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2019 YEARBOOK

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Dear Readers,

Our 9th *Yearbook* is a collection of articles drawn from authentic matters handled by lawyers from our firm. They explain how to protect your rights when encountering dishonest contractors, inadequate or overly specific regulations, and excessive formalism. They suggest how to arrange the legal side of corporate or personal matters to eliminate unnecessary risks and costs.

When the laws are defective or court decisions are divided, can we rely directly on the Constitution? What to do when Polish and foreign law overlap? How to defend against someone abusing their rights or making improper use of institutions intended to eliminate irregularities?

One of the greatest threats we perceive today as lawyers is a tendency to regulate everything in sight. Overproduction of regulations often results in abuse of administrative and other forms of power. While recognising that legal measures are designed to protect society, we also realise the negative consequences that can arise from improper application or poor interpretation of new regulations. It is precisely in such situations that the reason for the existence of the legal profession becomes most evident.

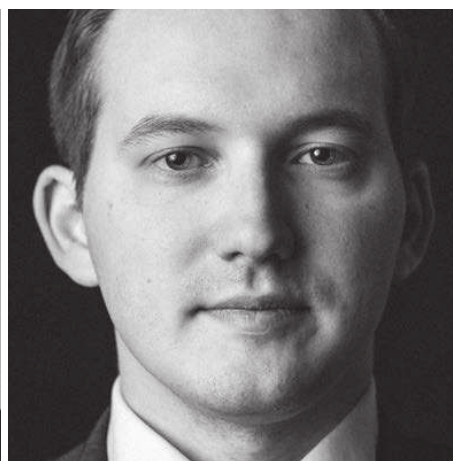
Tomasz Wardyński

Direct application of the Constitution by the general courts and administrative courts

The Polish Constitution guarantees numerous economic, social and cultural rights. Does this mean that we can rely on the Constitution directly in employment or housing cases? Or in situations where the statutes don't unequivocally resolve the issue and the case law is inconsistent?



Agata Józwiak



Dr Maciej Kiełbowski

The Constitution establishes the foundations of the Polish legal system and the rules for operation of the state. It defines rights and freedoms enjoyed by citizens and sets the bounds for permissible limitations on them. It's important to be aware that the constitutional provisions not only involve the rules for operation of the courts and other state authorities, but may also affect the individual affairs of all citizens.

Rising profile of the Constitution

The areas of law that most strongly impact our freedoms are deeply rooted in the Constitution—the country's basic law. It should thus come as no surprise that so far constitutional standards have been relied on primarily by parties to criminal and administrative proceedings and cases before the administrative courts. Often these parties have sought protection in the Constitution against imperious decisions by the state. For this reason, appearances to the contrary notwithstanding, the Constitution has already played an important role not only in the rulings of the Constitutional Tribunal. But it is apparent from observations that this phenomenon may gain strength and also encroach on other fields of law.

Which courts can apply the Constitution directly?

A constitutional principle may not only point the way towards interpretation of the law, but may also serve as a standalone basis for issuance of a ruling by the courts. This is because the courts are obliged to rule in compliance with constitutional priorities, and thus to consider the Constitution when interpreting the law. It is important to be aware, however, that only constitutional standards expressed with an adequate degree of specificity are suited to direct application. Specific claims cannot be derived from general provisions of the Constitution. Under normal conditions, therefore, a right to be assigned an apartment cannot be deduced from the state's obligation to maintain a housing policy conducive to satisfaction of citizens' housing needs.

The furthest-reaching manifestation of direct application of the Constitution will occur when a court finds there is a conflict between constitutional values and a statute, and for this reason refuses to apply the statute, without first seeking a ruling from the Constitutional Tribunal on the constitutionality of the regulation in question. This area of the jurisdiction of the courts may generate the most controversy in the future. It leads to a clash in competencies between the courts and the Constitutional Tribunal, and so far has rarely occurred in practice.

The Constitution in a specific civil matter

Most often the Constitution has been used by the courts as a touchstone in resolving doubts in interpretation. An example is the Supreme Court resolution of 25 August 2017 (Case III CZP 11/17), deciding the rights to a resi-

dential unit after the right to ownership of the land associated with the unit lapses.

The legislature had not expressly provided what should happen to the ownership of the unit in that situation, and a split in the case law had developed in this respect in the general courts. Some courts held that ownership of the unit lapsed also, as it was a right connected to perpetual usufruct of the land, while other courts found that the right of ownership of the unit took precedence over the other right. Thus the legal situation of owners of such units was uncertain, and it appeared essential to consult fundamental constitutional rights.

With an eye to other constitutional values and a housing policy advantageous to citizens, the Supreme Court found that the expiration of perpetual usufruct to the land cannot result in worsening the situation of persons who acquired a residential unit connected to the right of perpetual usufruct. The body of constitutional law was used as an argument of principle and was relevant in selecting a line of interpretation favourable to owners of residential units. The court cited constitutional standards of protection of ownership and the state's duty to support measures aimed at citizens' obtaining a place to live. Lapse of both rights in this case would contradict these constitutional principles.

The Constitution in a specific administrative dispute

Constitutional protections of fundamental civic rights and freedoms take on even greater relevance in interpreting provisions of administrative law. In dealings of an administrative nature, these freedoms are often limited in some way. In a certain sense this is the essence of the activity of public administrative authorities, which on one hand may award citizens certain entitlements, but on the other may impose on citizens specific and burdensome obligations.

In relations of this type it appears more important to cite provisions of a constitutional rank. They were after all designed partly to protect the individual against the omnipotence of the state. Fortunately, there are an increasing number of examples of application of provisions of the Constitution in the case law of the administrative courts— which themselves serve as a buffer between the executive branch (the public administration) and the individual against whom the actions of this branch are directed.

The Constitution stepped in to help property owners deal with the lack of appropriate interim provisions regarding the ability to deduct expenditures on improvements to real estate from the betterment levy (the fee charged to reflect the increase in value of real estate due to adoption of a local zoning plan). Property owners were stripped of this possibility upon entry into force of an amendment to Art. 37(2) of the Planning and Zoning Act. The Supreme Administrative Court held in its judgment of 23 November 2007 (Case II OSK 1455/06) and in a dozen or more similar

Constitution
direct application
of Constitution

Supreme Court
of Poland

Supreme
Administrative
Court

cases that the amendment violated Art. 2 of the Constitution in that it lacked interim provisions for cases already in progress, but merely repealed the provision. As a consequence of this legislation, property owners appearing before the courts had paid for improvements to property at a time when these expenditures could be deducted from a potential betterment fee, but lost this possibility because the decision in question was issued after entry into force of the amendment. The court rejected this result, relying on the constitutional principles that the law must not operate retroactively and that legislation must be enacted in a manner instilling trust in the state.

Direct application of the Constitution may also involve the administrative courts' refusal to apply provisions of law similar to those already held to be unconstitutional. Sometimes a vicious circle is created when, soon after a provision is overturned by the Constitutional Tribunal, a new, very similar provision is enacted. Such instances have occurred recently. One of them was the basis for the judgment of the Province Administrative Court in Poznań of 19 December 2007 (Case I SA/Po 1461/07) on Art. 109(6) of the VAT Act of 2004 then in force. It was worded the same as Art. 27(5) of the VAT Act of 1993, which had been held unconstitutional by the Constitutional Tribunal. This provision, combined with provisions of the Fiscal Penal Code,

resulted in imposition of two types of sanctions for the same act: fiscal penal liability and a tax surcharge. Considering the tax case, the administrative court refused to apply the regulation in the case because, in the court's view, double punishment would violate Art. 2 and 8(2) of the Constitution.

Summary

Unlike common-law systems, the Polish legal system is not based on precedent. Nonetheless, rulings on constitutional provisions have carried and continue to carry great weight. The reasoning presented in judgments citing provisions of the Constitution is often of universal relevance and may be applied in numerous other administrative cases (to a greater degree) and civil cases (to a lesser degree). Thus it is worth drawing on the case law and the legal literature in this respect so that the popularity of applying provisions of the Constitution does not decline, but grows in significance in the resolution of individual cases.

Agata Józwiak, attorney-at-law, Dispute Resolution & Arbitration practice

Dr Maciej Kielbowski, adwokat, Administrative Disputes practice, Dispute Resolution & Arbitration practice

Protection of whistleblowers

The management of a Polish branch of a multinational received a message from an employee describing a series of irregularities for which the head of one of the company's offices in Poland was allegedly responsible. The irregularities included improper management of the office and bullying of subordinates. The company launched an inquiry, and the allegations against the supervisor were confirmed. The supervisor was dismissed on disciplinary grounds, but contested the dismissal procedure in labour court. During the court proceedings, the employer had to disclose the identity of the whistleblower in order to prove its case. The whistleblower was immediately sued by the dismissed employee for defamation.



Łukasz Lasek



Magdalena Kotowicz

Whistleblowers, i.e. persons who report wrongdoing, are traditionally at risk of retaliation by the party reported for wrongdoing. This can take various forms, such as dismissal on disciplinary grounds, breaking off the contract between the parties, revocation of a permit to conduct a certain kind of activity, or discrimination.

