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Dear Readers,

We present to you the first Wardyński & Partners Yearbook. It is a collection of texts by our lawyers representing the fruit of our day-to-day work for clients and deep consideration of specific legal issues in Poland.

The Yearbook helps clarify typical legal problems encountered by businesses in their operations (such as differentiation in staff compensation or guidelines for the functioning of in-house compliance divisions), as well as more specialised issues arising in particular sectors of the economy (such as compassionate use of new drugs following completion of clinical trials and tax treatment of cross-border investment funds).

There are also issues that managers and legal practitioners everywhere are familiar with but which are approached in an unusual way under the Polish legal system. Some of these covered by the Yearbook include rules for liability of management board members for the debts of the company under certain circumstances, distinct liability regimes for soil contamination depending on the dates when land was acquired or held, and specific features of Polish bankruptcy practice.

The mission of a lawyer is to pursue and defend the values of the rule of law, and that, we believe, includes spreading legal knowledge. To this end, we would like to share our own knowledge with you, our readers.

Tomasz Wardyński

When should a law-abiding company seek advice from a criminal lawyer?

Dominika Stępińska-Duch
Janusz Tomczak

Why would a business need to be concerned at all about criminal law?

Janusz Tomczak: There are more and more criminal provisions in business law. Beyond the Penal Code itself, there are criminal provisions in over 100 other statutes, and almost every act governing specific spheres of business activity contains some criminal provision or other. There is a noticeable trend toward stepping up prosecutions in areas such as irregularities in securities trading reported in the press.

Not to exaggerate, but there seems to be a trend toward more frequent use of criminal provisions to regulate areas related to business activity. The European Union requires that more extensive criminal sanctions be imposed for all manner of environmental violations than under current law, and legislative initiatives are already underway in this area. It is businesses in particular whose activity poses a threat to the environment that may be subject to criminal liability in the event of a catastrophe or other events causing harm to the environment.

What can a business do then to protect itself from criminal liability?

Dominika Stępińska-Duch: Of course it is impossible to eliminate human error completely, or its consequences, which are also covered by criminal law to a certain extent. The effects can at least be minimised, including the consequences for the organisation. Emphasis should be placed on a number of different elements that in one way or another fall into the category of fault.

Criminal law is focussed on individuals' responsibility for their actions. Thus a manager has an interest in seeing that the company is run in a transparent manner, with clear distinctions in authority and duties among specific personnel. Increasingly, attention is drawn to the need to establish proper communication channels between staff and management, so that any irregularities are immediately reported and quickly eliminated, and further incidents prevented in the future.

Codes of conduct should be established – internal best-practice rules and regulations that help minimise the risk of irregularities, including those that may give rise to criminal liability. Finally, measures need to be in place that encourage use of the procedures in practice.

All of this should help minimise potential risks with respect to specific individuals, particularly the managers of the enterprise.

Observing what is going on nowadays in Poland, what seems to be particularly lacking is a preventive culture, inculcating good habits. Companies will typically seek legal advice when it is too late, and the only thing left to do is damage control.

Janusz Tomczak: This is reflected in the legal advice offered in Poland in the area of criminal law. Criminal law specialists are equated with defence counsel in criminal proceedings, and there are not many criminal lawyers advising businesses how to protect themselves from risk, how to approach situations that cause problems within an organisation, how to prevent such situations from developing, and so on. As mentioned, internal regulations that help uncover irregularities and diagnose the problem quickly are of paramount importance – particularly within large organisations.

Dominika Stępińska-Duch: The point is also to properly assess the permissible level of risk in order to avoid a threat of liability, including criminal liability. We know that every enterprise bears a certain amount of risk associated with doing business. But managers sometimes forget that in practice all of their actions need to be based on rational grounds. Otherwise we enter into an area of fault, which may constitute an offence, or at least come under the scrutiny of law enforcement authorities.

Janusz Tomczak: Managers often are not aware, or forget, that criminal liability may be imposed for negligent or reckless actions – or, to use the criminal law terminology, unintentional offences. We are not talking here about persons who deliberately commit a crime. We mean people who are threatened with criminal liability because of a lack of due care, deliberation and consideration.

Dominika Stępińska-Duch: Foreigners are in a somewhat special situation. They are not treated more lightly in Poland. Polish law applies here, so anyone who serves as a member of a management board or performs some other function in a Polish company cannot claim ignorance of the law, language or practices as an excuse. But the differences in criminal law from one country to the next are often major. Foreign businesspeople may be surprised by the degree of intervention in the private sector by law enforcement officials in Poland.

Janusz Tomczak: To answer the question briefly, legal commentators often refer to the "reasonable person" standard – acting with due diligence, taking decisions on rational grounds, striving to prevent improprieties, and hiring specialists to analyse risks, because that is cheaper than cleaning up after a catastrophe.

What kind of threat do careless businesspeople face? A fine? Imprisonment?

Janusz Tomczak: Businesspeople are rarely sentenced to a mandatory prison term for economic crimes. However, the criminal conviction or finding of guilt will still be disclosed in the National Criminal Register. This may prevent the person from serving on company boards or prevent the company from competing in public tenders.

Dominika Stępińska-Duch: The purpose of these regulations is to prevent persons convicted of crimes from conducting business. What may prove more painful in practice is stripping the person of the right to perform certain functions, or an outright ban on conducting business activity. Not only that, it is also possible to apply such sanctions as a "preventive measure" during the pendency of a criminal case, which immediately prevents them from acting on corporate boards.

Janusz Tomczak: It should be borne in mind that in certain fields of business, where there is a close connection between the private and public sectors (e.g. pharmaceuticals, medical equipment, and infrastructure investment projects), transparency and credibility are crucially important.

Anywhere the Public Procurement Law applies, where public funds are being invested, compliance with procedures and the actions of the participants will come in for heightened scrutiny by state oversight institutions and law enforcement authorities, such as the Central Anticorruption Bureau and the Supreme Audit Office.

Dominika Stępińska-Duch: These authorities have highly advanced technology at their disposal, and they look closely at technical issues that may go unnoticed in everyday work. At critical moments, compliance with principles of due care in carrying out basic tasks becomes relevant.

Won't anyone starting a business seek legal advice?

Dominika Stępińska-Duch: Yes, but not from a criminal lawyer.

Janusz Tomczak: Businesspeople treat the risk of criminal liability as a marginal issue. This is based on certain experience. There are industries and areas of operation that require special caution and sensitivity to risk, and there, before signing an agreement, it is important to consult with a specialist – but not necessarily concerning criminal law. The point is to exercise due care when taking various important decisions.

What approach should managers take when seeking legal advice?

Dominika Stępińska-Duch: First they should consider what the matter is about and what they expect. Managers shouldn't decide about things they do not know about. Maybe that doesn't sound much like legal advice, but it is one aspect of the right attitude.

When it comes to legal advice as such, it is important to remember that advocates and legal advisers are required to maintain the confidentiality of information given them by clients. A court can release them from this obligation only under exceptional circumstances. In the case of defending a suspect or the accused in a criminal matter, attorney-client privilege is absolute. In criminal cases, which are inherently sensitive, this is particularly important.

Janusz Tomczak: Also bear in mind that commerce crosses borders, which means that economic crimes increasingly often have a cross-border character. In criminal matters with an international element, the experience of the lawyers and the firm is important, and their ability to manoeuvre quickly in the international legal world and obtain legal advice that may be needed in various other jurisdictions. Our firm, for example, has actively participated for many years in international legal organisations with members who are criminal lawyers from all over the world, which in practice means that we can quickly coordinate legal assistance both in Poland and abroad for our clients.

What to do if a criminal proceeding is already pending, but we are then surprised to suddenly become involved – regardless of the role?

Dominika Stępińska-Duch: We often forget how much we can "help the case" at the preparatory or investigative stage, when the law enforcement authorities are trying to figure out what happened in the matter they are looking into. Oftentimes companies, as large commercial organisms, ignore the importance of inquiries from law enforcement, and react only at the stage when an indictment has already been issued, or a motion for punishment, or the case is already scheduled in court. Oftentimes the real bulk of our work takes place at the stage of the preliminary proceeding. This typically involves gathering evidence and providing a full explanation of issues that the police or the prosecutor's office has taken an interest in. This often heads off unnecessary measures, protecting both the authorities and our clients from incurring unnecessary costs.

Janusz Tomczak: We should also pay attention to the proper understanding of events that are of concern to us. Recently we dealt with a situation where our client was summoned to submit a number of documents to the prosecutor's office. Only a few months later did the client realise that the summons concerned a matter in which the company might be involved as the injured party, because the case involved an allegation of acting to the detriment of the company, even though the notice of a crime was filed by a third party.

Does the criminal law give a business that has been victimised by a crime an opportunity to seek redress of the loss it has suffered?

Dominika Stępińska-Duch: Definitely. There are a whole array of measures that law enforcement authorities can take in order to redress injury or minimise the material consequences. In our view, what is crucial in cases of this type is close cooperation between the injured party and the authorities – with the proper flow of information and an awareness that we are on the same side.

Janusz Tomczak: It should also be borne in mind that often excellent results may be obtained by combining the instruments offered by civil and criminal procedure, when prosecutors and civil courts are both interested in the same events. An active approach to dispute resolution, in the character of the injured party, may achieve good results, even if only in the form of access to information or evidence. This can make it easier and faster to repair the harm done to companies that become victims of crime. This is one of the most worthwhile aspects of commercial criminal law.

Dominika Stępińska-Duch is an adwokat *and a member of the Business Crime Practice*

Janusz Tomczak, an adwokat*, heads the Business Crime Practice*

When is the management board of a limited-liability company liable for the company's debts?

Maciej Szewczyk

As a rule, management board members of a limited-liability company are not liable for the company's debts to third parties, because the management board incurs obligations for the company and not on their own account. There is an exception, however, for cases where management board members themselves contribute to a state in which the company is unable to meet its obligations to creditors.

As a legal person, a company bears unlimited liability for its own debts, to the extent of any assets the company may have. The shareholders, in principle, are not liable for the company's debts, but merely risk whatever they have invested in the company. Similarly, as the management board does not incur liabilities on its own account, but acts as a company body, as a rule its members are not liable to third parties.

This rule is significantly limited, however, especially by Art. 299 of the Commercial Companies Code, which limits the exclusion of liability for the debts of a limited-liability company if members of the management board themselves contributed to the state in which the company is unable to meet its obligations to third parties (creditors).

Art. 21(3) of the Bankruptcy & Reorganisation Law and Art. 116 of the Tax Ordinance (for tax liabilities) also provide additional grounds for a management board member to be liable for the company's debts.

Liability under Commercial Companies Code Art. 299

Under this provision, management board members are jointly liable if enforcement against the company proves ineffective.

Such liability applies to all persons who were management board members when the debts in question were incurred, even if not yet due when they were holding office.

The condition of ineffective enforcement, as set forth in Art. 299 §1, means ineffective enforcement from all assets. Therefore, ineffective enforcement may be demonstrated through various evidence, and it is not necessary that it be declared in an enforcement proceeding.

Under Art. 316 of the Civil Procedure Code, whether a creditor's claim against the management board members should be allowed is determined according to the financial state of the company as of the close of the proceeding seeking to hold the management board members liable. It must be indisputably found that creditor satisfaction from company assets is impossible.

Creditor claims against management board members under Art. 299 of the Commercial Companies Code expire on the deadline set forth in Civil Code Art. 442^1, i.e. 3 years from the date the creditor learned of the loss and the party required to remedy it – therefore, when it became clear to the creditor that enforcement of the debt from the company is impossible. This deadline cannot be longer than 10 years from the date when the event causing the loss occurred.

The construction of Art. 299 shows that it suffices for a creditor to demonstrate the existence of the debt and ineffective enforcement against the company in order to establish the management board member's liability. The management board members then bear the burden of proving one of three circumstances provided by the law in order to exclude liability.

Conditions for release from liability

First, a management board member may be released from liability if he or she proves that a timely motion to declare the company's bankruptcy was filed or composition proceedings were initiated. The proper time to file a bankruptcy petition is when a management board member knows or with due diligence should have known that the company is no longer able to satisfy all creditors, even if it has sufficient assets to meet some obligations or cover the costs of bankruptcy proceedings.

Under Art. 11 of the Bankruptcy Law, a debtor is deemed insolvent if it fails to pay its debts as they become due or if its liabilities exceed the value of its assets, even if current obligations are being met. Under Art. 21(1), a bankruptcy petition should be filed within two weeks from the date when grounds to declare bankruptcy arose.

