect to foreign investment.

#### B. *Creating an Environment Congenial to Foreign Investment*

The Czech government realizes that foreign investment will be critical to the survival of its new political and economic system.<sup>170</sup> The Republic has demonstrated its commitment to attracting foreign investment both through general legislation addressing the rights of foreign investors, and through treaties with specific countries.<sup>171</sup>

The fact that foreign investment is important seems rather obvious. Less evident is the relationship of domestic property law to the attraction of foreign investment. Foreign investors and lenders to foreign investors are more willing to put money into foreign enterprises if the property law in the jurisdiction in which they are investing is clear as to their rights over property and the extent to which their rights will be protected. Certainly, large-scale foreign investors will be wary of investing in a country where property rights are insecure.<sup>172</sup>

169. See *supra* text accompanying notes 42-50.

170. Van Gorp, *supra* note 32, at 86.

171. *Id.* Such countries include the United States, the Ukraine, and Slovakia.

172. Balfour & Crise, *supra* note 130, at 87-88.

What is less often addressed, and perhaps far less obvious, is the importance of the relationship between the property law in the investor's jurisdiction and the property law in the jurisdiction where the investment will take place. As Professor Bruce has observed with respect to mortgage law in the United States, a critical factor in encouraging capital for mortgage loans to flow freely across jurisdictional borders is the uniformity of mortgage law among the individual states.<sup>173</sup> The greater the diversity of mortgage law, the less freely mortgage capital will flow between jurisdictions.

More generally, Sheldon Schreiber and Harold Levy have elaborated on some of the advantages of relative uniformity of property laws among jurisdictions:

Commerce by its very nature tends to expand beyond jurisdictional boundaries, and thus those who are engaged in growing commercial enterprises must adapt their practices to comply with the laws of diverse jurisdictions. Uniform laws promote economic development by making it easier for those engaged in commerce to expand beyond jurisdictional boundaries. Uniform laws simplify transactions by reducing the need to change procedures, standards of documentation to meet local laws, retain experts and professionals with specialized knowledge of such local laws, and resolve conflicts of laws among two or more jurisdictions that have a nexus to the transaction. While the need for uniform laws in commerce is most pronounced in the field of commercial law—*e.g.*, sales of goods, commercial paper and security interests in personal property—the increasing sophistication of real property financing has accentuated the advantages of uniformity in land laws as well.<sup>174</sup>

Thus, uniform property laws serve at least two important functions in encouraging foreign investment. First, if property laws are uniform, then foreign investors will generally be familiar with the laws and will feel comfortable investing in property in Czech land. Second, as Schreiber and Levy have said, uniform laws reduce the transaction costs of foreign investments.

Of course, the Czech Republic cannot make its laws uniform with respect to every country that harbors potential investors. It may be advisable, however, for the Czech Republic to consider the countries with which it desires to conduct business, as well as the countries that are most likely to invest in the Republic. One strategy may be to make real property laws uniform with respect to certain, well-chosen countries.

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173. Bruce, *supra* note 159, at 1.

174. Sheldon L. Schreiber & Harold A. Levy, *The Uniform State Law Movement in the United States as a Model for the Development of Land Privatization Legislation in the Newly Independent States 2* (April 1, 1993) (unpublished manuscript, on file with the author).

For example, the Republic may seek to harmonize its laws with those of Austria. Austria has been called the "Gateway to Eastern Europe."<sup>175</sup> Numerous multinational corporations have chosen Vienna as their Eastern European headquarters.<sup>176</sup> As such, many potentially large-scale international investors are familiar with Austrian law, which is generally regarded as stable and practicable.<sup>177</sup> Furthermore, Austria is currently negotiating terms on which to join the European Community (EC), and upon attaining membership, could provide easy access to EC markets.<sup>178</sup>

Currently, Austria and the Czech Republic are joint participants in the construction of the Cross-Border International Business Park at the Austrian-Czech border.<sup>179</sup> Dr. Nikolaus Pitkowitz has observed:

Unfortunately, it will not be possible to create a uniform legal environment for both sides in all respects, since many relevant laws—corporate law, labor law, real estate law, and tax law—are not subject to agreement. Since many of the Czech laws enacted in recent years have been modeled after Austrian (or German) laws, the differences between the two legal systems are not great; the two systems are, in fact, becoming more similar.<sup>180</sup>

Dr. Pitkowitz also points out that legal uncertainties, due to the fast pace of legal changes in countries such as the Czech Republic, may arise in determining the current state of the law, particularly with respect to title to real estate.<sup>181</sup> Thus, while it may not be possible to create a uniform legal environment in all respects, a uniform legal environment with respect to real estate law might prove particularly strategic. This would not only facilitate Austrian investment, but could also serve as an avenue for greater international investment.