But this case reveals that people dismissed from an organisation can also retaliate against a whistleblower whose information led to their dismissal. Are whistleblowers protected against actions of this kind?

Negative statements about other people

An individual's personal interests are strongly protected under Polish law. These include a person's dignity and reputation, and can be violated by statements presenting the individual in a bad light. Reporting to an employer that another employee is not performing his duties correctly or is guilty of inappropriate conduct of some other kind might constitute a statement of that kind.

On the other hand, not every statement of that kind containing facts or views regarding adverse acts or omissions is unlawful. True statements of fact and honest views that do not disclose confidential and private information are lawful. Statements about other people that are even untrue and present them in a bad light are also lawful if made to protect a legitimate public interest. Reporting by journalists is an example of such statements. In general, journalists are not liable for making untrue assertions if they exercised due diligence when preparing their report.

Protection of a whistleblower under the law

If a whistleblower is sued for breach of personal interests, the defendant can argue as a defence that the statements were true. In cases of this kind, however, the burden of proof is reversed under Polish law. It is the whistleblower who is required to prove that the statements were true and the views expressed were accurate and fair. For many whistleblowers, especially those lacking the support of their employer, bearing the burden of proof can be a severe challenge.

This is why we also take the view that a whistleblower enjoys protection similar to that of a journalist. Whistleblowers are not liable for making statements to their employer about other employees, even if untrue, if they do so in good faith and in the public interest and the interest of the employer.

Why it is important for whistleblowers to be protected

Whistleblowers are people within an organisation—employees or contractors providing services to the organisation. They possess vital information about the organisation: how it operates, what problems it has, and why the problems arose. Research shows that information provided by a whistleblower firmly entrenched in the internal structure

of the entity concerned is one of the most effective tools for detecting wrongdoing and irregularities in the workplace. Without reporting by whistleblowers, many of these cases of wrongdoing and irregularities would not come to light. At the same time, whistleblowers take a substantial risk because they can lose their job and their livelihood, or be intimidated and suffer discrimination. They can be sued and face court cases lasting years.

Protection of whistleblowers under EU and Polish law

In Poland there is no legal instrument expressly affording protection to whistleblowers. In 2017 and 2018, a range of new instruments protecting whistleblowers were drawn up or adopted in particular sectors (for instance in the Anti Money Laundering and Counter Terrorist Financing Act and an amendment to the Unfair Competition Act regarding trade secrets). The requirement to implement a system for reporting wrongdoing, conducting internal inquiries, and remedying wrongdoing found in businesses is provided for in the proposal for a new Corporate Liability Act. At the EU level, a directive is being drawn up requiring states to order large businesses and local government authorities to introduce a mechanism for reporting wrongdoing related to breach of EU law.

But the impact of these solutions is limited, as they relate to certain types of entities or certain subject matters. A horizontal approach would be useful. A solution of this kind has been proposed by a coalition of NGOs working at the public level to develop an all-encompassing Whistleblower Protection Act. Protection would be afforded to whistleblowers providing information concerning a wide range of issues posing a threat to the public interest, for example not only bribery, but also bullying, environmental crime, intellectual property infringement, and breach of company rules and codes of ethics. One example is Art. 14 of the proposal, which expressly provides for protection of whistleblowers against claims for breach of personal interests: "Reporting wrongdoing in good faith and in the public interest in accordance with the rules and procedure specified in this act shall not constitute a breach of the personal interests of the person reported for wrongdoing."

The absence of statutory protection for whistleblowers does not mean that people who report wrongdoing are not protected under current provisions. This protection is provided for in the Polish Constitution and the European Convention on Human Rights. Under the case law of the European Court of Human Rights, employee whistleblowers in the public and private sectors who act in good faith are protected. The information they provide may relate to secret or confidential information, but must be true, while the loss suffered by an entity reported for wrongdoing must not exceed the benefits gained by disclosing the information (e.g. *Guja v Moldova*, application no. 14277/04; *Heinisch v Germany*, application no. 28274/08; *Marchenko v Ukraine*, application no. 4063/04).

protection of
whistleblowers

reporting
irregularities

protection of
employees

human rights

Courts are also beginning to acknowledge protection of whistleblowers in cases alleging violation of personal interests. In a case similar to the one described here, the Piotrków Trybunalski Regional Court held that employees who expressed reservations to the employer about the conduct of another employee and were subsequently dismissed had acted lawfully and were entitled to protection as employee whistleblowers. The court also stated that they should not suffer retaliation by the employer or other persons reported for wrongdoing. The court's view was that under Polish labour law an employer has an obligation to organise work in a way that makes it less burdensome, to prevent employment discrimination, to apply fair and

objective criteria for evaluation of employees and their performance, and to prevent bullying. An employer also has an obligation to create means for employees to report wrongdoing, and should subsequently investigate reports and take appropriate action. Employees informing an employer of wrongdoing in the workplace are protected so long as they do so in good faith.

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Magdalena Kotowicz, Business Crime practice



The dark side of yellow unions

Due to lack of consent by the only trade union established at the workplace, an employer could not amend the workplace pay rules. But some of the staff supported the changes proposed by the employer. A potential solution would be to create another, competing trade union at the workplace. Then, the two unions' failure to agree on a joint position would allow the employer to introduce the changes unilaterally. But would an employee organisation sympathetic to the employer be regarded as a bone fide union?



Agnieszka Lisiecka



Dr Marcin Wujczyk

Trade unions established at the employer's instigation, or cooperating with the employer with the aim of forcing through solutions desired by the employer, are sometimes called "company unions" or "yellow unions." The term "yellow union" was coined by the communist movement to distinguish "red" unions fomenting class struggle from Christian workers' associations with a solidarity-based approach established in line with the encyclical *Rerum novarum* (*Rights and Duties of Capital and Labour*) issued by Pope Leo XIII in 1891. The current meaning of this term has thus evolved away from the original meaning. The existence of yellow unions can be advantageous to the employer, particularly if the employer encounters difficulty adopting internal workplace regulations such as pay rules.

Trade unions reject changes in pay rules

The rules for amending pay rules in Poland are highly formalised and require joint action by the employer and trade unions (if they are active at the workplace). If there is one trade union organisation functioning at the workplace, the employer is required to agree with the union on amending the pay rules (Labour Code Art. 77² §4). Lack of consent prevents enactment of the change, as the regulations do not provide for any alternative. Employers must rely on dialogue in such situations and seek a compromise with the union.

The obligation to agree on changes also exists in a situation where more than one trade union functions at the workplace. There is an exception, however: if all the trade union organisations, or at least representative union organisations within the meaning of Labour Code Art. 241^{25a}, fail to present a commonly agreed position within 30 days after submission of a draft of the regulation, the employer is entitled to introduce the amendments to the regulation unilaterally (under the wording of Art. 30(5) of the Trade Unions Act in effect at the time we advised our client). In other words, if the trade unions (all of them, or at least the representative ones) cannot reach agreement, the employer can act without having to obtain the unions' approval. But if all the unions oppose the amendments to the regulation, the employer will be barred from making the changes. The employer also cannot introduce the changes if they are consistently opposed by all the representative organisations at the workplace, even if the changes are supported by smaller organisations regarded as non-representative.

This rule doesn't provide an easy answer in two instances:

- When there is one representative organisation functioning at the workplace, opposed to the amendment of the work rules, and one non-representative organisation, supporting the proposed changes
- When in addition to a representative organisation at the workplace opposed to the changes, there are several non-representative organisations functioning at the workplace and at least one of them supports the changes proposed by the employer.

It is unclear in these situations whether the employer is bound by the position of the representative organisation (and thus cannot amend the pay rules), or, citing the disagreement between the union organisations functioning at the workplace, the employer is entitled to amend the pay rules unilaterally.

The views on this issue in the legal literature are divided. Some authors argue that the position of the representative organisation is decisive. They claim that the legislative intent was to reinforce organisations with a large number of employees as members. Consequently, the position of the representative organisation should always be binding. Thus if the only representative organisation is against the changes the employer has proposed to the unions, the employer is bound by that opinion despite the absence of a joint position worked out in conjunction with the other unions, and cannot unilaterally amend the pay rules.

Other authors take a literal reading of Art. 30(5) of the Trade Unions Act, which refers to "a jointly agreed position of the representative organisations"—implying there are at least two representative organisations. Following this line of argument, if there is only one representative organisation at the workplace, it is meaningless to refer to a joint agreement by one organisation that would be binding on the employer. In that case, all the trade union organisations at the workplace are treated equally for purposes of this provision, regardless of their size or status. Inconsistent positions on introduction of changes to the pay rules (in the case analysed here, one representative organisation opposing the changes, and one non-representative organisation supporting the changes) give the employer the freedom to introduce the changes. This position was adopted by the Supreme Court of Poland in the judgment of 8 September 2015 (Case I PK 234/14), among other cases.