It follows that a management board member may be released from liability if the member demonstrates on the basis of the company's books that the financial condition of the company did not warrant filing of a bankruptcy petition at the time the person held office.

Second, a management board member may also exclude his own liability by proving that he was not at fault for failure to file a bankruptcy petition or failure to initiate composition proceedings.

It is sufficient for the management board member to demonstrate that he was unable to determine the grounds to declare bankruptcy, even with due diligence. In theory, it cannot be ruled out that the management board member lacked knowledge of the company's financial situation because of an internal division of tasks among specific management board members, for example where one member was responsible for finances and another dealt with operations. A management board member may also not have had actual insight into the company's affairs due to an extended absence (for example due to travel or illness).

Third, a management board member may be released from liability by proving that the creditor did not suffer any harm despite failure to file a bankruptcy petition or initiate composition proceedings in a timely fashion.

The code effectively provides for a statutory presumption of harm to a creditor up to the uncollectable amount of the debt. This presumption rests on the premise that a management board member should always be aware of the current state of the company's finances, including the company's ability to satisfy creditors. As a consequence, management board members bear the burden of proving that the creditor was not harmed.

It follows that the harm for which a creditor may seek compensation from a management board member only includes losses caused by failure to file a bankruptcy petition on time.

Conclusions

Management board members' liability for the company's debts in such circumstances has been a feature of Polish law for nearly 80 years, but it continues to raise issues in the case law and legal scholarship. Awareness of this liability also appears to be low among management board members themselves and among creditors.

The growing number of claims by creditors against management board members of insolvent companies nevertheless indicates that awareness of the issue of liability for company debts is increasing. It also seems that management board members are more frequently taking the appropriate steps to protect themselves from liability for company debts.

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When does a purchaser of real estate incur liability for contamination?

Bartosz Kuraś

The risk of liability for contamination is significant when purchasing real estate or shares in a company holding real estate. If soil quality standards are not met, the purchaser of land may be required to remediate it. That is why it is worth checking the rules on liability for damage to the environment before each transaction.

Obtaining the relevant knowledge before acquiring real estate will permit contracts to be drawn up in a way that protects the purchaser against the effects of historic contamination that is detected later and may result in the purchaser's liability. The seller and purchaser may, for instance, provide in the contract that in the event of unfavourable soil test results, the purchase price will be reduced, or else the seller will cover part or all of the remediation costs. Knowledge of the principles of liability for contamination also simplifies the decision on whether to go ahead with soil tests before purchasing land. Such tests are often costly, particularly when activities carried out on the land before might have caused soil contamination.

According to the principles set forth in the Act on Preventing Damage to the Environment and Remediation of 13 April 2007, an entity using the environment whose activity creating a risk of damage either threatened to damage or did damage the environment is liable for soil contamination. However, the landholder is also liable for certain damage caused before the 2007 act came into force.

Ground surface damage

Defining "damage" is crucial to proper application of the liability rules. The act defines "damage" as a measurable adverse change in the state or functioning of natural elements, as compared to the initial state, which was directly or indirectly caused by activity carried on by an entity using the environment.

To evaluate whether damage has occurred, the initial state must be determined. This is defined as the state and functioning of the environment and specific natural elements before damaged occurred to the environment, determined on the basis of available information. However, in the case of ground surface damage, the Parliament assumed that the initial state is one that complies with the soil quality standards set forth in the Regulation of the Minister of the Environment dated 9 September 2002. This means that an obligation to remediate arises when the soil quality standards specified in the regulation are not met.

Liable entities

In relation to soil contamination, the 2007 act applies to entities using the environment and carrying out activities that create a risk of damage to the environment.

"Entities using the environment" include businesses as well as individuals conducting agricultural activity involving cultivation of arable land, animal husbandry, horticulture, cultivation of vegetables, forestry and inland fisheries, or persons practising a medical profession in an individual or specialist practice.

The act also lists types of activity creating a risk of damage to the environment. These include operating installations that require permits; activity associated with waste disposal requiring administrative authorisation; production, utilisation, storage or transport of hazardous substances, plant protection products, biocidal products and so on.

"Polluter pays" principle and "landholder pays" principle

The "polluter pays" principle is found not only in Polish environmental law, but in the legal systems of all EU member states. All persons must take responsibility for environmental contamination that they cause.

But this principle is not fully executed. In relation to damage caused before the 2007 act came into force on 30 April 2007, the landholder is generally liable regardless of who actually caused the contamination.

In practice this means that despite the constitutional force of the principle assigning the responsibility for contamination to the polluter, the purchaser of land contaminated before 30 April 2007 may be obliged to clean up the contamination. However, the relations between the seller and purchaser concerning clean-up costs would be a separate issue, subject to the agreement transferring legal title. Any disputes in this respect between buyer and seller may be resolved at a civil-law level. This solution does not always adequately protect the interests of the purchaser, for example when the polluter ceases to exist or becomes insolvent.

Principles of liability for historic contamination

If soil contamination (or a direct threat of soil contamination) was caused before 30 April 2007 or resulted from activity that ended before that date, then the landholder is generally liable for the contamination (according to the "landholder pays" principle) and also responsible for remediation, even if the contamination occurred before the landholder acquired the property, and also in a situation where it acquired the property after 30 April 2007.

The landholder's liability is subject to certain exemptions and restrictions regarding the required remediation and the extent to which it must bear the costs. The basic exemption is the ability to prove that another entity caused the contamination. The obligation to remediate generally rests on that entity, in other words the polluter. This exemption is available only where the contamination occurred after the real estate was acquired, which essentially prevents current purchasers from benefiting from this.

Liability for contamination which arose after 30 April 2007

The most important change made by the Act on Prevention of Damage to the Environment was introduction of the "polluter pays" principle in relation to damage to the environment, including soil contamination.

Under the current regulations, the obligation to undertake remedial action rests on the entity whose activities led to the risk of environmental damage, if such damage was then actually caused to the soil. Essentially, that same entity has to pay the clean-up costs. If the soil contamination was caused by another entity, then the entity currently using the environment will not have to cover the remediation costs if it can prove who caused the soil contamination and that it occurred despite the use of applicable safety measures.

An entity using the environment which has had to clean up the soil despite not being responsible for causing the contamination may sue the party that caused the contamination for reimbursement of expenses.

In order to ascertain whether soil contamination occurred and whether there is an obligation to remediate it, the provisions of the 2002 regulation concerning soil quality standards apply.

The landholder continues to be jointly and severally liable for contamination together with the entity that caused the contamination, which means that either or both of them may be obliged to participate in the clean-up, if either party knew that the activities directly caused a risk of contamination or agreed to these activities or to the actual contamination. A landholder may avoid liability if after finding out about the contamination it immediately notifies the relevant environmental protection authority.

Summary

The obligation to remediate contaminated soil arises when soil quality standards specified in the regulation are not met. Soil remediation is often very expensive, and thus the question of responsibility for remediation is crucial. Two models of liability exist: "landholder pays" or "polluter pays". The latter is currently predominant. However, in relation to historic contamination (i.e. caused before 30 April 2007), liability is borne by each successive landholder (usually the owner or perpetual usufructuary), and therefore issues concerning landholder liability for pollution continue to keep investors awake at night.

Before purchasing real estate or acquiring shares in a company owning real estate, it is worth knowing the rules on liability for soil contamination. This may cause the buyer either to carry out soil testing before acquiring the property or shares, or to insist on including provisions in the acquisition agreement addressing how liability for soil contamination will be shared between the buyer and seller if contamination is discovered after the acquisition.

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Takeovers involving public tender offers

Anna Grygo Danuta Pajewska

The Polish capital market offers investment opportunities to both institutional and individual investors. The market may be used to acquire shares during IPOs of private companies going public, or state-owned companies via privatisation, or to buy or sell government bonds or other financial instruments. It is also an important source of capital for publicly traded companies, which can issue new shares on the market.

The Warsaw Stock Exchange lists more than 370 Polish companies, with an overall market value of PLN 541 billion, and 28 foreign companies with combined capital of PLN 280 billion. Trading of shares on the WSE is subject to Polish regulations no matter where the company is registered. The regulations are based on the EU's Directive on Takeover Bids (2004/25/EC).

In Poland, shareholders have substantial rights which they can exercise in takeover situations. These include equal treatment of all shareholders, the right to have sufficient time and information to determine whether to accept a tender offer, an opportunity to consult the company's management board as to the possible effects of a tender offer, and assurance that the purchaser will pay for the shares at the price offered.

Notification obligation

The Polish Act on Public Offerings addresses issues associated with trading in securities. In particular, it provides special regulations governing the purchase of large numbers of shares in a public company. However, the Act on Public Offerings no longer contains a requirement to obtain the consent of the Polish Financial Supervision Authority for acquisition of a substantial number of shares.

Under these regulations, any investor who:

- acquires or owns more than 5%, 10%, 15%, 20%, 25%, 33%, 33-1/3%, 50%, 75% or 90% of the total number of votes at the general meeting of shareholders of a public company, or
- holds at least 5%, 10%, 15%, 20%, 25%, 33%, 33-1/3%, 50%, 75% or 90% of the total number of votes at the general meeting and, as a result of a reduction in that share, falls below 5%, 10%, 15%, 20%, 25%, 33%, 33-1/3%, 50%, 75% or 90%, respectively, of the total number of votes,

must notify the Financial Supervision Authority and the company immediately, not later than 4 or 6 days following the change in the total number of votes or the date when the change was deemed to occur.

The same notification obligation arises upon acquisition or sale of a number of shares which changes the number of previously held shares over:

- the 10% threshold by at least 2% of the total number of votes at the general meeting in respect of a company whose shares are admitted to trading on the official market, or by 5% if the shares are admitted on an official market, or
- the 33% threshold by at least 1% of the total number of votes at the general meeting.

For purposes of these percentage thresholds, individual transactions are aggregated.

Tender offer

An increase in the number of votes at the general meeting of shareholders by more than:

- 10% within a period of less than 60 days, if the number of votes already held is less than 33% of the total votes in a company, or
- 5% within a period of less than 12 months, if the number of votes already held is at least 33% of the total votes in the company,

may occur only through a public tender offer for subscription by sale or conversion of such shares in a number not less than 10% or 5%, respectively, of the total votes in the company.

The requirement to announce a public tender offer does not apply to some transactions specified in the law. The process of announcing and handling a tender offer must be entrusted to a brokerage house.

The threshold of 33% of total votes may be exceeded only when a voluntary tender offer is announced to acquire 66% of the votes, and the threshold of 66% only when a voluntary tender offer is announced for all outstanding shares.

The offeror does not have complete discretion in determining the price offered, but must follow certain pricing regulations:

- The bid price cannot be lower than the average market price for the shares in the 6-month period prior to the announcement, or the average market price for a shorter period if the company's shares have been traded for less than 6 months.
- The bid price cannot be lower than the highest price paid by the offeror (or its subsidiaries or parent companies or parties acting in concert with it) over the 12-month period immediately preceding the announcement.
- For bids exceeding 66% of shares with voting rights in the target company, the bid price cannot be lower than the average market price for the shares in the 3-month period prior to the announcement of the bid.

A lower price than that determined according to the rules may be offered when more than 5% of the shares are being acquired and the parties to the transaction have given their prior consent.

One very important requirement is that prior to announcing the tender offer, the offeror must provide security for the bid in the form of 100% of the value of the shares the offeror is looking to acquire. The security must be documented with a certificate issued by a bank or other financial institution that holds the security on behalf of the offeror.

Before the subscription for the target company's shares starts, the company is required to announce the position of its management board on the potential acquisition. The company also has the right to publish an external expert's opinion on the bid price, as well as a statement of the opinion of any relevant trade unions active at the company.

The announcement of a tender offer also affects shareholders who do not intend to accept the offer. Where a purchaser buys shares representing 90% of the votes in the target company, the purchaser may request that all other shareholders sell it any shares remaining in their possession. This compulsory sale or "squeeze-out" of minority shareholders is mandatory, and does not require any acceptance from the minority shareholders. By the same token, minority shareholders have the right to request that a shareholder who has reached 90% or more of the total number of shares in the company buy out all of their shares in the company, in a "reverse squeeze-out".

When determining whether announcement of a public tender is required, under Polish law consideration must be given to the purchaser's subsidiaries and joint undertakings.