### C. *Achieving Uniformity of Real Property Law*

There are several means by which the Czech Republic might achieve, with respect to its real property law, uniformity among strategic countries. Some uniformity might already exist as a

175. Nikolaus Pitkowitz, *The Greenfield Approach and the Role of Austria for Privatization in Eastern Europe: A Case Study of the Cross-Border International Business Park (Austria—Czech Republic)*, in *PRIVATIZATION IN EASTERN EUROPE: LEGAL, ECONOMIC, AND SOCIAL ASPECTS* 216, 217 (Hans Smit & Vratislav Pechota eds., 1994).

176. *Id.*

177. *Id.*

178. *Id.* at 220.

179. *Id.* at 219.

180. *Id.* at 220.

181. *Id.* at 217 n.2.

result of common roots and traditions.<sup>182</sup> It may also be accomplished through agreement among governments, in the form of compacts, treaties, or conventions, or by the development and enactment of uniform laws by several jurisdictions.<sup>183</sup> Professor Bruce observes that an international federation or community of states could create a commission to propose uniform law.<sup>184</sup> Several authorities have suggested that such a commission might be modeled on the National Conference of Commissioners on Uniform State Laws in the United States (hereinafter National Conference or NCC).<sup>185</sup>

The difficulties with using this approach in the Czech Republic are two-fold. First, it assumes that all of the states among which uniformity is desired have real property laws roughly at the same stage of development. Secondly, it assumes that the states will be willing, at least to some extent, to adopt the laws suggested by such a commission. In the United States, for example, uniform mortgage acts have not been adopted by the states.<sup>186</sup> On the other hand, the National Conference has been successful in gaining acceptance in other areas of law.<sup>187</sup>

The property law of the Czech Republic is not at the same stage of development as the laws of the countries from which it likely anticipates investment. Nor is it clear how receptive those countries would be with respect to working toward uniformity. However, since the Czech Republic will be working for the most part from scratch, it can determine, in large measure, the degree to which its law will correspond to other countries.

For example, the Republic might want to form a commission consisting of representatives from the countries with which the Republic desires uniformity. This body could perform the task of drafting the laws to be put before the Czech Parliament. With regard to the functioning of the commission, it might be closely modeled after the National Conference.<sup>188</sup>

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182. See, e.g., Pitkowitz, *supra* note 175, at 220; Schreierberg & Levy, *supra* note 174, at 3.

183. Schreierberg & Levy, *supra* note 174, at 3.

184. Bruce, *supra* note 159, at 13.

185. See, e.g., Schreierberg & Levy, *supra* note 174, at 3; Bruce, *supra* note 159, at 13. The National Conference of Commissioners (NCC) has, throughout the last century, fostered uniformity of law among the states in the United States. The NCC is composed of Commissioners on Uniform State Laws, usually four from each state. Schreierberg & Levy, *supra* note 174, at 6-7.

186. Bruce, *supra* note 159, at 13.

187. Schreierberg & Levy, *supra* note 174, at 9.

188. See *id.* at 7-8 (detailing the operation of the National Conference).

## VII. CONCLUSION

Current property law in the Czech Republic largely ignores details regarding the rights and responsibilities associated with the ownership of property. Prior to the Velvet Revolution, land ownership rights were so severely trammled by rights of use that the law of real property never really evolved. Since the revolution, questions pertaining to the proper allocation of land have eclipsed issues respecting the details of ownership. Thus, if the Czech Republic is to create a system of well-defined property rights, it must do so from scratch.

Most authorities agree that well-defined property rights are important, but the degree of importance seems to be underestimated. Even if state enforcement of property law is minimal, it is a necessary starting point from which and according to which a culture of private property ownership may evolve. More immediately, clear rights and responsibilities associated with land ownership will encourage foreign investment, a critical source of capital. A cost-benefit analysis weighs in favor of allocating resources to the creation of detailed real property law in the Czech Republic.

In creating such law, the Republic cannot ignore the state of its recording system. It is crucial that an accurate system of recording title be instituted in the Republic. The Czech Republic must also consider the countries from which it anticipates investment in the future, and take care to draft its laws so that they achieve some degree of uniformity with those of strategically chosen countries, such as Austria. This will encourage foreign investment by reducing the transaction costs of investing and by instilling confidence in investors (and their lenders) that the property in the Czech Republic in which they invest is secure. Such uniformity may be achieved in a number of ways, one of which is the creation of a commission modeled after the National Conference in the United States. Representatives from nations whose nationals are potential investors may then have some input with respect to the drafting of Czech laws. It is thus clear that, while the establishment of a system of well-defined real property rights will not, of itself, effect the transformation in the Czech Republic from a command economy to a market economy, it is necessary to that end.

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