The latter position currently predominates in the legal literature and the case law. Thus if there is only one union organisation operating at the workplace, or there are several organisations but only one of them is regarded as representative, it is in the employer's interest for a union to be created (even a small one) capable of acting in agreement with the employer. But if there are two or more representative trade unions in place, establishment of another organisation supporting the employer's views will be advantageous to the employer only if the newly established organisation qualifies as a representative organisation. Otherwise, the consistent position of the two (or more) representative organisations will always prevail over the position of the non-representative organisations, and then the employer will be barred from acting contrary to the other unions' views.

Independence doesn't mean refusal to cooperate

But the establishment of such new organisations is often met with charges of the employer's interference with the freedom of union activity. Opponents allege that a com-

trade unions

collective rights
of employeesindependence
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workplace sources
of labour law

pany union is not independent of the employer and does not act in the employees' interests, and thus such a union should not be considered.

An examination of the legality of the operation of a union sympathetic to the employer may raise doubts. A fundamental principle for the functioning of employee representation is the independence of trade unions. This is expressly provided for in the Trade Unions Act and the Right to Organise and Collective Bargaining Convention of the International Labour Organisation (no. 98). But it would be hard to find that encouraging employees to establish such a union is a violation of trade union independence (even if intended as an alternative to trade unions also operating at the workplace). While such actions do raise doubts that the employer may seek to influence the union when it is established, unless and until it attempts to interfere in union activity there cannot be said to be an infringement of the principle of independence.

There are just as many doubts surrounding the allegation that the union would be acting in the employer's interest. This issue is multifaceted. A trade union should act in the best interests of the employees. But ultimately the union decides independently which actions it deems to be advantageous for employees or not. (Indeed, disputes often arise on this issue between union organisations: some will allow only measures awarding immediate benefits to employees, while others allow measures that are immediately disadvantageous, in the expectation that in the longer term they will for example save jobs.) On the other hand, it should be borne in mind that under Art. 7(1) of the Trade Unions Act, when it comes to collective rights and interests, unions represent all employees, regardless of their union membership. Thus a union should not justify its actions by arguing that it regards a decision as favourable for its members. It must also consider whether the decision is advantageous for the staff as a whole. Nonetheless, it is common for unions to place the interests of their own members above the interests of other staff.

Consequently, we should be cautious in treating a new union as a company union solely depending on whether its activities are regarded as favourable to the employees. The law permits a trade union to be established by a minimum of 10 persons performing gainful work. They have a right to decide what union activities they regard as proper and advantageous to their members, as long as they meet the criteria for the number of members specified by the

law. A negative view of the union's cooperation with the employer cannot be grounds to deny the union the right to exercise its statutory competencies.

A company union is not necessarily illegal

Even if a trade union in fact acts in the interest of the employer and not the employees, there are no grounds for regarding the union's activities as ineffective or illegal. The law does not provide for any verification mechanism in this respect. This is because determining what is or is not advantageous for members of a trade union is often a subjective issue. Attempts to obtain a judicial ruling that such a union has no right to act, or to initiate proceedings to delegitimise the union, have little chance of success. The answer to the problem of a company union is the possibility of establishing another union. If the employees believe that an existing union is acting to their detriment, they can create another, larger union organisation and thus take power away from the organisation they believe is acting against the employees' interests.

Black and white?

In the case described here, the employer managed to work out a compromise with the union operating at the workplace and introduce amendments to the pay rules.

We should add that the amended Trade Unions Act has introduced mechanisms limiting the power of small, non-representative organisations (which are most often the ones accused of acting in the employer's interest). Under the provisions in force from 1 January 2019, even if there is only one representative union functioning at the workplace, its position on introduction of new pay rules will—unlike under the prior law—be binding even if one or more non-representative organisations disagree. It is a condition, however, that the members of the representative organisation comprise at least 5% of the persons performing gainful work for the given employer. Thus, under the new regulations, establishment of a small yellow union will not allow the employer to act unilaterally, even if there is a difference of opinion between a single representative organisation and existing non-representative organisations.

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Dr Marcin Wujczyk, attorney-at-law, Employment practice

trade unions

collective rights
of employees

independence
of trade unions

internal
workplace sources
of labour law

Limits on internal investigations

An employee in the sales department of a company that sells its own products reported to a management board member a suspicion that the employee's superior—the head of the sales department—was passing confidential information to a competitor. The employee discovered this when accidentally copied on an email the superior sent to the competitor. The company launched an internal investigation.



Dr Marta Derlacz-Wawrowska



Katarzyna Żukowska

The investigation was conducted to protect the company's information, determine the scale of the damage done, and prevent similar cases from occurring in the future. The employer's aim was to introduce technical and organisational safeguards and to take action against the employee who breached his obligations.

At times an employer may have a legal obligation to launch an inquiry. This is the case for example when occupational health and safety rules are breached or there are reports of bullying or harassment. This is because an employer is required by law to take measures to prevent dangers from arising in the workplace.

Effective, but within the law

When an internal inquiry is required, the employer has to decide what kind of measures should be taken and determine the legal limitations within which it can manoeuvre. The aim is to achieve the objectives of the inquiry effectively, but not risk allegations of violating the law. Any legal violations could render the employer liable, or cause the evidence collected to be contested or inadmissible. Although in the Polish legal system there is no rule that evidence obtained unlawfully is inadmissible in court, use of such evidence can be grounds for third-party claims (brought for example by former employees whose privacy has been infringed). It can also affect how the employer's actions are viewed in terms of the principle of community life, which in turn could lead to an unfavourable ruling in civil cases.

The investigation will certainly proceed more efficiently if the employer already has in place an appropriate policy for internal inquiries into wrongdoing, a privacy policy, and rules properly regulating surveillance issues. Rules also need to be introduced on the employer's disclosure of personal data to other entities, in particular other companies in the group. This is because the law does not provide for specific rules for conducting proceedings of this kind, even when the law requires the employer to launch an inquiry.

Problems may arise, for example, if the employer has not established rules required under the Labour Code on monitoring of work tools issued to employees, such as computers and telephones, and the applications installed on them, such as company email and messaging programmes. An employer is required to define the scope of such monitoring (whether it only collects metadata or accesses the content of messages, and if so in which situations) and inform employees in the appropriate manner. If the employer does not comply with this obligation, then when obtaining information about illicit contact between an employee and the competition, retrieving that data could give rise to a risk not only of breach of the employee's personal interests, in particular privacy, but also an allegation of unlawful processing of personal data. This could lead not only to imposition of an administrative fine under the General Data Protection Regulation, but also criminal liability

under the Personal Data Protection Act of 10 May 2018, or possibly, if applicable, failure to comply with the GDPR notification obligation, which can also lead to an administrative penalty. This issue becomes even more complex if the employer also allows private use of work tools and applications. Essentially, introduction of monitoring in any form of employees or civil-law contractors could require a data protection impact assessment to be performed, as stated in Art. 35 GDPR. Failure to conduct a data protection impact assessment could also lead to an administrative penalty. These risks are always assessed case by case, but nevertheless any wrongdoing in these areas could be examined by the Personal Data Protection Office if it learns of it.

Today best practice, soon to become compulsory

Within the next few years, it could become compulsory for employers to implement rules for investigation of reports from employees of wrongdoing in the organisation. In April 2018, a proposal (COM (2018) 218) was published for a Directive on the protection of persons reporting on breaches of Union law. Under the proposal, from mid-2021 onwards, essentially all employers with a headcount of 50 or more would have to introduce procedures for reporting and investigating actions or failures to act that might constitute a breach in certain areas of law, such as public procurement, financial services, safety of products, foodstuffs or transport, environmental protection, protection of consumers, privacy and personal data, and security of networks and IT systems.

Under the proposal, the procedure would have to state the forms in which wrongdoing could be reported, ensuring that the identity of the reporting person is kept secret. It would also have to specify a person or unit to investigate the matter diligently within a reasonable time, as a basic rule not exceeding three months from the time the activity is reported, and inform the reporting person of the results of the action taken. Similar legislative proposals have been put forward in Poland. One of these is a government proposal for an Act on Transparency of Public Life. Work on this bill has practically come to a halt in recent months. Another, concerning entities in the public finance sector, is a citizens' proposal for a bill protecting whistleblowers. This has yet to be submitted to the Sejm.

Protection of the data of a person in breach?

When examining policies for conducting internal investigations, regulations in various areas of law have to be consulted. The issue of protection of the personal interests and personal data of the reporting person and persons subject to the inquiry has to be considered, and, under certain circumstances, criminal law provisions as well.

In terms of the confidentiality of investigations, there is an important notification obligation towards people whose data are processed in connection with the inquiry. This is

internal investigations
employee procedures
whistleblowers
protection of personal rights
groundless accusations

a requirement under Art. 13–14 GDPR. This obligation can be fulfilled by notifying the data subject among other things of the identity and contact details of the data controller, the categories of data processed, the source from which they are obtained, the purpose for which they are processed, and who they are disclosed to. Information must also be given about the data subject's rights in the context of the processing of their data. This essentially means that in the case in question, the suspect and the competitor's employee, and thus the competitor as well, had to be notified that the company was conducting an inquiry concerning them and that it might be taking legal action against them, depending on the findings.