Liability

Investors should be aware of the consequences of failure to comply with the requirements discussed above. If the relevant authorities or the company is not notified that the thresholds have been reached, or if no public tender offer is made, the investor may not exercise voting rights to the shares. The investor may also be subject to a fine of up to PLN 1 million (approximately EUR 250,000).

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Risks involved in use of severability clauses in commercial contracts based on the example of a contractual right of rescission

Natalia Kobyłka

Piotr Wcisło

Among clauses commonly found in standard commercial contracts, severability clauses are particularly important. A severability clause, also known as a "saving" clause, is intended to secure the interests of the parties if any of the provisions of the contract prove to be invalid or unenforceable. The severability clause thus "saves" the rest of the contract and the entire transaction is not invalidated.

The most frequently encountered severability clauses in commercial contracts read more or less as follows: "A finding of invalidity or unlawfulness of any of the provisions of this agreement shall not affect the validity or effectiveness of the remaining provisions." In practice, such a clause means that the contract remains in force without the invalid provision, even if it was of great commercial or practical importance for the parties.

It should be pointed out, however, that the issue has to do with provisions that are regarded as only subjectively material for one or both of the parties, but objectively are considered to be incidental. A severability clause will not protect the validity of the entire agreement if the invalid provisions go to the essence of the agreement.

For purposes of this discussion, use of the term "severability clause" refers to a clause reading more or less the same as the provision given above.

Severability clause under Polish civil law

It should be pointed out that a severability clause differs from the comparable rule set forth in the Polish Civil Code, which provides that "if only part of a legal act suffers from invalidity, the act remains in force with respect to the remaining parts, unless it appears from the circumstances that were it not for the provisions suffering from invalidity, the act would not have been made." This provision enables a partially invalid legal act to be upheld unless the invalid provision is so important for the parties that without it the legal existence of the agreement has no purpose for them.

In making a consistent interpretation of an agreement containing a severability clause that provides for the agreement to remain unconditionally in force regardless of the invalidity of part of the provisions, it should be concluded that the intention of the parties was to maintain the agreement in force notwithstanding the subjective importance of the invalid contractual provisions. Thus, in a way that was wholly unexpected by the parties, the situation may arise in which as a result of application of the severability clause an agreement will remain valid, and the parties may not escape from its legal effects even though it causes consequences different from those contemplated by the parties. In practice it may even happen that the contract loses its entire commercial purpose for one of the parties, or brings about legal effects that are unfavourable to the party and were not taken into consideration when entering into the agreement, but it is nonetheless impossible to undermine the binding force of the agreement.

The Civil Code provision cited above and the severability clause perform the analogous function of maintaining a contract in force notwithstanding its partial invalidity. The difference between the two legal mechanisms is that while the Civil Code provision seeks to maintain an agreement in force in the part that does not suffer from invalidity, it does so only under the condition that pursuant to principles of contract interpretation the intention of the parties would have been to maintain the agreement in force. The severability clause, however, results in maintaining the agreement in force unconditionally.

If a severability clause is included in a contract, it will take precedence over the Civil Code rule because under the principle of freedom of contract it is regarded as an optional provision that may be contracted out of. It is accepted that the parties' inclusion of a severability clause renders reliance on the Civil Code provision moot when determining the validity of the contract, because the severability clause takes priority over application of the Civil Code provision. Thus if the parties include a severability clause, and incidental but subjectively important contract terms are held to be invalid, a party cannot rely on the Civil Code provision. The party will therefore be barred from attempting to prove that the invalid provision was so important to the party that without it the party would not have entered into the contract at all.

Contractual right of rescission as an example of a subjectively material provision in the context of a severability clause

A contractual right of rescission is an example of a subjectively material but objectively incidental provision whose invalidity may have serious practical consequences for the parties to the agreement if the agreement also contains a severability clause, consisting of the inability to rescind the entire agreement.

Including a contractual right of rescission in an agreement gives the holder of the right the opportunity to undo the legal existence of the agreement, regardless of whether it has been performed yet or not, by submitting a unilateral declaration. In commercial practice, a contractual right of rescission is typically provided for in the event of occurrence of certain events which would wholly undermine the purpose of maintaining the agreement in force.

Alongside the main grounds for exercising a right of rescission, i.e. non-performance or improper performance of the contract by the other party, other grounds under which a party might have a right to rescind could include, for example, unsatisfactory results of due diligence in the case of an agreement to acquire a company or enterprise, where the agreement is concluded before completion of due diligence, or if the other party's warranties and representations prove to be untrue, and the like. A right of rescission may be material also in the event of substantial defects in an item being sold, making it more beneficial to the buyer to undo the contract from the start than to demand a price reduction or cure of the defects. It is apparent from these examples that a contractual right of rescission may be important enough to the holder that without that right, the party would have no interest in maintaining the contract in force.

However, instances of defective reservation of a right of rescission are common in commercial practice, because the parties do not always remember to include in the agreement all of the elements necessary for the validity of such a provision. The Polish Civil Code provides for the mandatory wording of a contractual right of rescission, requiring that if there is a contractual right of rescission the parties must specify the deadline by which the rescission must be made. Thus if the parties provide for a contractual right of rescission but fail to state a deadline for rescission, the right of rescission will always be invalid. The rationale for requiring a deadline by which the right of rescission must be exercised is that a right to undo the legal effects of an agreement, unlimited in time, even after the agreement has been performed, would cause uncertainty in legal relations and would be contrary to the principle of enforceability of contracts, which is fundamental to contemporary systems of civil law, and, ultimately, inconsistent with the rule of law. The consequence of this is that if an agreement contains an invalid contractual right of rescission and also contains a severability clause, the party seeking to rescind the agreement may not successfully claim that were it not for the contractual right of rescission it would not have entered into the agreement at all.

The situation would be different if under the severability clause the parties do not exclude application of the Civil Code to determination of the legal effects of the invalidity of subjectively material provisions of the contract. The Civil Code rule, in connection with the factual circumstances of the transaction, would enable the party seeking to escape from the contract to construct an argument that the invalid provision of a contractual right of rescission renders the entire agreement invalid, because without the right of rescission the party would not have entered into the agreement at all. This enables a holder of an (invalid) right of rescission, who is interested in exercising it and thus undoing the agreement, to avoid maintaining the agreement in force and achieve the same effect as it would if it could exercise the right of rescission, i.e. the non-existence of the agreement, effective from the outset, with an obligation for the parties to restore the consideration exchanged.

A party seeking to set aside the entire agreement under the Civil Code would have the burden of proving that the intention of both parties to the agreement was to formulate the contract in such a way that the contractual right of rescission was an essential element, and thus invalidity of the right of rescission renders the entire transaction invalid. Clearly, this would be difficult to prove, if for no other reason than that the other party will object to such interpretation, arguing that there was no intention of ascribing such importance to the right of rescission, and thus the agreement should remain in force despite the invalidity of that provision. Also arguing against the party asserting the invalidity of the agreement because of the invalidity of the contractual right of rescission would be the professional duty of care, under which a professional entity should be expected to state its intended contractual provisions clearly and correctly. Nonetheless, the Civil Code would give the parties to the agreement at least a potential opportunity to achieve the same effects as exercise of the (invalid) right of rescission, which could be of decisive importance under the factual circumstances of the given case.

Conclusions

In light of the arguments presented above, inclusion of a severability clause may bring about legal effects for the parties that are not necessarily consistent with their intentions. This may lead to situations where, thanks to application of the severability clause, an agreement is maintained in force that significantly differs from the intent of the parties when they entered into the agreement, but nonetheless, under the law, must be enforced. This is because inclusion of a severability clause excludes application of the relevant Civil Code provision, which is optional in the case of contractual provisions of only subjective materiality.

This is well-illustrated by the example of a defective right of rescission, whose defectiveness deprives the party of the ability to escape from the legal effects of the contract under the given factual circumstances. Numerous examples of other instances with similarly great practical importance could also be presented, such as inclusion of a suspensory condition in a contract, where invalidity of the condition could result in maintaining the contract in force despite the occurrence of events rendering the contract commercially pointless for one of the parties.

Thus it is important to take a cautious approach to use of severability clauses in contracts, and to word them carefully, with particular attention to the legal effects they may exert under the specific circumstances. It may turn out that the intention of the parties is served perfectly well by the Civil Code rule, whose function is to maintain the agreement in force as fully as possible, but only if that would be consistent with the parties' intent.

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Recent developments in Polish corporate recovery practice

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In recent amendments to the Polish Bankruptcy & Reorganisation Law, in force from 2 May 2009, corporate recovery was thoroughly revamped. The aim was to make this previously unpopular form of protecting an enterprise from collapse more appealing to Polish businesses.

Although Poland managed to avoid most of the fallout from the global financial crisis, the situation is far from satisfactory. Many businesses are seeking protection by filing for bankruptcy involving an arrangement with creditors, or are being forced into liquidation bankruptcy.

The dynamic Polish market constantly seeks its own remedies for business ailments, and new strategies for survival are being developed and tested. We would like to describe briefly one such interesting case, involving broad and comprehensive cooperation between a debtor and its creditors, on a previously unprecedented scale, with the goal of saving the debtor's business.

Overview

In March 2009, PKM Duda S.A., a listed company which is the largest red meat slaughtering and packaging company in Poland, filed a petition to commence recovery proceedings, as it was unable to satisfy its obligations to creditors. The Bankruptcy Law gave the debtor a maximum four months to agree a recovery plan with its creditors, or the recovery proceeding would be dismissed, resulting in the need to declare bankruptcy. Negotiation of the recovery plan continued almost to the last minute and involved 7 major Polish banks, as the main creditors, the debtor and its main shareholders (family members of the debtor's founder). Ultimately, about EUR 72 million of obligations were covered by the recovery plan, including about EUR 50 million under outstanding loans and guarantees.

Mechanisms

The recovery plan provided for around EUR 36.6 million of the banks' claims to be converted into stock in the debtor. The plan included a timed mechanism for the debtor to buy back these shares, as well as a call option allowing the shareholders to purchase the shares from the banks at a later stage. In order to protect the price stability of the debtor's shares on the Warsaw Stock Exchange, a lock-up mechanism was included to limit the banks' sale of the newly issued shares. The plan also provided for the shareholders to contribute an additional EUR 4.75 million in capital, to secure cash flow for normal operations.

The banks also extended a new credit consolidation facility (of around EUR 24 million) as well as a revolving facility with an extended repayment date. This was aimed at safeguarding the financial stability of the debtor and providing it with the funds to undertake necessary restructuring and modernisation and to lower production costs and increase competitiveness.

Numerous security measures were introduced to safeguard proper fulfilment of the plan by the debtor, including personal guarantees by certain shareholders (management board members, in some cases), mortgages, irrevocable powers of attorney from shareholders authorising the banks to exercise voting rights in the debtor's general meeting, and appointment of the banks' nominees to the debtor's supervisory board.

Debt-to-equity conversion

One of the main mechanisms ensuring proper security of creditors' claims was the conversion of 50% of the banks' unsecured receivables into shares of the company. The conversion involved issuing new shares to the banks, excluding the current shareholders' pre-emptive rights. The banks were required to retain the shares for a specific period, during which they could be bought back (through call or buy-back).

Call option

In order to allow the shareholders to regain full control of the debtor's business, a call option mechanism was introduced. The banks undertook (in the form of a promissory share sale agreement) to sell the newly issued shares to the family shareholders, upon request and at the shareholders' discretion, at any time, at a pre-set price which would serve to repay the banks' receivables thus secured together with interest. The mechanism was implemented to allow the family shareholders to be able to shorten the time that their company was under the banks' supervision (during which time shareholder control and company management were also restricted to safeguard the banks' interests), provided they had accumulated enough funds to repay their debts to the banks earlier than foreseen in the recovery plan.

Buy-back option

The buy-back option was the main means of repayment of the receivables which had been converted into the debtor's shares. The buy-back was implemented as a preliminary share purchase agreement in which the banks undertook to sell the newly issued shares back to the debtor at a pre-set price, upon request by the debtor. The offer to sell the shares was limited in time. The option was also conditional on the purchaser accumulating enough funds to be able to repay its obligations to the banks (albeit converted into shares). Furthermore, since the debtor is a listed company, once purchased, the shares could be either redeemed by the debtor or floated on the stock market to provide the debtor with additional financing.