Providing this information during the inquiry seems at best ill-advised, but failure on the part of the data controller to observe this notification obligation could lead to liability under the GDPR. Fortunately, in the case in question, the system in place at the company for investigating wrongdoing, based on the Article 29 Working Party guidelines in opinion 1/2006 and the European Data Protection Supervisor guidelines of July 2016 (applicable to EU institutions but not the private sector), not only described in detail the procedure for internal inquiries. It also provided information required under Art. 14 GDPR. Due to these employer rules, notification of the individuals concerned that the inquiry had been launched could be deferred or even omitted.

This raises the question of compliance with the GDPR. As a rule, the notification obligation has to be fulfilled within a reasonable time once the personal data are obtained, within no more than one month. Meanwhile, if personal data are intended to be disclosed to another recipient (for example another company in the group responsible for conducting inquiries within the group), the deadline is the moment the data are disclosed for the first time. However, if providing the information specified in Art. 14(1)–(2) GDPR is likely to prevent or seriously impair achievement of the objectives of the processing, the notification obligation does not apply, provided that the controller takes appropriate measures to protect the data subject's rights and freedoms and legitimate interests. In the case in question, the company decided to apply this exception in relation to the suspect and the competitor's employee.

Third-party participation

If other entities in addition to the employer are involved in the inquiry, for example another company within the group (as in this case) or external entities providing internal investigation and evidence-gathering services, rules have to be established regarding those entities' access to information, including personal data, collected and processed in connection with the assistance they provide to the employer. In the case in question, the company's management

board requested the compliance team at the parent company, based in the EU, to conduct the inquiry. The subsidiary and the parent signed an agreement on engagement of another processor as required under Art. 28 GDPR. This is one of the solutions available. As a rule, the solutions chosen should depend on the circumstances and true role of the entities involved in the data processing.

Consequences for the reporting person

When conducting an investigation, the possibility that the allegations of unlawful contact with the competition would prove unfounded had to be considered. In the case in question, the employee had sufficient grounds to reasonably presume that inappropriate contact with the competition had occurred. The form in which the information was reported was also judicious, suggesting that the report was made in good faith and within the law.

Even if further investigation had revealed the allegations to be unfounded, this would not be grounds for the suspect or the employer to impose sanctions on the reporting person. The employer has to make sure that there is no retaliation in the future against the reporting person by the superior whose actions were reported. Although the law does not currently provide special protection for whistleblowers who act in good faith, apart from provisions applicable to certain sectors, this protection follows from labour law, for instance due to the obligation of equal treatment and non-discrimination against employees. This is also an established international standard. At the same time, the need for protection of whistleblowers is acknowledged in the case law (e.g. Supreme Court of Poland judgment of 6 March 2018, Case II PK 75/17).

However, protection is not afforded for reporting in bad faith, for instance when the reporting person is aware that the information provided is factually untrue, or the reporting takes a form that exceeds the limits of acceptable criticism. In such a case, claims can reasonably be brought against the reporting person for breach of the personal interests of the person concerned. The employer also has the option for example of terminating the employment contract of a person who reports misconduct in bad faith.

To summarise, it is worthwhile to introduce in-house procedures for investigation of wrongdoing, while properly observing the limits for investigation procedures specified above all in provisions on protection of personal interests and personal data, even if in general there is no current requirement to adopt such procedures.

Dr Marta Derlacz-Wawrowska, attorney-at-law, Employment practice

Katarzyna Żukowska, adwokat, Employment practice

internal
investigations

employee
procedures
whistleblowers

protection
of personal
rights

groundless
accusations

In the 1st quarter of 2018, inspectors from the Office of Competition and Consumer Protection (UOKiK) searched the headquarters of Polish company X, a subsidiary of an international food corporation. The inspection ran smoothly, but from time to time there were doubts on the part of the company management and staff. One of the doubts involved copying correspondence with the company's external lawyers from the mailboxes of management board members. Management also had questions of a more general nature, such as when they could halt the UOKiK inspection or challenge it in court. Employees were also concerned about the presence of the Police accompanying the UOKiK officers.

Searches by the Office of Competition and Consumer Protection: An overview



Sabina Famirska

What we are dealing with

A search is one of the most powerful tools in the hands of the competition authorities. Its purpose is to assist in obtaining evidence in cases where there is a suspicion of antitrust infringements, such as illegal price-fixing or abuse of a dominant position. In fact, a search by UOKiK is similar to a search by prosecutors in criminal proceedings. At the same time, it can be deeply intrusive in the life of the inspected entities, due to the extensive powers of the officers conducting searches. For this reason, permission to search must be issued by a specialised court, the Court of Competition and Consumer Protection (SOKiK), which will issue an order permitting a search only when there is suspicion of a serious violation of antitrust regulations. The court must decide on the application within 48 hours from submission by UOKiK.

By nature, an UOKiK search is unannounced, which is why such a search is referred to in English as a “dawn raid.” This name is slightly misleading, as searches don’t really happen at dawn. The inspectors must respect the working hours of the company and carry out their duties in a manner that does not interfere with the company’s work. Thus, if the working hours are 9 am to 5 pm, it can be expected that the inspectors will appear after 9 am and leave at 5 pm.

UOKiK inspectors may carry out the search with the participation of the Police (which is usually the case). They may also document the search activities, much as prosecutors would do. The search does not have to take place only at the headquarters or manufacturing facilities of the company. In extreme cases, the Police and UOKiK may enter a private apartment, or search a private car or other premises where they expect to obtain valuable evidence.

It is essential to distinguish between a search and a “normal” inspection by UOKiK. An ordinary inspection is less invasive than a search and more like an inspection by the Social Insurance Institution or the tax office. Then, after arriving at the company’s headquarters, the UOKiK officers ask for indicated documents and media. Given the less severe nature of a “normal” inspection, no court approval is needed from SOKiK.

What UOKiK can do

Inspectors can enter the company’s headquarters unassisted, even in the absence of the company’s authorities. This does not mean that entry will be made by force; the officers enter the company’s headquarters much as customers or inspectors from other public institutions would do. Upon arrival, the officers are required to identify themselves and present the authorisation and consent to the search from SOKiK. Generally, the officers will agree to wait half an hour for the company’s management to arrive, if they are not present at the office at that time. However, that is left to the good will

of the UOKiK inspectors. In the absence of management, there is nothing preventing them from presenting their identification and the court documents to receptionists or any other persons present at the company, or in extreme cases before a surrogate such as a Police officer.

By its nature, a search is a direct attempt to find evidence. How does it look in practice? In general, the scope of powers is wide. The UOKiK officers may move around the company on their own, search file cabinets, browse through the mailboxes of management and staff, look at private calendars and notes, and review the content of mobile devices. Often employees are asked not to make phone calls while the search is underway. The aim is to keep the search secret so it runs smoothly, without interruptions, and achieves its purpose. The inspectors may also address various types of requests to the company’s authorities and staff, to allow them to examine documents of interest to them. Employees may be asked to provide computer passwords or copy entries from private diaries. They should comply with such requests.

The company’s authorities and authorised staff may also be questioned by inspectors on circumstances relating to the subject of the inspection. A controversial issue is whether they must answer UOKiK questions in a manner that *de facto* admits guilt (for example if asked, “Did you agree on prices of goods with your competitor?”) Formally, there is no prohibition against asking such questions, but the persons interrogated may refuse to answer them only if it would expose them to criminal liability. However, in practice, officers try not to ask questions that would lead to self-incrimination. It is also worthwhile to ensure the presence of a lawyer at the inspection, as there is no legal obstacle to an *adwokat* or attorney at law attending, hearing the UOKiK questions, and if necessary raising appropriate objections.

Formally, the duration of the search is set out in the authorisation to carry out the inspection. In practice, the search usually lasts several days, although sometimes it may be wrapped up the same day. After the search activities are completed, the officers remove the secured material to the UOKiK offices, where they are allowed time to prepare a protocol of the inspection. It may come as a surprise to learn that the inspection protocol does not resemble a typical document of this kind from other types of inspections. In particular, it will not contain an analysis of the evidence gathered or irregularities found. Rather, it will be a chronological summary of the search activities, with an enumeration of the documents found during the search. A summary of any explanations provided by the company’s personnel will be included as an appendix to the inspection protocol.

From a formal point of view, the UOKiK search ends with signing of the inspection protocol. The respondent has seven days to sign the protocol, but it may assert objec-

tions to the protocol. It is important to read the protocol thoroughly when it is presented for signature. If any irregularities are not formally raised as objections to the protocol, it will be difficult to challenge measures taken by UOKiK later. In case of a dispute, the courts may find that signing the protocol without any objections is proof that the company accepted all the actions taken by UOKiK during the inspection. The respondent may also bring matters to a head by refusing to sign the protocol. In principle, this should be reserved for situations where there was clear misconduct by UOKiK. Certainly it is not worth fighting over small things.

When to go to court

It is not easy to complain against UOKiK search activities. First of all, there are limited possibilities to challenge the very decision of UOKiK to carry out a search. In principle, a search cannot be halted or delayed on the grounds that there was a mistake or insufficient cause for suspicion against the company. However, as stated in a recent ruling of the Constitutional Tribunal, it should be possible to lodge a complaint against the SOKiK consent to conduct the search.

The respondent may lodge a complaint with SOKiK over steps taken exceeding the scope of the search, or other actions in violation of law. For example, the authorisation of the search might not contain all the necessary elements (e.g. it lacks required signatures or fails to identify the material scope of the search), the inspectors may have copied documents relating to a period not itemised in the authorisation, or legally privileged material may have been taken. But even lodging a complaint will not stop the search. Prevailing in such a challenge in court will only prevent improperly acquired evidence from being used against the company in subsequent proceedings.

In case of a complaint, UOKiK and SOKiK are supposed to act swiftly. UOKiK should forward the complaint to the court within seven days, and the court has only seven days to address it. As a rule, however, complaints are dealt with

when the dust settles—usually after the inspectors have left the company's premises.

What cannot be taken

The power of UOKiK is not unlimited during a search. The inspectors cannot take or copy documents covered by legal privilege, e.g. correspondence with law firms or legal advice provided to the company. If the respondent alleges that a document contains legal privilege and this claim does not raise any doubts (for example when an opinion is clearly marked "confidential," "covered by attorney-client privilege," "legally privileged," or other annotation of this type), the inspectors have no right to read or copy the document. In disputed or doubtful cases, the "envelope procedure" is followed. This means that the documents allegedly covered by legal privilege are sealed, unread, in an envelope and then submitted to SOKiK for review. It is up to SOKiK to decide whether UOKiK may use such evidence.

An atypical situation may arise similar to one we dealt with in the case of company X discussed above. A document covered by legal privilege may be copied by mistake or as a result of carelessness, for example because it was given a misleading title. In such a situation, the respondent can demand that the document be excluded from the evidentiary material in the case even after the end of the search at the company's headquarters, up until the signing of the search protocol. The criminal procedure regulations are applied as relevant to UOKiK searches with respect to inadmissibility of evidence, including legal privilege. In general, those provisions do not allow privileged documents to be used at trial.

This is not the case with trade secrets or personal data. Here, the respondent has little room for manoeuvre, as it cannot plead these circumstances as grounds for refusing access to the information. However, it may request that such information be protected from disclosure to third parties. Such requests will be fully respected by UOKiK.

Sabina Famirska, attorney-at-law, Competition practice

Office
of Competition
and Consumer
Protection search
and inspection

challenging
a search

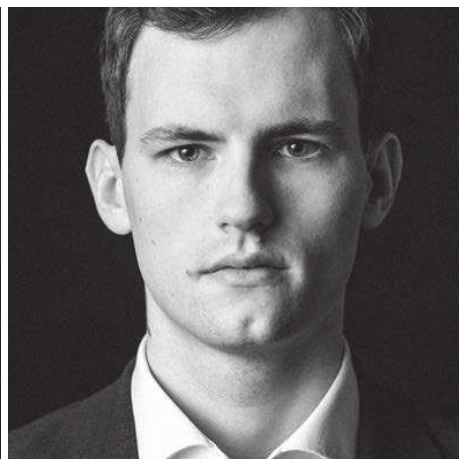
trade secrets

Time for corrections: Eliminating personal tax risk

Fair or not, it is a question of taste and perspective. It is certain, however, that the Polish tax administration, with the aid of its foreign counterparts, is casting ever-widening nets to catch taxpayers. The nets are sometimes full of holes, sometimes are cast for poaching, and sometimes are excessively tangled. But regardless of their properties, we don't want to fall into them.



Michał Nowacki



Wojciech Marszałkowski

The general aversion to the tax administration has recently been compounded by a media frenzy over entry into force of the tax on income from unrealised gains, in particular in relation to individuals. The number of media reports on this “exit tax,” the evolving proposal, the underlying European directive, the loud critique of the unclear provisions of the bill, and the announcement that clarifications are being drafted, has all raised anxiety among taxpayers that a hastily created law could hit them with a ricochet.

Many taxpayers have begun to wonder what they are threatened with if they accumulate too much wealth abroad, if they have been too late in deciding to move to warmer countries, or if they will take a major financial hit by living a bit in Poland and a bit abroad.

Along the way, many taxpayers have used this opportunity to reflect on the quality and correctness of their tax filings and put their affairs in order. That is a smart move, given that the authorities have greater access to information and still limited possibilities to process the amount of information they receive.

But such reflections often raise doubts about tax residence or the impact that activities abroad have on taxpayers’ situation in Poland.

Establishing and maintaining tax residence

Many expats have problems with establishing a clear tax residence: with two houses or flats, family scattered all around the world, practising a free profession, frequent travel, accounts with banks and brokerages in different countries, and filing annual tax returns more out of habit than on the advice of a professional, sometimes dual nationalities.

Sometimes expats submit tax returns in two countries, in each of them reporting as a tax resident (a person with a place of abode in that country for tax purposes), but only in relation to income derived locally.

A hypothetical client living for example in the UK and Poland, displaying some of these symptoms, learns from his tax adviser that there is a risk of double taxation, which can and should be managed by adhering to simple rules and applying tax treaties.

Why tax treaties are useful

A bilateral treaty on avoidance of double taxation will usually provide that the jurisdictions, such as the UK and Poland in this case, may apply reasonable criteria (such as the place of abode or permanent residence) to treat the taxpayer as a resident.

As a rule, one does not become a resident of the UK or Poland only because he receives some money from that country.

In a situation when both the UK and Poland, based on reasonable criteria, could consider a taxpayer to be a resident, the rules established in the tax treaty will determine which country the taxpayer will be considered a resident of, and which country he will not.

The practical consequence of treatment as a resident or non-resident is usually that in the country of residence the taxpayer is obliged to report and pay tax on all his income derived in the country of residence and abroad. In the country where the taxpayer is not a resident, he will usually be obliged only to report and pay tax on income derived in that country. To avoid double taxation, the taxpayer may employ the methods recognised in the agreement.

The taxpayer’s permanent home will determine in the first instance whether the taxpayer has the status of a tax resident in the UK or Poland. According to the OECD Commentary on the Model Tax Convention on Income and on Capital, a permanent home is a place that is permanently at the disposal of the taxpayer, regardless of whether it is owned or rented.

If a taxpayer has a permanent home in both the UK and Poland, he will be considered a resident in the country where he has closer personal and economic ties. When assessing this criterion, consideration should be given to family and social relationships, occupation, political and cultural activity, place of business, place of managing assets, and many other criteria not expressly mentioned in the OECD Commentary. In fact, the above elements make up the majority of the taxpayer’s life. Only their entirety, presenting a reasonable and relatively uniform picture of where the taxpayer’s life is truly focused, may be used as prevailing proof of residence.

If it is not possible to determine if the taxpayer has his centre of life interest in the UK or Poland, or if he does not have a permanent home in either of those countries, he will be considered a resident in the country where he has a habitual abode. A habitual abode is a place of routine stay—frequent, long, regular—as opposed to a temporary or one-off stay.

If a taxpayer stays in the UK and Poland or does not stay routinely in either of those countries, residence will be decided by his nationality. If the taxpayer is not a national of the UK or Poland, or holds nationality of both countries, the UK and Poland will decide in an agreement the country in which the taxpayer will be considered a resident.

A diagnosis based on these rules may enrich the taxpayer’s perspective on his own tax identity. It may also help to take steps regarding past periods or give a picture of what to do to prevent misunderstandings in the future.

In case of past events that are not yet time-barred, it may be necessary to file amended tax returns so that they accu-

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amended
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rately and safely reflect the taxpayer's status in each of the countries in the relevant periods, taking into account transition periods, exit tax equivalents, or other taxation institutions. It is also worth obtaining tax residency certificates or gathering documents supporting the taxpayer's view of his residency in the event of a tax dispute. The taxpayer can also manage his own tax status for the future. The first reasonable step might be to review the statements submitted to banks in fulfilment of legal requirements concerning tax information exchange—Common Reporting Standard (CRS) and the Foreign Account Tax Compliance Act (FATCA).

Local view on international arrangements and investments

For many years, foreign banks have served Polish tax residents as a safe place for capital investment and a point of access to investment vehicles not accessible in Poland. Private banking advisers and inheritance planning advisers offer their clients various types of investment and insurance products which do not have equivalents in Poland. Often those products are offered as tax-neutral. However, their neutrality follows from the fact that they were created and shaped to meet the needs of local law, not Polish law. Therefore, a situation may arise where a tax-neutral event abroad might become a taxable event in Poland and result in income being realised here. Therefore, it's worthwhile to start establishing the nature of foreign investments by determining with an investment adviser how exactly the transactions the taxpayer participates in take place. If it is determined with an adviser in Poland that an investment is tax-neutral only in the country where it is carried out, it may be necessary to file amended returns for any tax events that have occurred and are not time-barred.

The same applies to benefits paid from trusts, foreign private foundations or other fiduciary institutions. Benefits received by taxpayers who are tax residents in Poland will

usually be subject to personal income tax in Poland, or inheritance and gift tax, despite their tax neutrality abroad.