Consolidated facility

Part of the banks' unsecured claims under various facility agreements were restructured by establishing a new separate consolidated facility agreement which encompassed all the previous receivables (in the form of preliminary and, later, final facility agreements). The consolidated facility agreement involved repayment of amounts under various facility agreements by way of a new facility agreement with a delayed repayment date. In addition to postponing the effective repayment date for its principal debts, this gave the debtor access to additional funds necessary for restructuring its business. The creditors benefited from the consolidated facility agreement through having their unsecured receivables under the old facility agreements converted into secured receivables, as a number of security measures were established on the debtor's assets (including mortgages on real estate) in connection with conclusion of the consolidated facility agreement.

This represented a significant advantage for the banks (despite the delay in repayment), as in the event of the debtor's bankruptcy very few unsecured receivables could be recovered. If the recovery plan failed and the debtor went into a liquidation bankruptcy, these receivables would most likely remain unrecovered, whereas by securing them against specific assets of the debtor, the creditors gained the security of the assets' market value. Without concessions on the side of the banks (delay in repayment), the debtor would never have agreed to establish additional security on its assets and both sides would have lost money following bankruptcy.

Additional measures and securing the recovery plan

In order to secure the fulfilment of the recovery plan and the various obligations of the debtor and its shareholders, a number of other measures were implemented. The management board members of the debtor (its shareholders, in certain cases) were required to conclude management contracts with the debtor, which included a number of requirements and limitations on conducting the debtor's business, as well as strict non-competition clauses.

Representatives of the banks were nominated to serve on the debtor's supervisory board, and a number of amendments to the debtor's statute were made to define which actions now required the banks' consent (as shareholders). The family shareholders granted the banks an irrevocable power of attorney to adopt relevant shareholder resolutions (these were listed in the recovery documents and the powers of attorney) and ensure the smooth fulfilment of the recovery plan. Certain shareholders provided personal financial guarantees of performance of the recovery plan, and securities were established on some of their real estate and other assets to secure the debtor's obligations.

Results

The arrangement was finally adopted at a creditors' meeting in July 2009 and submitted to the Bankruptcy Court for approval. In September 2009, the Bankruptcy Court issued a decision approving the arrangement completing the recovery procedure, and the recovery arrangement became effective. Although it is difficult to predict the course and fulfilment of the arrangement, it is evident that due to this agreement, the continued existence of a major Polish food producer was not jeopardised.

Approval of the arrangement in this case may be perceived as a great victory for all parties involved, considering that one of the banks had filed a bankruptcy petition against the debtor before the recovery process was completed and could easily have waited for the four-month recovery period to end and then participated in standard liquidation bankruptcy proceedings.

However, since there was an opportunity to save the debtor's business (in the past, it had been a major client of the banks, and in the future it could continue to be if the recovery succeeds), at the cost of some concessions on the part of the banks (including significant delays in repayment of the facilities and increased complexity of the legal relationship between the banks and the debtor), the banks were able to secure a final 100% return ratio on their receivables. This guaranteed that the banks would not have to write down part of their receivables from the debtor (as they surely would have had to in a bankruptcy), the debtor would continue to operate and generate revenue, with most of its employees retaining their jobs, and once the arrangement was completed the banks would retain a large and profitable (overall) client.

This shows that in crisis situations, close cooperation between creditors and debtors, with a view to achievements in the longer term, is a win-win solution that is available under the Polish Bankruptcy Law.

As a final comment on this recovery proceeding, following recent registration of the share capital increase (as a result of the debt-to-equity conversion), the market value of the debtor's shares has risen and investor interest in the debtor's shares has increased, due to the widespread view that the debtor has managed to solve its problems and is on the road to full recovery. The debtor is now planning a new EUR 25 million issue of shares on the Warsaw Stock Exchange. Initial investor response is very positive, and the issue appears likely to be successful.

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Overview of bankruptcy and restructuring in Poland

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Sources of bankruptcy and restructuring law in Poland

The cornerstone of bankruptcy and restructuring regulations in Poland is the Bankruptcy & Reorganisation Law of 28 February 2003. The Bankruptcy Law includes provisions on corporate bankruptcy, including cross-border bankruptcy, corporate recovery, and, following enactment of the amendment dated 6 March 2009, consumer bankruptcy.

The sections of the Bankruptcy Law on cross-border bankruptcy proceedings were drafted in accordance with the UNCITRAL Model Law on Cross-Border Insolvency of 1997. The Bankruptcy Law implements EU Directives 2001/17 and 2001/24 on the Reorganisation and Winding-up of Insurance Undertakings and Credit Institutions and is also compatible with the EU Insolvency Regulation (1346/2000).

Since Poland acceded to the European Union on 1 May 2004, the Insolvency Regulation is directly applicable in Poland.

Overview of bankruptcy and recovery

Corporate bankruptcy and recovery proceedings are a sort of "general enforcement proceedings" available to several creditors against a single debtor. They allow all of a debtor's obligations to be finally settled in a single judicial proceeding. Bankruptcy proceedings may involve selling some or all of the debtor's assets, and may also involve the creditors and the debtor reaching an arrangement for repayment of all or an agreed part of the debtor's obligations over a specific period, through a repayment plan.

Corporate bankruptcy and recovery proceedings may result in the debtor ceasing to do business, or even result in an end to the debtor's legal existence, or may result in an arrangement to restructure the debtor's obligations while the debtor regains its financial position. Creditors may then obtain satisfaction of a larger portion of their receivables than they would normally achieve through individual enforcement proceedings, but over a longer period.

Corporate recovery involves a debtor that has not yet been declared bankrupt, but is threatened with insolvency and wishes to be given some time to reorganise its business and pay off its creditors without going into corporate bankruptcy. Corporate recovery involves the debtor reaching an agreement with its creditors. This procedure takes place out of court to the extent that it is only the final recovery arrangement and repayment plan that must be approved by the bankruptcy court.

Consumer bankruptcy is a relatively new type of proceeding allowing individuals who do not conduct business activity but are unable to pay all their debts due to circumstances beyond their control to settle all their debts with their creditors by liquidating their assets and paying the remaining debts over a period of up to five years, in accordance with a repayment plan.

Aim of bankruptcy proceedings

The main statutory aim of bankruptcy proceedings in Poland is to maximise satisfaction of the insolvent debtor's obligations, with the secondary aim of maintaining the debtor's business as a going concern, if feasible.

Satisfaction is obtained by appointment of a bankruptcy trustee who assumes the management of the debtor's business in order to liquidate its assets and perform the debtor's obligations to its creditors, or by appointing a court supervisor to oversees the debtor's management of its own business (debtor in possession) to make sure the debtor performs its obligations to creditors, liquidates some or all of its assets, and complies with the court-approved repayment plan. The method of satisfaction and mode of management of the debtor's business depends on the type of bankruptcy proceeding that has been initiated.

Commencement and types of bankruptcy proceedings

Generally bankruptcy proceedings are initiated by a petition for bankruptcy, which may be filed either by the debtor itself or by one or more of its creditors.

A corporate bankruptcy proceeding may be conducted either as a proceeding involving liquidation of the debtor's enterprise (liquidation bankruptcy) or a proceeding seeking to reach an arrangement with creditors (arrangement bankruptcy).

Only a debtor that has become insolvent may be declared bankrupt. Under the Bankruptcy Law, an insolvent debtor is one that is not performing its monetary obligations as they become due, or, if the debtor is a company, has debts that exceed the total value of its assets (even if obligations are being performed on time).

The court may reject a petition for bankruptcy if the debtor is no more than 3 months behind in paying its debts and the total value of unpaid debts does not exceed 10% of the total balance sheet value of the debtor's enterprise. In such a case, recovery proceedings may be initiated instead.

Bankruptcy cases in Poland are handled by specialised commercial divisions within the district courts, with relatively young judges presiding. The bankruptcy petition should be filed with the court that has local jurisdiction over the debtor's principal place of business. If the debtor has multiple places of business under different Polish court jurisdictions, any of the courts is proper. If the debtor's business is located outside Poland, the court with jurisdiction over the debtor's registered office or domicile is proper, and if the registered office or domicile is also located outside Poland, the court with jurisdiction for the location of the debtor's assets in Poland is proper.

The Polish Bankruptcy Law generally only applies to debtors with their registered office in Poland and debtors with assets in Poland. The EU Insolvency Regulation authorises a Polish court to initiate the bankruptcy of a foreign entity if the court finds that the debtor's centre of main interests is in Poland (e.g. the managing directors reside in Poland, the decision-making process takes place in Poland, or the like).

If the court decides that the statutory grounds have been fulfilled to initiate a bankruptcy proceeding, it will issue an order declaring the debtor bankrupt. The order is published in the official journal Monitor Sądowy i Gospodarczy and in a nationwide daily newspaper. Creditors are requested to file proofs of claim with the bankruptcy court. After the claims have been verified, a list of claims is prepared.

Meanwhile, the trustee in a liquidation bankruptcy, or the debtor in possession overseen by the court supervisor in an arrangement bankruptcy, prepares a complete list of the debtor's assets and allows court experts to appraise any asset to enable future sale.

Course of corporate bankruptcy proceeding after bankruptcy is declared

A liquidation bankruptcy involves the sale and liquidation of all assets of the debtor in order to satisfy the creditors' claims. The Bankruptcy Law favours selling the entire enterprise of the debtor as a going concern, but if such sale is not possible, each asset is sold separately until all creditors' claims have been satisfied to the fullest extent.

In a liquidation bankruptcy the debtor is removed from managing its assets, and instead a bankruptcy trustee is appointed by the bankruptcy court. The trustee takes charge of the debtor's assets, which then constitute the bankruptcy estate. The trustee is required to take any actions necessary to allow for maximum satisfaction of the creditors' claims.

The trustee's actions are supervised by the judge-commissioner, a bankruptcy judge who is appointed to oversee the specific bankruptcy proceeding. Bankruptcy trustees are registered with the local court and must be experienced in managing enterprises, although in practice they rarely have sufficient experience to manage large-scale businesses.

An arrangement bankruptcy is initiated if it appears likely that creditors would be satisfied to a greater degree if the debtor's business were retained by the debtor and not liquidated. This usually happens if there are sufficient assets left in the debtor's enterprise to allow a reorganisation to take place and allow the debtor to pay off its creditors and return to full solvency. In such a situation, the debtor is usually allowed to continue managing its assets as a debtor in possession, but under the supervision of a court-appointed supervisor as well as the judge-commissioner, and certain actions of the debtor cannot be undertaken without their consent.

The petition to initiate arrangement bankruptcy proceedings must contain detailed arrangement proposals as to how and when the creditors are expected to be satisfied. Arrangements usually involve repayment of a debtor's obligations over a longer period, debt-to-equity swaps, or a partial write-off of the debtors' obligations to the creditors, as well as liquidation of the debtor's redundant assets. In order to become effective, an arrangement requires acceptance by the majority of creditors, who must represent at least 3/5 of all the outstanding debts to be paid by the debtor, as well as confirmation by the judge-commissioner.

The bankruptcy court may convert an arrangement bankruptcy into a liquidation bankruptcy or vice versa in the course of the proceeding if the circumstances warrant.

Process and order of satisfaction of creditors in liquidation bankruptcy

The bankruptcy trustee sells the debtor's property by public tender, with the minimum bid and the general conditions of sale set by the judge-commissioner. If the tender is unsuccessful, the judge-commissioner may allow the trustee to hold another tender, at a lower minimum bid, or sell the assets or business of the debtor to whomever the trustee chooses (provided the minimum price and general sale conditions set forth by the judge-commissioner are met).

It should be noted that the purchaser of an asset or business in the course of a bankruptcy proceeding acquires the asset or business free from any encumbrances or other third-party claims (such as tax liabilities connected with the business, which in an ordinary business purchase would be assumed by the purchaser up to the value of the business acquired).

Creditors are satisfied in specific categories in bankruptcy proceedings. The first category involves general costs of the bankruptcy proceedings, including the trustee's fees, costs of actions concerning the bankruptcy estate, pensions payable by the debtor etc. If the bankruptcy court finds that the remaining assets of the debtor do not suffice to pay the costs of the proceeding in this category, the bankruptcy petition will be rejected. The second category includes salaries, maintenance payments etc. The third category involves taxes and social security payments and other unsecured public levies. All unsecured commercial creditors' claims are included in the fourth category, together with interest for the year preceding declaration of bankruptcy, and category five includes interest for remaining years and possible administrative or judicial fines and penalties. (The position of secured creditors is discussed separately below.)

Creditors from a lower category may be satisfied only when all claims from the higher ranking category have been satisfied in full. All creditors in a given category are satisfied proportionally to the total amount of their claims. In many cases the satisfaction of creditors is effected in several successive payments (as the assets of the bankrupt are liquidated). Creditors whose claims are listed in the fourth and fifth category rarely have more than 10% of their claims satisfied.

Position of secured creditors in liquidation bankruptcy

Certain types of claims are treated in a special way under the Bankruptcy Law. These involve creditors whose claims are secured by liens, specifically mortgages, registered and ordinary pledges, treasury pledges and maritime mortgages. Moreover, creditors whose claims are secured by a fiduciary transfer of title as security are treated the same as creditors whose claims are secured by an ordinary pledge.

Secured creditors' claims are satisfied from the proceeds of sale of the respective secured asset. The proceeds of sale of a secured asset are first applied to satisfy the claims secured thereby, and whatever is left after complete satisfaction of all creditors secured by a given asset is transferred to the bankruptcy estate to be used to satisfy the claims of general unsecured creditors.

The Bankruptcy Law also honours retention of title clauses. However, for retention of title to be effective in a Polish bankruptcy proceeding, the agreement must be endorsed with a certified date, which can generally be attached to any document by a notary or other authority serving that function in a given country. Creditors who have retained title to assets which were held by the debtor at the moment of declaration of bankruptcy may apply to the bankruptcy court to release such assets from the bankruptcy estate and turn them over to the creditor.

Position of secured creditors in arrangement bankruptcy

In an arrangement bankruptcy, creditors whose claims are secured by assets of the debtor are not automatically included in the arrangement (unlike all unsecured creditors), but only in relation to the amount of the claim equal to the value of the secured asset. The amount of the claim exceeding the value of the secured asset is treated as an unsecured claim in an arrangement bankruptcy. However, should such secured creditors wish to participate in voting and discussing the arrangement proposal and therefore choose to allow their otherwise excluded claims to be included in the arrangement, they may issue an unconditional submission to having their secured obligations included in the arrangement. Such submission requires them to comply with the confirmed arrangement even if they voted against it. Without such submission, secured creditors cannot be forced to be included in the arrangement. This is a powerful instrument in favour of secured creditors, as generally all unsecured creditors in arrangement proceedings are bound by the confirmed arrangement, even if they voted against it or did not participate in voting, provided they were entitled to participate.

Liability for failure to file bankruptcy petition

Members of the corporate body which manages the debtor's affairs (in Polish limited-liability and joint-stock companies, the management board) or persons who are otherwise authorised to represent the debtor (e.g. partners authorised to represent a partnership) are required to file a bankruptcy petition within 14 days after the debtor becomes insolvent. Otherwise, all such persons authorised to represent the debtor are liable for any damage suffered (by the creditors or the debtor) due to failure to file a timely bankruptcy petition. In the case of limited-liability companies, members of the management board also bear subsidiary liability for the debtor's obligations if enforcement against the debtor is ineffective and they failed to file a timely bankruptcy petition. Such liability may be avoided if the person proves that he or she was not at fault for the failure to file a timely petition or that no creditor suffered any harm.

Cross-border bankruptcy proceedings

The Polish Bankruptcy Law contains provisions on cross-border bankruptcy proceedings which are based on the UNCITRAL Model Law on Cross-Border Insolvency of 1997 and allow Polish courts to declare the bankruptcy of foreign entities if their "centre of main interests" (COMI) is in Poland. Correspondingly, a foreign court may declare the bankruptcy of a Polish entity if its COMI is in that country.

Foreign bankruptcy proceedings concerning Polish entities require recognition by a Polish court in order to obtain the effectiveness of general bankruptcy proceedings in Poland and to prevent any further bankruptcy proceedings (apart from secondary proceedings) from being initiated in Poland.

The bankruptcy proceedings initiated in the country where the COMI is located are considered primary bankruptcy proceedings. It is possible to initiate secondary bankruptcy proceedings in another country if the debtor has assets in the country and creditors from the country apply for secondary proceedings to be initiated to protect their interests.

Since Poland joined the European Union on 1 May 2004, EU law is now part of the Polish legal system. This includes the Insolvency Regulation (1346/2000), which governs the issue of cross-border bankruptcies, including the initiation of primary and secondary bankruptcy proceedings. The Insolvency Regulation is generally similar to the Bankruptcy Law provisions on cross-border insolvency, but wherever there are differences the Insolvency Regulations takes precedence over the Bankruptcy Law. Although they still have relatively limited experience in applying EU law, Polish bankruptcy courts have dealt with some cross-border insolvencies under the Insolvency Regulation in Poland. Some foreign bankruptcy proceedings handled by courts of other EU member states on the basis of COMI have been recognised in Poland.

Corporate recovery proceedings

Recovery proceedings are available to a debtor that is only threatened with insolvency but has not become insolvent yet. It is also possible for the court to initiate recovery proceedings concerning an already insolvent debtor if its bankruptcy petition is rejected, but only if the debtor is no more than 3 months behind in performing its obligations and the total value of unfulfilled obligations does not exceed 10% of the total balance sheet value of the debtor's enterprise, and further provided that the rejected petition provided for initiation of recovery proceedings as an alternative.

Recovery proceedings are not available to every debtor, as certain conditions must be met in order to qualify. Recovery proceedings are initiated by publication of an announcement in the official journal Monitor Sądowy i Gospodarczy, with notice to the bankruptcy court, which may overrule the announcement.

The initiation of recovery proceedings results in a stay of enforcement proceedings against the debtor and suspension of accrual of interest on the debt. The debtor may then reorganise its enterprise and reach agreements with its creditors for payment of their claims. For the duration of the recovery proceedings the debtor is restricted in certain actions, and a court supervisor is assigned to oversee its recovery. The restructuring of debts and arrangements with creditors are generally regulated in a way similar to the arrangement with creditors in an arrangement bankruptcy, and require consent of the creditors and confirmation by the bankruptcy court in order to be effective. The main difference between a recovery proceeding and an arrangement bankruptcy is that the majority of recovery actions are undertaken out of court by the debtor and its creditors, thus greatly decreasing the duration and cost of the entire process.

Consumer bankruptcy

An individual who does not operate a business may file a bankruptcy petition. This is only possible if the debtor became insolvent due to exceptional circumstances, through no fault of his or her own, and the debtor was not in bankruptcy within the previous 10 years.

The debtor's assets (including real estate if any) are then liquidated and creditors paid from the proceeds. In a consumer bankruptcy, a portion of the outstanding obligations of the debtor are to be discharged in return for full cooperation of the debtor and the timely and proper payment of the remaining obligations. The other unsatisfied obligations, in the event that the sale of assets fails to satisfy creditors fully, are to be paid by the debtor in accordance with a repayment plan, which is prepared by the bankruptcy trustee and the bankruptcy court. The repayment period cannot exceed 5 years. Once the debtor has properly paid off all his or her debts under the repayment plan, he or she is free of all obligations that were included in the proceedings, regardless of whether they have been paid by the debtor or discharged.

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Equal pay for equal work

Agnieszka Lisiecka

Charges of discrimination because of different pay for similar jobs may come as a surprise to employers. An employee may claim discrimination because he or she earns less than a colleague doing the same job. Once the employee shows that the position is the same but the pay is different, the burden of proof shifts to the employer to show that there is no unlawful discrimination. Does the employer have strong enough arguments to show that the employee is wrong? It is worth considering some legal safeguards at the early stages.

Wage discrimination?

Discrimination in earnings is one of the forms of employment discrimination. This has been directly governed by the Labour Code in its present form since 2004. Wage discrimination means violating the principle that employees have the right to equal pay for the same work or work of equal value.

Employers are in violation of this principle if they differentiate in wages without objective, reasonable cause, and thus when they use an arbitrary criterion that does not further a justified purpose or is disproportionate to achieving the purpose.

This relates to a very broad understanding of pay, extending to all components of employee earnings, regardless of how they are labelled, including employment-related benefits in cash or in kind. An employee may claim discrimination as to all elements of their compensation package together, some specific elements, or even just a single element of the overall package.

What is identical?

As a rule, identical work is work performed at the same job position. Work of equal value is work that requires employees to have comparable professional qualifications (as demonstrated by relevant certifications and by practice and professional experience) and also entails comparable responsibility and effort.

Equality should be assessed in terms of duties actually performed as well as the responsibility assigned to the employees. Work by employees at the same position, and holding similar professional qualifications, is not considered to be identical work if the duties entrusted and actually performed indicate a different degree of complexity or a different scope and degree of responsibility.

In practice, a detailed comparison should be conducted to show that the work is not really the same, or of the same value. This means that litigating these kinds of cases is complicated and time-consuming, and the court has a considerable amount of discretion when deciding the case.

Equality for all?

The principle of equal treatment in the area of wages does not mean that pay should be absolutely equal. Differences in pay are one of the many components that go to make up employee incentives. These are of course indispensable to the process of establishing the employee's overall compensation package. It is important to differentiate in salaries using legally permissible criteria and parameters, which are objectively justified, further a justified purpose and are proportionate to achieving the purpose.

The Labour Code directly states that pay for work should be set in a way that corresponds to the particular kind of work performed and the qualifications required to perform it, and also takes account of the quantity and quality of the work performed. An employer may thus differentiate in salary when describing an employee's work duties and assessing the quantity and quality of effort expected.

This will be particularly significant in cases where employees hold the same job titles, and thus where the work is basically identical. From this point of view, it is important to specify precisely the scope of duties and responsibilities of employees in particular job positions and to carry out periodic assessments of the employees' work. Then, if a discrimination case is filed, this will serve as evidence that any differentiation in earnings is justified by the quality and quantity of the work performed.

Other criteria for permissible differentiation arise from the definition of work of equal value. Professional qualifications, backed by relevant certifications, practice and experience, are one such criterion, so long as they are relevant and necessary to perform the work. One of the valid criteria for wage differentiation is that there are different levels of responsibility or effort associated with the work.

Another differentiation criterion that is also allowed, and indeed expressly recognised in the Labour Code, is length of service. Since length of service is closely associated with professional experience, the employer need not demonstrate the rationale for applying this criterion. However, if the employee questions this criterion (e.g. in a situation where the employer cites length of service with previous employers), the employer must show that the criterion is being applied in a justified manner.

The main burden of proof in any court case will rest with the employer. The employee needs to make an initial showing of discrimination (for example by specifying the basis of the alleged discrimination and demonstrating that the work performed by the employees in question is comparable). The employer must then show that it does not discriminate against the employee, in other words, that it applied legally permissible criteria when setting the employees' pay at different levels.

Why is this a threat?

If discrimination is proved, the employee has a right to compensation in an amount not less than the gross minimum wage (which in 2010 is PLN 1,317, or about USD 400, per month). The regulations do not provide a maximum level for compensation, but the predominant view, based on Polish Supreme Court case law and legal scholarship, is that compensation for wage discrimination is intended to made up for the difference in earnings that the employee received and what he or should have received were it not for the discrimination. The court may also establish non-discriminatory terms and conditions for continuing employment in the future.

It is important in discrimination cases to recognise that the employer's image is on the line, and the employer is also running the risk of further claims from other staff if it loses a case. For these reasons, settlements are difficult for an employer to accept in such court cases. Any concession that requires the employer to pay compensation creates the impression – not necessarily accurate – that the employer has admitted discriminating.

Summary

The principle of equal pay for equal work gives staff a handy yardstick for checking whether their salary was set at the right level. A disgruntled employee may easily compare himself to other staff and try to claim wage discrimination. If a case comes to court, the employer must be prepared to present evidence to demonstrate in an objective way the differences in the quality or quantity of work performed by particular employees, and make a persuasive case that differences in pay are justified.

An employer will be all the more credible if it precisely specifies the scope of duties and responsibilities for every employee, introduces wage bands for particular positions, and, most importantly, a system for periodic appraisal based on uniform assessment criteria. It is worthwhile considering introducing job evaluation systems for more complex organisational structures.

Agnieszka Lisiecka, an adwokat *and partner, heads the Employment Law Practice*

Easier to file for bankruptcy

Michał Barłowski

An amendment to the Polish Bankruptcy Law went into effect on 22 December 2010, giving debtors a chance to supplement deficient bankruptcy petitions while maintaining the original filing date.

Under the Bankruptcy & Reorganisation Law dated 28 February 2003, the debtor is required to file a bankruptcy petition within two weeks after it becomes insolvent (Art. 21(1)). If the deadline is not met, the debtor is liable for resulting damages. (In the case of a legal person or organisational unit without legal personality, the debtor's representatives, e.g. the members of the management board, are liable.) Thus the consequences of failure to file a bankruptcy petition on time may be serious. The bankruptcy court may also strip the debtor's representatives of the right to conduct business activity for up to 10 years, and the members of the management board may also be personally liable for the company's debts under Commercial Companies Code Art. 299.