The administrative practice developing mainly in the form of individual tax rulings issued by the head of Poland's National Revenue Information points to a rather rational approach of the tax authorities to the issue of trusts and private foundations, despite the almost complete lack of relevant regulations or cases from the administrative courts based on Polish law. For example, it has been recognised that in case of inheritance where trustees are responsible for carrying out the decedent's intentions, members of the decedent's immediate family are still eligible for an exemption from inheritance and gift tax.

However, non-taxation of benefits from a trust or private foundation is certainly not a rule, and the determination of the tax owed on benefits, as well as the source of income, may have a significant impact on tax liability.

Observing the development of tax law

The tax environment is changing rapidly for both legal persons and individuals. Until recently, taxpayers' activities, especially abroad, were largely invisible to the tax administration. With the development of international tax law and the introduction of numerous new anti-avoidance institutions, the dense fog enveloping taxpayers began to lift.

The aim of filing amended tax returns and taking the other actions described above to manage the taxpayer's situation is that when this fog finally disappears, the tax administration sees the taxpayer in the same light as the taxpayer would like to be seen.

Michał Nowacki, partner, attorney-at-law, tax adviser, Tax practice and Private Client practice

Wojciech Marszałkowski, adwokat, Taxation LL.M. (Georgetown), Tax practice and Private Client practice

uniform tax
residency

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of double
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institutions

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The influence of marital property regimes on estate planning in the EU

Planning for succession in the case of persons living, working or holding assets in different EU countries cannot be limited to an analysis of inheritance and tax law. First of all it must consider marital property regimes and the possibility of modifying them by future heirs. National and EU regulations provide greater and greater flexibility for framing marital property arrangements, which may in turn shape the structure and distribution of the future estate. Clients of our firm who are citizens of Poland and France and hold assets in both countries took advantage of such instruments in the process of cross-border estate planning.



Dr Radosław Wiśniewski

A married couple who are citizens of both Poland and France, permanently residing in France, sought our advice on cross-border estate planning. They were both born in Kraków and were married there in 1976. The law governing their marital property regime was thus Polish law, under which—in the absence of a marital property agreement—the marital community property regime referred to in Art. 31 of the Polish Family and Guardianship Code exists. The spouses had not concluded any marital property agreement in Poland or France.

The clients own significant joint assets in Poland and France. In addition, their individual property includes real estate in Poland and France acquired through inheritance. The spouses have two grown daughters permanently residing outside Poland, who are intended to inherit their parents' estate.

Before beginning their estate planning, our clients realised that in France, unlike Poland, it is not possible to obtain a complete exemption from inheritance tax in the case of inheritance by immediate family members. But they noted the existence of French constructions facilitating the consolidation and simplification of the transfer of all of the spouses' property to the surviving spouse in the event of the death of the first spouse, while avoiding inheritance tax in France. The spouses considered adopting this solution, but wanted to ensure that it was effective with respect to all their assets, including joint and individual assets located in Poland.

Planned agreement under French law

Under Art. 1526 of the French Civil Code, it is permissible to conclude an agreement establishing a community property regime between spouses (*communauté universelle*) covering everything that had previously been part of the spouses' separate property, as well as everything the spouses acquire on various grounds, including through inheritance or gift. In practice this means combining into one joint marital estate the spouses' joint estate (created under the regulations) and their separate property as well as property obtained by them in the future.

Moreover, such agreement may include a clause provided for in Art. 1524 of the French Civil Code (*clause d'attribution intégrale au conjoint survivant*), which indicates that in the event of the death of the first of the spouses, the entirety of the spouses' joint property becomes the exclusive property of the surviving spouse by operation of law. This passage of ownership of joint property is not treated as inheritance under French law and thus does not entail a tax obligation. The need to pay the applicable inheritance tax arises only on the inheritance of the property after the second spouse's death.

This construction also enables the passage of the spouses' consolidated property to future generations. Moreover,

from the time such an agreement is concluded until the time of the second spouse's death, the value of the property to be passed on may be significantly reduced, thus reducing the basis for assessment of the inheritance tax due following the death of the second spouse.

Effectiveness of *communauté universelle* agreement in Poland

The marital property agreement planned by our clients is unknown in Polish law. Conclusion of the agreement will be permissible, and the agreement will exert effects in Poland, if the spouses choose French law as the law governing their marital property agreement.

The possibility of making such a choice of law is provided for by Art. 52 of the Polish Private International Law. But in light of the precedence of application of international conventions and conclusion of a relevant agreement between Poland and France, in verifying this possibility it is essential to consult the provisions of a bilateral treaty. Under Art. 5(1) of the Polish-French Agreement on Governing Law, Jurisdiction and Enforcement of Rulings under Personal and Family Law of 5 April 1967, personal and property relations between spouses are subject to the law of the state where the spouses reside. Thus the applicable law governing the clients' marital property relations is French law, without the possibility of a choice. However, the possibility of making a choice of law is provided for in Art. 6(1) of the bilateral treaty in the case of the law governing a marital property agreement. For this reason, the *communauté universelle* marital property agreement should first confirm that pursuant to Art. 5(1) of the bilateral treaty, the law governing the clients' marital property relations is French law. However, to avoid any unforeseen consequences of possible later changes in the place of residence, the spouses should make a choice of French law as the law governing their marital property agreement.

The choice of law governing the marital property agreement will cover only an agreement expanding the joint marital estate between the spouses. But from the point of view of EU law, making a choice of law will be irrelevant in relation to the *attribution intégrale au conjoint survivant* clause, which must be treated as an "agreement as to succession" within the meaning of Art. 3(1)(b) of the EU's Succession Regulation (650/2012).

Effectiveness of *attribution intégrale au conjoint survivant* clause in Poland

An *attribution intégrale au conjoint survivant* clause is a disposition of property upon death within the meaning of Art. 3(1)(d) of the Succession Regulation. In such a disposition, under Art. 22(2) of the regulation, a person may make a choice of law to govern his succession as a whole. The *attribution intégrale au conjoint survivant* clause cannot be treated as an institution strictly of French marital law gov-

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erning exclusively the marital property regime. Although Art. 1525 of the French Civil Code expressly provides that it is an institution of marital law, to which the rules of inheritance law do not apply, this clause nonetheless meets the conditions for an agreement as to succession referred to in Art. 3(1)(b) of the EU Succession Regulation, because it regulates the manner of passage of property following the death of one of the spouses and determines the scope of succession rights, i.e. the necessary heirs. An “agreement as to succession” is an autonomous concept of EU law and should be interpreted functionally and independently of the rules of national law. Consequently, this clause should be assessed in terms of the law governing succession as a whole or the law governing the agreement as to succession.

The EU’s Succession Regulation now designates the law governing succession matters in most EU member states. Under Art. 21(1), “Unless otherwise provided for in this Regulation, the law applicable to the succession as a whole shall be the law of the State in which the deceased had his habitual residence at the time of death.” However, under Art. 22(1), a choice of law is possible: “A person may choose as the law to govern his succession as a whole the law of the State whose nationality he possesses at the time of making the choice or at the time of death.” Art. 22(2) requires the choice of law governing succession as a whole to be made expressly in the form of a disposition of property upon death. In turn, a “disposition of property upon death” is defined in the regulation as “a will, a joint will or an agreement as to succession” (Art. 3(1)(d)).

Because our clients hold French citizenship, they could therefore choose French law to govern their succession as a whole. They could make this choice expressly when making an *attribution intégrale au conjoint survivant* clause in the *communauté universelle* agreement. Under Art. 25(1) in connection with Art. 22(1) of the regulation, the choice of French law would result in the necessity to apply French inheritance law in Poland also when considering agree-

ments as to succession—and in particular the *attribution intégrale au conjoint survivant* clause in the *communauté universelle* agreement.

Summary

Our clients decided to take advantage of the construction provided for by French law. This allows them to have the same law governing their marital property regime and their succession as a whole, which is an advantageous approach. Otherwise, submitting the marital property regimes and succession matters to different legal systems could lead to dissonance between the family-law and inheritance-law institutions applicable under the two legal systems.

It should be added that from 29 January 2019, Council Regulation (EU) 2016/1103, on matrimonial property regimes, began to be applied. That regulation also provides for the possibility of making a choice of law governing marital property relations or agreements. In its content, this regulation is linked with the Succession Regulation, but in most cases the new regulation applies to spouses who marry or make a choice of law governing the marital property regime after 29 January 2019. While Poland and most of the other countries in this part of the EU have not elected to apply this regulation, this does not mean that Polish citizens will not be impacted by it. If in addition to Polish citizenship the spouses also hold citizenship of other EU member states applying the regulation (such as France), or their assets include property located in other member states applying the regulation, it will be possible to make use of the solutions arising out of the regulation. But then it will be essential to coordinate the planned measures with Polish conflict-of-law rules and substantive legal rules, to ensure the consistency of the instruments used for cross-border planning of marital property and succession matters.