In practice, these negative consequences have also arisen in cases where a bankruptcy petition was filed on time, but it was formally defective or incomplete, failing to meet the conditions set forth in Bankruptcy Law Art. 22 or 23, or the fee was not paid. These provisions require numerous documents to be submitted with the bankruptcy petition, particularly when filed by the debtor, such as a list of the debtor's assets and estimated value, a balance sheet prepared within the past 30 days, a description of the circumstances indicating that the debtor is insolvent, a list of creditors, and so on. It is a long list, and most of the items are not readily available but must be prepared especially for the purpose of filing the bankruptcy petition.

Legal practitioners as well as bankruptcy judges admit that preparing a bankruptcy petition with all the required enclosures within the course of two weeks is extremely difficult. Nonetheless, filing of an incomplete petition, which did not meet the formal requirements – whether or not the debtor was represented by counsel – resulted in rejection of the petition without an opportunity to amend it to supply the missing items.

The grounds for dismissal of a bankruptcy petition were considered by the Polish Constitutional Tribunal, which held in a judgment issued in November 2009 that Bankruptcy Law Art. 28 is unconstitutional because it does not provide an opportunity to supplement a defective bankruptcy petition where the petitioner is not represented by an advocate or legal adviser. In the court's view, such a restrictive regulation violated the right to due process guaranteed by the Polish Constitution.

The amended Art. 28 gives a petitioner who is not represented by counsel seven days from service of the order rejecting a bankruptcy petition to supplement the petition or pay the fee for the petition, while retaining the original filing date of the petition. The new rule also provides a right to refile the petition even if the petitioner is represented by counsel, but in that case the petition is returned without a summons to supplement or pay for the petition. In either case, a grace period is given to the petitioner only once.

In light of the amendment, it appears that a debtor preparing to file for bankruptcy who realises that it will not be in a position to file a complete petition should nonetheless file a petition within the statutory 14-day period following insolvency, even if the petition is incomplete. Then the debtor should gather any missing documentation as quickly as possible so that it will be in a position to file a complete petition within 7 days after rejection of the original petition. In reality this extends the deadline to file a complete petition not only by the 7 days referred to in the law, but also by the period required for the court to review the original petition and serve the order rejecting the petition on the debtor.

Practice will show what effect the amendment will have on the number of properly filed bankruptcy petitions.

In terms of the goals which the Bankruptcy Law is designed to serve, the amendment appears justified. On one hand, the debtor will still be required to file a petition within a short time, and the debtor's representatives must remain aware if the debtor becomes insolvent, while, on the other hand, problems that arise in complying with the 14-day deadline will not in and of themselves result in liability for failure to file a complete bankruptcy petition on time. Under the previous rule, filing an incomplete petition was treated the same as filing no petition at all.

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Caution advised when tendering in Poland

Mirella Lechna

Anna Prigan

Foreign businesses intending to participate in Polish tenders should prepare themselves for difficulties. They need to take into account that tenders are conducted in Polish and that Polish tendering procedures, although compliant with EU laws, are more formalised than those applied in other EU member states.

One: power of attorney

The bid must be signed by an authorised agent. The authority to sign must be demonstrated by an entry in the commercial register or by a power of attorney. The power of attorney authorising the proxy to act for a company in a tender procedure must be in writing, with the original attached to the bid. The power of attorney must expressly state the proxy's authorisation to act in tender procedures – specifically to sign bids. Usually the power of attorney also authorises the proxy to conclude contracts when the bid is successful and to exercise legal remedies available to bidders. The latest that a power of attorney can be dated is the date of the bid.

Two: bid security

If the contracting authority requires posting bid security, it must be disbursed in cash and deposited before the deadline for submitting bids in the bank account indicated by the contracting authority. The funds have to be credited to the bank account before opening the bids. From this perspective the date of transferring the funds is irrelevant. The bid will be rejected should the funds be credited to the contracting authority's bank account too late or in the wrong account. Bid security amounts cannot be supplemented. The contracting authority retains the bid security if the bidder whose bid has been selected refuses to sign the contract on the terms specified in the bid and the terms of reference. Additionally, the contracting authority may retain bid security funds if a bidder who was requested to submit additional information or documents failed to comply with the request within the time provided, unless the bidder proves that it was due to reasons for which it was not responsible.

Three: tender terms

The terms of a tender are set forth in the tender notice and the terms of reference. A draft contract is part of the terms of reference. By submitting their bids, bidders agree to sign the contract on the terms provided by the contracting authority. Bidders are not allowed to negotiate the terms of reference, but they may request clarifications from the contracting authority and in this way can influence the provisions of the future contract. The contracting authority is not required to comply with the bidder's remarks, although it must provide the bidder with clarifications or information concerning the tender documentation as long as the request for clarification is received by the contracting authority no later than halfway through the period allowed for submission of bids.

Four: legal remedies

Actions and decisions of the contracting authority during the tendering procedure may be appealed. Bidders may file appeals with the President of the National Appeal Chamber.

Appeals may be based on legal violations or prohibited acts or omissions. In general, an appeal must be filed within 10 days after the violation or the prohibited act or omission is committed or the appellant learns about it. An appeal may be filed on paper or in electronic form. No other types of appeals are allowed.

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A well-functioning compliance division lets management sleep easier

Danuta Pajewska

Many companies are forming compliance divisions. What does a compliance division do?

Danuta Pajewska: The "compliance" concept arose in the United States in the 1990s following a wave of corporate scandals. The US Supreme Court held that every firm should comply with certain standards to protect its directors and officers from liability. It is crucial that the rules be consistent at all levels of the corporate structure, vertically and horizontally. Everyone in the company must know what they are supposed to do and know their own scope of responsibility and authority. Corporate boards must organise supervision over all processes within the firm in such a way that they can be monitored and managed. It is also necessary to have certain mechanisms in place for reviewing procedures and identifying and eliminating risks. It is important to teach people that procedures are not just a whim from the higher-ups, but a method for achieving understanding and cooperation within a company. The purpose of compliance procedures is to eliminate the consequences of instances in which both the external law and the internal rules are vague or unclear in practice.

The compliance concept spread beyond the US with the creation of companies with numerous offices, subsidiaries and entire capital groups. Procedures became necessary in order for companies to function in a uniform way.

In Poland, compliance principles have entered the law. The Polish Banking Law and regulations governing brokerages and investment funds require that a financial institution have a risk management system in place, as well as a "compliance officer" – a kind of internal policeman who checks whether all rules are being observed. This person is also responsible for adapting procedures to suit new laws. Compliance divisions are not limited just to companies in highly regulated fields. We know from practice that compliance specialists are also hired in production companies and in the pharmaceutical and food industries. Anywhere that there is a risk of liability or violation of certain norms, compliance issues will be particularly relevant. It is important to make sure that everything is in order within the company and that there are people responsible for executing and monitoring compliance. A well-functioning compliance division lets management sleep easier.

What is the threat if these rules are not in place?

A lack of rules may create serious risks for a company. Legal compliance programmes help companies avoid a whole series of risks, from poor reputation, through a declining share price, to fines, invalidation of contracts, withdrawal of operating licences, and even insolvency.

It is crucial for internal rules and procedures to bind the company with standards that function vertically and horizontally, to insure information exchange and cooperation between units operating at the same level, even though vertically they answer to different people. We have seen how a lack of such procedures exposed a bank to liability to customers. Debt securities were issued in unit A and sold to investors in unit B. Later unit A learned that one of the issuers was threatened with insolvency, but it failed to share this information with unit B, which continued to sell the securities. The result was liability claims. The cause was improper flow of information.

How to assure that the compliance division operates effectively?

In financial institutions this is defined by specific regulations. For example, it is very important for the compliance officer to be positioned correctly within the corporate hierarchy. The compliance officer should not be subordinated to too many people, who may pressure the officer to overlook certain areas of the company's operations.

It is also important for companies to review their own regulations from time to time. Our law firm has experience in such projects. It may turn out during the course of such reviews, for example, that certain areas of the company's operations are not covered by the regulations at all, and procedures do not govern all aspects of the business. We have also seen from our experience that even when employees know how they are supposed to act in practice, if there is no relevant provision laid out in the company rules, then in the event of any irregularities the employees will claim that they were never told in writing that they were supposed to act in a certain way. This also means that there will not be proper grounds to charge the employee with violation of specific rules and obligations, which is key from the point of view of holding employees accountable.

How should such a review be carried out?

In one company the management board hired us to examine whether staff and managers running specific divisions are aware of the risk of criminal activity in their divisions, or whether they think about these issues at all. We began the study by selecting the offences that might be relevant to the particular type of operations, and then we raised these issues in interviews with the staff. We were concerned that employees would not want to talk frankly with us because they might suffer repercussions if any shortcomings were exposed. But in fact their awareness and willingness to talk were huge. The staff perceived areas of risk, and during the review they saw the benefits of developing the right preventive measures.

Of course, even the most effective compliance division cannot guarantee that there will never be any violations. The fact that we have criminal laws on the books is not enough to stop people from killing or stealing.

However, the existence of written rules does make it possible to "force" certain behaviours within an organisation, prevent bad actions and take corrective measures at the employment and process levels if they do occur. With a functioning compliance programme in place, corporate officers and directors have the tools at their disposal to monitor the company and protect it from exposure. Compliance helps protect the company and employees from civil, criminal and administrative liability.

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A roadmap to saving lives

Joanna Krakowiak

A report by the Supreme Audit Office from an investigation into clinical trials in Poland found that studies are often conducted improperly. Extreme instances, in which an investigator conducts up to dozens of different studies at the same time, at a single hospital, without the knowledge of the hospital director, paint a picture of clinical trials as a source of extra income on the side for doctors. One person who seems forgotten in the current media debate is the patient, whose well-being is the overriding reason for conducting tests of new medicines.

Purpose of clinical trial

In the classic view, the purpose of a clinical trial is to verify the safety and efficacy of a new substance or mixture of substances that might be admitted to the market in the future as a medicinal product. Without clinical testing on humans, it would not be possible to study new medicines accurately or achieve progress in medicine.

A patient who decides to take part in a clinical trial is informed of the purpose of the study and the possible benefits, but also the risks that the patient may face by taking part in the study. Before joining the study, the patient submits a statement giving informed consent to participate, in which the patient confirms that he or she is aware of the nature of the study. When agreeing to participate in a clinical trial, the patient acknowledges both the possibility of a cure, but also the risk that his or her medical condition may grow worse.

Participation in clinical trial and patient's health

For patients suffering from rare diseases or particularly severe cases of common illnesses, receiving treatment with the medicine being tested may be the only chance to improve their health. If the patient responds positively to the medicine received during the study, the chance for a cure or at least longer survival increases. However, a clinical trial is scheduled for a fixed period, determined in advance, which is deemed to be sufficient to test the new medicine (e.g. 24 months).

Doctors conducting trials often face the question: is it possible to continue treating the patient with the medicine after the end of the trial? This is a question of vital importance to patients, because even if the medicine is approved, it will then be a year or more before the new medicine reaches pharmacies. That is how long it takes to pass through European, Polish or central registration procedures for medicines. Is an interruption in treatment with a lifesaving medicine unavoidable?

Treatment with unregistered medicines – current regulations

Under the Polish Pharmaceutical Law dated 6 September 2001, in its current wording, a patient has only a tiny chance of continuing to receive treatment with the tested drug immediately after the end of the trial. The Pharmaceutical Law does allow for the possibility of importation of a finished medicine that is not registered in Poland, for a specific patient or group of patients, but this option is restricted.

Current procedure

In order to import the medicine, the doctor leading the trial, the hospital, or theoretically the patient himself, must file an application for consent to import a medicine that is not registered in Poland. The application is assessed by the national or province consultant from the given field of medicine, and then considered by the Minister of Health. If the cost of the medicine is to be reimbursed by the National Health Fund, the application must also be approved by the president of the Fund.

Doctors filing an application must submit a declaration that they are aware that they are ordering a medical product that is not authorised for sale in Poland and that the product will be used on the applicant's responsibility.

The details for this complicated and time-consuming procedure are governed by the regulation of the Minister of Health dated 18 April 2005. If the tested medicine is completely new, however, i.e. has not been registered in any country, there is no possibility of obtaining consent to use it.

Compassionate use in the EU

For the sickest patients, for whom treatments that have been admitted to the market are ineffective, "compassionate use" programmes have been created to enable them to be treated using the newest, sometimes unregistered medicines. The foundations for these programmes are set forth in Regulation (EC) No 726/2004 of the European Parliament and of the Council of 31 March 2004 laying down Community procedures for the authorisation and supervision of medicinal products for human and veterinary use and establishing a European Medicines Agency. Compassionate use programmes may be organised under the regulation throughout the EU, including Poland. However, this applies only to medicines that are subject to central registration at the European Medicines Agency, in London.

With respect to medicines registered in the decentralised procedure (DCP), the mutual recognition procedure (MRP) or national procedure, there are no harmonised rules for seeking continuation of treatment using a tested medicine after the end of the study but before the medicine is admitted to the market. Efforts to deal with this issue have been attempted in some EU member states, however.

A new right for patients?

The possibility of continuing therapy with a tested drug after the end of the trial is beginning to be perceived as a right of the patient arising out of his or her involvement in the clinical trial. In some European legal systems, it has even been decided to impose on the sponsor an obligation to provide the medicine after the end of the trial. In the UK, the National Research Ethics Service has published guidelines under which there are various options for providing a drug to the patient after the end of the study, depending on what is agreed between the sponsor and the investigator, but when the patient agrees to participate in the trial he or she must be informed in detail whether there will be a right to receive the medicine afterwards and under what conditions.

Closing a loophole

The current version of the white paper outlining the draft Clinical Trials Act (dated 11 June 2010) provides that a participant in a clinical trial who has responded positively to the action of the medicinal product will be able to seek consent to receive it after the end of the trial but before the product is registered. This is good news for the sickest patients who are not helped by the available treatments. The new regulations are designed to create a legal framework providing an opportunity to make up for the negative effects of ceasing to take the tested drug after the end of the trial, until it is registered.

New procedure

The white paper issued by the Polish Ministry of Health outlines a proposal for a Clinical Trials Act. The act would comprehensively regulate clinical trials issues and replace the current provisions included in the Pharmaceutical Law. Based on the white paper, however, the path to receiving possibly lifesaving treatment would not be easy. The Minister of Health would have to consent to the chief investigator's providing the medicine to the participants, at the sponsor's cost, after the clinical trial ends. In practice this would require consultation with the chief investigator, signing of an agreement with the sponsor, and obtaining an administrative decision issued by the minister.

Financial undertaking of sponsor

Under the white paper, the sponsor would be required to make an undertaking to cover the costs of importing or producing the tested medicinal product, delivering and providing it. The sponsor would also state in its undertaking the period for which it would finance treatment with the product after the end of the clinical trial. Financing of the product after the end of the trial would not continue after the product is registered.

The sponsor's consent to provide a medicine that has not yet been admitted to the market to a specific patient free of charge would shift the financial burden of treating the patient to the pharmaceutical company. The white paper does not provide for any reimbursement of the cost of such product by the National Health Fund, or any form of copayment by the patient. In this sense, the pharmaceutical company would effectively assume the state's obligations with respect to providing access to medicines.

Risk of liability of pharmaceutical company and doctor

Apart from bearing the cost of providing unauthorised medicines to a specific patient or group of patients, the sponsor would also have to accept the risk of liability for any injury it could cause the patient. Even if the patient responded positively to the medicine during the clinical trial, the patient's response may change.

The sponsor as well as the chief investigator would bear liability for providing the medicine under the same rules as during the clinical trial. If the Clinical Trials Act were adopted in accordance with the white paper, such liability would be stricter than it is now, because the sponsor or investigator would be liable for injury even if the trial were conducted properly. They could be released from liability only if the injury were caused by the participant himself, a third party for whom the sponsor or investigator is not responsible, or force majeure.

In a classic clinical trial, the sponsor bears the risk of liability and the costs of conducting the trial in order to introduce the new medicine onto the market. If the trial has been completed and the medicine has been found to be safe, but the medicine has not been registered yet and the medicine is provided to patients at the sponsor's cost and risk because the registration process is still ongoing, the sponsor makes up for the effects of the long-lasting registration procedure by its own choice and at its own risk – offering the new medicine prior to registration free of charge. Under the proposed act, when issuing consent to compassionate use, the Minister of Health would approve the terms agreed among the patient, the sponsor and the investigator, but would not assume on behalf of the state any financial obligations associated with a therapy that is still undergoing approval.

What to expect in the future?

There is a chance that a new Clinical Trials Act will create a legal framework for establishing compassionate use programmes in Poland. It is difficult to predict when the white paper will be turned into an actual bill, or when the bill could then be enacted. Given the critical findings by the Supreme Audit Office, work on the bill may be expedited, but there is still time for debate on the ethical and legal ramifications of the proposal.

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“Recertification” of a delisted but still functioning employment agency

Szymon Kubiak Radosław Teresiak

In a difficult labour market, it is becoming more and more popular to operate an employment agency. In Poland, this is considered a regulated activity for purposes of the Business Freedom Act and requires entry in the Register of Employment Agencies under Art. 18 of the Act on Promotion of Employment and Labour Market Institutions.

In commercial practice, however, it is fairly easy – even unintentionally – to bring about deletion of an agency from the Register of Employment Agencies. For example, if the agency fails to submit an annual report on its activity to the province marshal, as required by Art. 19f of the Act on Promotion of Employment, the marshal will issue a decision deleting the agency from the register.

The question thus arises of what an agency should do if it finds itself in this situation for whatever reason. Should it seek to re-register as quickly as possible? Even after it re-registers, will it still face significant sanctions – including the most severe, i.e. a ban on doing business for as long as three years (the sanction that may be applied to a business that conducts operations without a required entry in the register)?

A fine?

Under Art. 121(1) of the Act on Promotion of Employment, operating an employment agency without the required registration is a petty offence punishable by a fine.

Only an individual may be guilty of this offence – typically a management board member if a legal person is involved. Even though the person convicted of such an offence is an individual, the entity registered as an employment agency may be a legal person, and thus even if a member of the management board were convicted of the offence under Art. 121, this would not result in the employment agency being deleted from the Register of Employment Agencies if the agency is a company.

Prohibition on conducting business activity?

The Business Freedom Act provides for an administrative sanction in the form of a prohibition against conducting business activity, as well as possibly removing a legal person once again from the Register of Employment Agencies. This represents a very serious risk.

Under Art. 18m(2) of the Act on Promotion of Employment, the province marshal shall delete an entity from the Register of Employment Agencies if a decision is issued prohibiting the business entity from conducting activity pursuant to the entry. The legal basis for the decision in this case would be Business Freedom Act Art. 71(1)(3), and lack of a required entry in the Register of Employment Agencies would be regarded as a gross violation of conditions required to perform a regulated activity.

Significantly, in a situation where such a decision has not been issued and the fact that a regulated activity has been performed by the given business entity without a required entry in the register has not been discovered by the administrative authority, but in the meantime the entity has obtained a new entry, in our view the authority will no longer be able to issue a decision based on a retroactive finding that the entity was in gross violation of the conditions required to perform a regulated activity, under Business Freedom Act Art. 71(1)(3). There would be no substantive grounds for issuing the decision, because no gross violation of conditions could be found at a time when the entity has again obtained an entry in the register. The substantive grounds for issuance of any decision, including a decision prohibiting a business entity from conducting an activity that is subject to entry in a register, must at least exist as of the date of issuance of the decision.

Or prohibition on seeking registration?

The possibility is still open, however, for the relevant authority to impose a 3-year ban on the ability to obtain an entry in a register of regulated activity, which is the sanction provided under Business Freedom Act Art. 72(2). This is another serious risk.

We take the view that this is not a freestanding administrative sanction, in the sense that application of this sanction is dependent on issuance of a decision under Art. 71(1). In the situation discussed here, issuance of such a decision would appear not to have any foundation under the applicable regulations. Thus we may state that in the case of an employment agency, a ban on the ability to obtain an entry in the register could be applied only in a situation where the relevant authority discovered that the employment agency was operating without the required registration and issued a decision prohibiting the agency from performing the activity that required entry in the register.

In summary, in the example presented in the introduction, the best approach would be to take steps to obtain a new entry in the register as quickly as possible – before the authority discovers that the employment agency has been operating without the required entry and issues a decision on this basis prohibiting the agency from conducting such activity.

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Opportunities for EEA and EU investment and pension funds in Poland

Aldona Leszczyńska-Mikulska

Tax refund opportunities for the years 2006-2010

Until the end of 2010 there was a general corporate income tax exemption applicable to investment funds (both open-end and closed-end) operating under the Polish Investment Funds Act. These provisions were often viewed as contrary to EU law and freedoms by limiting the exemption to Polish funds only. In 2009, the European Commission found that restricting this CIT exemption to Polish investment funds discriminated against similar entities from other member states of the European Union or the European Economic Area.

In our opinion, EU or EEA investment and pension funds, as well as investment companies, are entitled to a tax refund if any CIT was withheld on their income sourced in Poland before 1 January 2011.

This view is supported by recent judgments of Polish administrative courts, which confirmed that the CIT exemption applicable to Polish funds should have been applied also to EU/EEA funds and investment companies.

Following recent court cases, we believe that opportunities exist to recover tax at the administrative level, without litigation, if a taxpayer, specifically an open-end investment fund or investment company as defined in the UCITS Directives (2001/107 EC and 2001/108/EC), submits a claim for a refund of tax withheld on interest or dividends received from Poland in 2006–2010. We take the view that other entities conducting activity in the nature of an investment fund, regardless of the legal form – even if not covered by the UCITS Directives – are also entitled to a tax refund.

New corporate income tax exemption (from 2011)

Until the end of 2010 the Polish CIT Act provided for a general CIT exemption for investment (and pension) funds operating under Polish regulations. This exemption also offered many tax optimisation opportunities to investors who had established closed-end investment funds in Poland.

As mentioned, in 2009 the European Commission found that restricting that CIT exemption to Polish funds was contrary to EU law as it discriminated against investment and pension funds from other EU/EEA member states.

In consequence, as of 1 January 2011 the CIT exemption was broadened to cover investment and pension funds from the EU or EEA, provided that they met certain conditions. The exemption for investment funds now covers EU/EEA funds, defined as collective investment institutions, which meet all of the following conditions:

- The fund is liable to tax on its worldwide income in the state where it has its registered office.
- The exclusive objective of the fund's activities is collective investing of money, raised by issuing participation units through public offering or private placement, in securities, financial market instruments and other property rights.
- The fund operates on the basis of a permit from the relevant authorities of the state in which it has its registered office.

- The fund's operations are supervised by the relevant authority of the state in which the fund has its registered office.
- The fund uses a depositary which holds its assets.
- There is a legal basis (international agreement) for exchange of information between Poland and the country in which the fund has its registered office.

The condition referring to the objective of the fund's activities differs in the case of pension funds. A pension fund falls within the scope of the exemption if the exclusive objective of the fund's activities is collection and investment of money for the purpose of making payments to participants in a pension scheme after they reach retirement age. The other conditions are the same as for investment funds.

The new exemption opens up new possibilities for tax planning and tax structuring of investments in Poland. EU/EEA funds can be used as vehicles for investing in Poland directly from abroad and can earn income in Poland through target companies (e.g. a joint-stock limited partnership) without it being taxed. Moreover, exiting from such investment is, in principle, not associated with any CIT burdens in Poland. This structure assures that, in practice, an EU/EEA fund pays no corporate income tax on its business income in Poland.

Application of the exemption and possible non-compliance with EU law

The following requirements which have to be met by investment/pension funds in order to take advantage of the exemption may create doubts as to the scope of the exemption or whether these provisions comply with EU law.

The "liable to tax" requirement

A basic condition that has to be met by the fund to benefit from the exemption is that it must be "liable to tax" on its worldwide income in the state where it has its registered office. This requirement may create problems, since the tax treatment and legal structure of investment funds vary from one jurisdiction to the next.

The first question arises with regard to the treatment of funds that are tax-exempt in the state in which they are registered. Some countries (e.g. Canada) consider tax-exempt entities as "liable to tax" even if they are not "subject to tax", while some others interpret "liable to tax" to mean the same as "subject to tax". If the latter interpretation is accepted it will make the exemption virtually unavailable to a large group of foreign funds, and that would probably infringe EU law.