Dr Radosław Wiśniewski, Real Estate, Reprivatisation and Private Client practices

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roperty rental by the day may be taxed preferentially

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Short-term rental of an apartment at the seaside generally does not constitute business activity, even if arranged through a website or professional agent managing the unit. This means that such rental does not have to be taxed as lodging services, but may enjoy a lower tax rate (8.5% or 12.5% of revenue) applied for ordinary administration of private property.



Dr Przemysław Szymczyk

One of our clients (before she became our client) inherited an apartment in a popular tourist town on the Polish Baltic coast. Because she lives permanently in Warsaw, she decided to enter into a cooperation agreement with a professional agent for management of the apartment to provide short-term rental of the unit (mainly in the summer months). Under the contract, the owner authorised the agent to collect fees for providing access to the unit to guests found by the agent under lease agreements concluded by the agent in the agent's own name. In exchange for this service, the owner promised to pay the agent an appropriate commission. The owner was also supposed to cover the costs of renovations and to maintain the furnishing of the flat in a condition suitable for letting. The owner and her family also had a right to use the apartment during the term of the contract (not only outside the summer season). She determined that in this situation she need not register a business, and decided that under Art. 1(2) of the Act on Flat-Rate Income Tax on Certain Revenue of Natural Persons of 20 November 1998, she would pay flat-rate tax on the revenue (8.5% on revenue up to PLN 100,000 and 12.5% of the excess).

Unfortunately the tax office challenged this approach and found that the rental constituted business activity, and thus should be taxed at higher rates. The owner turned to us for help.

Business or private rental?

For tax purposes, rental of real estate may be treated in two ways: as non-agricultural business activity (Art. 10(1)(3) of the Personal Income Tax Act) or as a separate source of revenue known as private rental (Art. 10(1)(6) of the PIT Act). Classification of revenue to one source excludes classification to the other source.

Lawmakers largely left it up to the landlord to elect the classification and method of settlement of rental income, but each case must be considered individually. What is fundamentally important is how the rental is conducted, i.e. whether the activity is professional, for profit, organised and continuous, and the rental is made for the landlord's own account and risk. In other words, the taxpayer cannot always choose, in every case, whether to treat the rental real estate as private property or as property connected with the operation of a business. If the rental of real estate meets the conditions for being regarded as business activity, then tax should be paid under the rules applicable to business activity, and not, at the taxpayer's election, as a private rental. In this case the PIT Act expressly states that rental may not be treated as a source of income separate from business activity. It is irrelevant in this respect whether the business is registered or not.

To find under the PIT Act that a given activity is business activity, among other things three conditions must all be fulfilled: first, the activity must be for profit; second, it

must be performed in an organised manner; and third, it must be performed in a continuous manner. It is possible to obtain income from business activity without fulfilling certain formalities (e.g. official registration), as the conduct of business activity is an objective category, regardless of how the taxpayer regards or names the activity or whether the taxpayer carries out the obligations imposed on the taxpayer as the operator of such activity.

The inclusion of the criterion of continuity was designed to eliminate from the notion of business activity ventures of an incidental or sporadic nature. Continuity in performing business activity means a relatively permanent intention to perform it. To maintain continuous operation it is sufficient that it appears from the overall circumstances of the case that there is an intention to repeat a defined set of concrete actions in order to achieve the effect of earning money.

When is preferential taxation allowed?

The difference in taxation of the two types of rental is that rental conducted as part of business activity is subject to general rules, meaning under the tax brackets (a marginal rate of 18% up to PLN 85,528 of net revenue per year and 32% above that amount), a flat rate of 19% of net income regardless of amount, or a flat rate of 17% of gross revenue (if the rental is classified as provision of lodging services); while private rental may be taxed either under the general rules (at a marginal rate of 18% or 32% of net revenue) or may enjoy a preferential flat rate (8.5% of gross revenue up to PLN 100,000 and 12.5% of the excess).

This means that from the point of view of a taxpayer who does not incur significant costs on her own real estate, the best solution is to treat rental activity as private rental (not connected with operation of a business) and pay tax on the gross revenue generated in this manner at a marginal rate of 8.5% or 12.5%. A condition for application of this form of taxation is to file a written declaration on election of this method with the head of the tax office for the taxpayer's place of residence by the 20th day of the month following the month when the taxpayer obtained the first revenue from this source, or by the end of the tax year if the taxpayer obtained the first revenue in December of the tax year.

Ordinary administration of one's own property

On behalf of the client, we challenged in court the tax authority's ruling against her. During the proceeding we explained that while the client's rental is gainful, that is not sufficient to classify the revenue as earned from the operation of a business. The scale of the rental (one apartment) and the absence of a repetitive and systematic nature (as the unit is rented mainly in the summer months) do not point to the criteria for business activity. The rental is treated only as a supplemental, i.e. occasional, source of income. Apart from concluding a contract with a professional agent (necessary because of her distance from the unit and inability to

private lease
(occasional)

lower flat-rate
taxation

administration
of own property

lease via
booking.com

meet tenants in person), the owner does not take any other action indicating that she is operating a business. Rental of the apartment is not connected with other services such as operating a reception desk, registering the tenants' stay, providing access to a restaurant, preparing meals, providing cleaning services during the guests' stay, and so on. The taxpayer does not operate an office or an organised marketing campaign. The offer to rent the apartment is found on only one website. Moreover, the apartment is private property rather than a business asset, and establishing a business solely to rent out a single unit would be uneconomical and generate additional obligations and costs.

The court fully shared our reasoning and held that there were no grounds for classifying as business activity the actions taken by our client falling within ordinary administration of her own property, i.e. aimed at proper administration of the property and meeting family needs. In short, the owner could exercise the right to pay the flat-rate tax on the gross revenue from this rental.

Summary

Our client's case shows that neither the duration of specific lease contracts nor finding tenants through a profes-

sional agent or website is dispositive on whether lodging services are being provided. These are not essential characteristics of business activity, and only within such activity can it be said that any services are being provided, including lodging services. The mere fact of letting a unit for brief periods does not make this into business activity connected with lodging. Nor can hotel services be found to exist in such situation, as they involve entirely different features. Additionally, concluding leases for short periods enables the owner to use the unit for her own residential or recreational purposes, as was the case here. Lodging services can be said to exist only if, within the operation of a business, the taxpayer also performs other activities for tenants beyond lease of the unit, such as reception services, operation of a restaurant, preparation of meals, cleaning and so on.

Consequently, when the taxpayer manages his own property rationally, but does so only occasionally, not adopting any organised form of operation, such activities cannot be regarded as operation of a business, even if the substance of the activities is similar to lodging services.

Dr Przemysław Szymczyk, adwokat, Real Estate, Reprivatisation, and Private Client practices



Serving notice of termination of a fixed-term lease

To mitigate the losses if a venture proves unsuccessful, a business providing niche services needs to have the option of early cancellation of its lease. The lease will probably be concluded for a fixed term, which is the practice for commercial leases in an overwhelming number of cases. To secure the option of terminating the lease early when neither party is in breach, a break option clause should be employed, but it must be worded so that the court does not question it or find that the entire lease was concluded for an indefinite period.



Dr Jakub Baranowski



Michał Wons

If a particular location or type of business no longer generates the envisaged level of profit, the most favourable solution for the business might be to relocate or make alterations to the premises to accommodate new requirements. This can be problematic if the business has a fixed, long-term lease and the landlord does not consent to termination of the lease or alteration of the premises. If the agreement is not appropriately worded, the tenant will not be able to take any of these measures without the landlord's consent. The tenant will therefore be paying rent for premises not suited to its business.

As advisers, our role is to anticipate possible legal issues and formulate the lease so that it does not become a burden, but helps the client generate revenue years into the future.

In a recent case, a client suggested that a break option be inserted in a lease agreement under negotiation. It would provide for a 12-month notice period if the tenant's management board adopted a resolution stating that the tenant no longer needed the premises due to a change in the nature of its business.

This was important because the tenant was planning to provide services for a narrow target group, and the risk of failure was significantly higher than average. Also, the tenant agreed to perform expensive renovation work and alterations. For this reason, the lease was to be concluded for a fixed term of more than 20 years, so that the tenant could claim the outlays as a depreciation expense. The unit itself did not have features enabling it to be used for other purposes.

Determining whether a contractual clause of this kind is permitted and then preparing for negotiations meant analysing a range of issues in order to draw up a valid break option clause.

Long-term agreement, but with exceptions

A particular feature of fixed-term leases is that they exist for a long time. It is emphasised in the legal literature and court decisions that the essence of a lease for a fixed term is preservation of the relationship between the parties for the entire term agreed upon beforehand. This ensures permanence and continuity, and protects the interests of both parties. The element of permanence can be especially important when leasing business premises, because a particular unit may be important for the tenant from the viewpoint of its image and as a location customers are accustomed to.

Towards the end of the 1990s, the Supreme Court of Poland gradually began to take a more liberal view allowing lease-break options in fixed-term leases (for example in the judgment of 22 January 1998, Case III CKN 365/97). To some extent as a result of this, a new §3 was added to Art. 673 of the Civil Code in 2001, stating, "If the term of the lease is fixed, both the landlord and the tenant may serve

notice of termination of the lease in cases provided for in the agreement."