Nevertheless, the current practice of the tax authorities is to issue certificates of residency to Polish investment funds that are tax-exempt in Poland, thus confirming that they are considered to be "liable to tax". This indicates that tax-exempt foreign funds will also be considered "liable to tax" within the meaning of the new exemption.

Similar problems arise in reference to investment funds having the legal form of tax-transparent partnerships or trusts. It may be difficult to consider such entities as "liable to tax". As a result, the compatibility of the "liable to tax" requirement with EU law may be called into question in the future, unless it is interpreted broadly.

As the exemption is in force only from 1 January 2011, the practical application of these provisions by the tax authorities and courts remains to be seen. In the meantime, the applicability of new structuring opportunities and their tax efficiency must be analysed on a case-by-case basis.

The "exclusive objective" requirement for pension funds

Pension funds may enjoy the exemption if the exclusive objective of their activities is the collection and investment of money for a specific purpose. Thus, pension funds that are allowed by national law to conduct other business activity, even to a very limited extent, will not benefit from the exemption. The situation of such funds is indeed different than that of their Polish counterparts, but it probably does not justify a total denial of the exemption. Thus this condition may also infringe EU law.

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Competition advocacy as a tool supporting competition law

Tomasz Wardyński

Twenty years have passed since inception in the Polish legal system of a specialised authority to safeguard free competition: the Office of Competition and Consumer Protection (UOKiK). This is a good opportunity to draw public attention to the important role played by this institution in ensuring the rule of law.

Polish society is increasingly aware of the potential benefits from free competition and antitrust legislation. Media coverage of raids and high fines imposed by UOKiK, as well as implementation of the leniency programme, have sparked considerable interest among businesspeople and the general public.

Still, the majority of Polish society does not view anti-competitive activities negatively from a moral standpoint. This is largely due to Polish history and a lack of awareness of the essence of competition as a legally protected interest. To remedy this, competition authorities promote principles of free competition, in addition to enforcing competition law. Activity of this type is described as "competition advocacy". It is directed at government agencies and society as a whole and constitutes an important pillar of competition policy.

Understanding competition advocacy

The term "competition advocacy" refers to the activities of competition authorities aimed at protecting competition through measures other than enforcing the prohibition on anti-competitive agreements, abuses of a dominant position, or prohibitions on mergers that restrict market competition. According to the definition adopted by the International Competition Network, competition advocacy rests on the creation of competitive conditions for business activity, mainly by influencing other state bodies and promulgating public awareness of competition-related benefits.[1]

In other words, competition advocacy consists of activities undertaken by competition authorities resting on participation in the process of making and applying law, but without the exercise of public authority, for purposes of propagating competition rules. It is in this sphere of activity that they act as "competition advocates" in relation to other authorities and society as a whole.

The need for actions of this type stems from the fact that "competition may be significantly limited by various official actions. Indeed, private restrictive business practices are often facilitated by various government interventions in the marketplace. Thus, the mandate of the competition office extends beyond merely enforcing competition law. … It must assume the role of competition advocate and be proactive in influencing government policies that lower entry barriers, promote deregulation and otherwise minimise unnecessary government intervention in the marketplace."[2]

Significance of competition advocacy

It is first necessary to define competition before establishing the significance of competition advocacy. But defining competition itself is problematic.

The term evades strict legal definition in the sense that various public objectives that are frequently contradictory have been pursued under the banner of protecting competition. Competition law has evolved from its ordoliberal roots to current regulations favouring economic efficiency and primary defence of consumer interests. The problem with defining competition stems from the fact that the definition

[1] Advocacy Working Group, International Competition Network Advocacy and Competition Policy Report 25 (2002), http://www.internationalcompetitionnetwork.org/OutreachToolkit/media/assets/resources/advocacy_report.pdf.

[2] World Bank & OECD, "A Framework for the Design and Implementation of Competition Law and Policy," in Competition Advocacy: Challenges for Developing Countries (1998), Chapter 6, at p. 93, http://www.oecd.org/dataoecd/52/42/32033710.pdf.

must not only identify competition as such, but also its desired results. In determining whether any practice has an anti-competitive nature, authorities must compare its actual or potential consequences to a situation in which there is no such limitation on competition. Hence there is a natural tendency to define the subject of protection of competition law through attempts to determine the consequences of unrestricted competition, so that it is upheld with appropriate administrative orders and prohibitions.

However, the very value of competition stems from the inability to predict its results or replicate them through arbitrary decisions. Competition elicits particular effects without state coercion. It is thus assumed that the effects of unrestricted competition are indeed fair specifically because they are achieved in a somewhat diffuse manner, free of arbitrary authoritative decisions. According to Friedrich Hayek, the superiority of competition not only stems from the fact that it is one of the most efficient methods of attaining our goals, but also, or even more so, from the fact that it is the only method owing to which our actions can mutually adapt to each other without coercion from the state or its arbitrary intervention.[3]

Defined in this way, competition is more than just an order of things that maximises economic efficiency and leads to material well-being. It is a value that is part of the axiology of a democracy under the rule of law and a civic society respecting individual liberty and dignity.

An economic system based on the principle of free competition is an expression of respect for the premise that citizens who are free and aware of their rights are able to establish better and fairer mutual relations independently than through state coercion. Protecting competition, understood in this way, is therefore an element of protecting basic constitutional values such as the freedom of citizens from unjustified state coercion, and the resulting civic society and democratic state founded on the rule of law.

Objectives of competition authorities

This manner of perceiving competition as a legally protected interest allows us to define properly the sorts of tasks facing competition authorities. These institutions are authorities responsible for protection of the law and constitute an important element of a system founded on the rule of law. Indeed, their role is to safeguard the liberty of individuals.

The human right to freedom, like any other human right, requires protection against the activity of private entities abusing the rights accorded to them, as well as against unjustified and excessive state intervention.

In protecting competition, antitrust bodies safeguard citizens' liberty in both of those areas. By enforcing competition laws, they prevent private entities from abusing their right to economic freedom in order to violate the rights of others. By acting as "competition advocates" towards other state authorities, competition authorities counteract unjustified or excessive restrictions of individual liberty on the part of the state.

Key areas for competition advocacy

In an attempt to safeguard competition, competition authorities closely monitor all activities of the state that may result in excessive state intervention in the economy.

The important role that competition authorities can play in the process of privatisation of state enterprises in developing countries should be emphasised. State monopolies are turned into private monopolies far too frequently.[4] This is usually due to an open desire to ensure a solid market position for the privatised enterprise, which influences its value and consequently results only in short-term benefits from privatisation. Unfortunately, competition authorities frequently do not possess a sufficiently solid position when a socio-economic system is undergoing transformation to draw attention to long-term threats to competition arising from irregularities in the privatisation process, and thereby effectively protect free competition principles against limitations.

The main area of activity by the Polish competition authority as a competition advocate is engagement in the process of legislation and influence over its application. According to a report on the activity of UOKiK in 2008,[5] its experts reviewed over 2,000 legislative proposals and other policy documents submitted to the office during inter-ministerial consultations. This was done in order to evaluate the impact that proposals would have on competition in the market. These included such proposals as laws affecting competition-sensitive markets like energy, aviation, pharmaceuticals and telecommunications.

Advocacy and enforcement

Implementing competition protection policy is a complex, multi-level process, and competition advocacy is an essential complement to the competition authority's enforcement actions.

In many cases, anti-competitive behaviour of private entities would not have been possible if not for unnecessary state

[3] Friedrich Hayek, The Road to Serfdom, London 1979, at p. 27; Robert Gwiazdowski, "O zaletach konkurencji i potrzebie jej efektywnej ochrony" ["On the Benefits of Competition and the Need for Its Effective Protection"], in Ochrona Konkurencji i Konsumentów w Polsce i Unii Europejskiej (Studia prawno-ekonomiczne) [Competition and Consumer Protection in Poland and the European Union: Legal and Economic Studies], Cezary Banasiński (ed.), Office of Competition and Consumer Protection, 2005.

[4] Robert Gwiazdowski provides an example of negligence in ensuring competition protection in the privatisation of the telecommunications sector. Id. at p. 79.

[5] http://www.uokik.gov.pl/pl/o_urzedzie/informacje_ogolne/sprawozdania_z_dzialalnosci_urze/

intervention in the economy, which only encouraged it. Proper legal or institutional solutions could in large part limit the need for intervention by competition authorities and thereby facilitate and increase the effectiveness of such intervention when needed.[6]

The role of competition authorities should, therefore, not only be to enforce competition law, but also to enhance public knowledge of the law and ensure that government authorities respect the principle of the state's fundamental obligation with respect to competition protection of refraining from any activities that encourage anti-competitive behaviour.[7]

Even though competition and human liberty are pillars of a liberal state founded on the rule of law, these are not absolute values. Lawmakers at times restrict competition in order to protect other socially important values. The role of competition authorities is to ensure that these restrictions are justified and proportionate. For this, it is essential to consider the importance of all conflicting interests in an objective and professional manner.

Competition authorities, acting as competition advocates, should especially ensure that there are no restrictions on competition arising from oversights by lawmakers, poor-quality legislation or inadequate implementation, lack of due respect for competition as a value, or activities of state authorities that are undertaken in bad faith or are simply unfair. State authorities act as a single entity from a public standpoint, and thus their actions with respect to citizens should be coherent. Trust in public institutions is essential and, in turn, necessary for a state to call itself democratic and founded on the rule of law.

Citizens' confidence in the state is placed at risk when, on the one hand, the state does not respect competition as a value in its own activities while, on the other, it severely punishes private entities disregarding this value. Such a discrepancy can even undermine the legitimacy of competition law and erode public approval for this authority to enforce this law. In extreme cases, competition law may merely serve to increase executive power while encumbering private entities with heavy liability for errors made by the state.[8] The legitimacy of competition law is a pressing issue today, when there is ongoing debate in Europe on the criminalisation of gross anti-competitive practices.

Free competition cannot exist without competition law backed by state coercion. Similarly, personal freedom cannot exist without laws supported by coercive power to protect such freedom against abuse by others. Undoubtedly, administrative intervention by competition authorities in economic freedom should be restricted to a minimum, while poor and overly restrictive competition law may constitute unjustified restriction of economic activity.[9] Before it was reformed, the system of European competition law could serve as an example here.[10]

It therefore seems that the most important element of competition advocacy should be for competition authorities to analyse their own actions critically and review competition legislation from the standpoint of its efficiency, together with the proportionality of restrictions of economic freedom that it entails. The task of these institutions is also to ensure that competition law is applied reasonably and that it is not applied in areas where competition may occur in a natural manner free of any state intervention or pressure.

Competition advocacy is an important pillar of competition policy. Competition law could not be effective without it. The promotion of competition by competition authorities renders the process of competition law enforcement easier, increases the effectiveness of its outcomes, and strengthens the legitimacy of competition authorities in exercising public authority.

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[6] The taxi services sector may serve as an example here. Legal barriers in access to this profession resulted in anti-competitive agreements in this industry (see UOKiK decisions dated 25 August 2006, No. RPZ 23/2006, and 9 June 2006, No. RWR 23/2006). Opening the market to businesses offering "human transport" services alongside "taxi" services will (understandably) raise protests from businesses that made efforts and incurred costs in order to meet the more restrictive legal requirements for "taxis", but this problem could have been avoided if the rationale for introducing the restrictions had been analysed more thoroughly in the first place.

[7] Long before the establishment of modern competition law, Adam Smith drew attention to the state's responsibility for protecting competition in *The Wealth of Nations*.

[8] This is an argument against competition law raised by the American philosopher Ayn Rand, who writes in *The Voice of Reason*: "Antitrust laws were the classic example of a moral inversion prevalent in history: an example of the victims, the businessmen, taking the blame for evils caused by government, and the government using its own guilt as a justification for acquiring wider powers on the pretext of 'correcting' the evils."

[9] This is the threat to which Milton Friedman draws our attention by paradoxically concluding that competition law can do more harm than good to competition. Milton Friedman, "The Business Community's Suicidal Impulse," *Cato Policy Report*, vol. 21 no. 2 (March/April 1999).

[10] One of the aims of the reform of Community competition law introduced by Regulation 1/2003 was to reduce the number of obstacles and restrictions to enterprise caused by the system of individual notifications, rendering businesses unable to benefit from any general exemptions. See Richard Whish, *Competition Law* (Reed Elsevier, 5th ed. 2003) at p. 246, and literature cited therein. Before the reform, European competition law was based on the presumption that agreements between businesses were illegal – a presumption that was set aside under general or individual exemptions. This must have raised doubts from the standpoint of respect for fundamental freedoms.

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