Since that amendment came into force, practitioners have concurred that a fixed-term lease can be terminated unilaterally. Meanwhile, the vagueness of this new provision triggered a debate that continues today on when and in what situations termination of this kind is possible.

What are these "cases"?

The issue is whether each "case" (instance, event, grounds) specified in the agreement as grounds for serving notice of termination will be valid and effective. Should the cases where termination is possible be listed exhaustively, or can they be specified according to some general interpretational rule?

This is dealt with more specifically in rulings subsequent to the amendment. A case described in Art. 673 §3 of the Civil Code must be material and assessed equally by both parties, meaning that it has to concern events beyond the parties' control. The Supreme Court concluded that in accordance with this rule it can be stipulated in the agreement that a party can terminate the lease before the fixed term ends for "material reasons" (Supreme Court resolution of 21 November 2006, Case III CZP 92/06).

It goes without saying that a catch-all provision will not fully protect the legitimate interests of the parties to the agreement because it can trigger a dispute. When the landlord is served notice from the tenant of termination on the basis of a "material reasons" clause, and the reason stated is that the company's management board no longer wishes to use the leased premises, it would be much easier for the landlord to argue that this is not material grounds from the point of view of the objective interests of the parties to the agreement. The landlord can argue that this is intended to protect only the subjective interests of the tenant. As a court dispute could last for years, with a risk that the lease would be found to be still in force, and notice of termination on such grounds was ineffective, this solution would obviously not be desirable from the client's point of view.

It is a lot more advantageous to provide for grounds for early termination in as much detail as possible. These should also be grounds that are objectively verifiable. On the other hand, the list does not have to be exhaustive.

Freedom of contract above all

Recently, a more liberal approach has gradually been taken in rulings on the freedom to formulate grounds for early termination of a lease. The Supreme Court has held that "there is no reason to limit the intent of the parties more than provided for in Art. 353¹ of the Civil Code and the special provision, Art. 673 §3 of the Civil Code, where their lease relationship is structured in a manner that benefits

them and does not conflict with the fixed-term nature of the lease” (Supreme Court judgment of 21 January 2015, Case IV CSK 208/14).

Thus, as the court held in that case, if the tenant can demonstrate true and acceptable grounds for serving notice of termination of a fixed-term lease, and the notice period is sufficient to preserve the landlord’s essential interests, there is no reason to deny that right to the tenant.

In one case, the Warsaw Court of Appeal held that a provision stating that the tenant was entitled to serve notice of termination if the games facility operated on the premises did not generate the profit expected by the tenant was permissible under Art. 673 §3 of the Civil Code, when notice of termination could not be served within six months after signing the lease and required a minimum of three months’ notice (judgment of 19 October 2017, Case VII ACa 932/17).

Therefore there is currently nothing to prevent the inclusion of a break option clause, even based on circumstances the tenant does have some control over, but these must be “material” grounds that are objectively verifiable. One example given in a court case is a decision by a company to relocate its enterprise. However, it is certainly not possible to provide in a fixed-term lease that the parties can simply terminate it on notice (e.g. of three months).

Professionals have more options

The final element that has to be considered is the need to strike a balance between the parties’ interests. It is stated clearly in the legal literature and court decisions that if the parties to the lease are professionals, and in addition, they consult professional advisers during the negotiations, then essentially a break option clause negotiated in these conditions will not be found to materially breach the interests of either of the parties.

However, it is significantly more likely that a court would not uphold the entitlement to serve a notice of early termination under a clause that appears to be imposed in an agreement between a large firm and an individual operating a small business. This could be a manifestation of abuse of a dominant position rather than freedom of contract. Naturally, the court should examine this on a case-by-case basis.

Invalidation of agreement or reclassification as a lease for an indefinite term

The problems that arise when a break option is not properly formulated can be far-reaching, and the risk lies principally with the party serving notice. If a dispute arises, the court could find that contrary to the parties’ intention, the break

option clause is invalid, and order the party serving notice to make up for the other party’s loss (for example by paying the entire rent due from the date when ineffective notice was served).

Another possibility is that the court would find not only the break option clause, but the entire lease to be invalid, because under Art. 58 §3 of the Civil Code, “If only certain elements of a legal transaction are invalid, the remaining elements remain in effect, unless, given the circumstances, the transaction would not have been effected without the invalid provisions.”

Therefore, ultimately it would have to be determined whether the parties would have entered into the lease at all without the break option.

Some legal commentaries also point out that a break option clause that is too vague, is open to interpretation, or does not specify a time limit, could cause the agreement to be reclassified as an agreement for an indefinite period. This is because, in essence, a fixed-term lease that can be terminated freely by either of the parties is no different from a lease for an indefinite term.

But that result would most often conflict with the interests of both parties to the legal relationship, because an agreement for an indefinite term does not guarantee the permanent nature of the legal relationship and can be terminated by either party upon notice, subject to the applicable notice period (as a rule, the notice period is three months if rent is payable on a monthly basis).

Summary

When the conclusions above are applied to the problem that the client in fact faced, as a rule there was nothing preventing inclusion of a provision in a fixed-term lease allowing the tenant to terminate the lease upon notice if the management board adopted a resolution stating that the premises were no longer needed for business operations. However, a clause of this kind must provide for a notice period of sufficient length to enable the landlord to protect its interests by finding another tenant. The clause must also be subject to a time limit, for example the earliest or latest date when the right of termination can be exercised. If this is not assured, there is a danger that in the event of a dispute the court would reclassify the agreement as one concluded for an indefinite term.

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lease
termination
on notice
real estate

To return properties or not? That is the question

At the beginning of the political and economic transformation in Poland, public opinion was rather favourable to the idea of returning property seized during the communist era. But 30 years on, the media write almost exclusively about corruption, extortion, and violence against tenants. Despite their revolutionary ruthlessness, the nationalising provisions seem too lenient to the public opinion. In free Poland, there are views to complete the revolution and not return anything anymore. A draft of the “large reprivatisation act” has been prepared, where reprivatisation is completely cut off, granting only minimum compensation, in some cases, to a limited group of claimants. The return of property has many aspects: legal, moral, economic, historical, sociological and probably many others. To answer the question posed in the title of this article, we need a thorough understanding of what happened in Poland in the past and what is happening now.



Stefan Jacyno

Reprivatisation and restitution

From a legal point of view “reprivatisation” is the inverse of “nationalisation.” The process takes place as follows: by virtue of nationalising acts, citizens or legal persons lost their property and the state became the owner of specific property. After many years, by means of reprivatisation acts, the state transfers ownership back to those who were the owners at the time of nationalisation.

It is said that Poland is the only country in the former Eastern Bloc where no reprivatisation law has been adopted. This is not true, as on 17 May 1989 the Polish parliament passed the Act on the Relationship of the State to the Catholic Church, before the June 1989 elections, with the votes of members of the Polish United Workers’ Party and other communist-allied parties. That act provided for the return of property, mainly real estate, to the church. Later, during the Third Polish Republic, the parliament passed acts with the same effect for other religious congregations.

Properties of religious congregations were nationalised, and the state controlled them as the owner for several more decades. As a result of new acts, by way of decisions of the Regulatory Commission, state property became the property of private (religious) organisations once again. That means that the ownership to those properties was transferred twice: first to the state (nationalisation) and then back to the private entity whose property was nationalised. That is reprivatisation.

When talking about other returns of real estate, we should not use the word “reprivatisation.” There are no reprivatisation cases. All such returns, without exception, take place because in proceedings conducted under the rule of law (administrative or court proceedings), it comes to light that the state never became the owner of the property; nationalisation never occurred, but only an unlawful appropriation of something that still constituted private property. In such a case, the owner regains his own property. This is recovery or restitution.

The nationalisation laws adopted at the beginning of the Polish People’s Republic did not cover all private property, but only specific types of property. Decrees and acts dating from the first years of the communist era stated that agricultural or forest properties became state-owned if they exceeded a certain quantum of agricultural productivity, defined by area. Rural residences became state-owned if they were buildings used for operating agricultural holdings. Manufacturing plants became state-owned if they could employ 50 employees or more per shift. Only companies abandoned by their owners were placed under compulsory administration by the state. And so on.

However, the state apparatus at the time did not attach importance to compliance with the law, such as it was, but was guided by the axiology of the new state system. Com-

panies and agricultural assets were taken away in order to eradicate class enemies and to introduce a new social and economic system. No care was taken to determine correctly if a particular property actually qualified for nationalisation, to interpret lawfully the provisions of the law adopted by the same authority, or to comply with applicable procedures. Under the growing dictatorship of the proletariat (see Stalin’s theory of the “aggravation of the class struggle along with the development of socialism”), intimidated people rarely pursued appeals, which generally were fruitless, and judicial review of administrative decisions was non-existent.

We must distinguish between two situations. In the first situation, suppose that the state took over an agricultural property consisting of 60 hectares of agricultural land. The state assumed its property pursuant to the decrees and acts mentioned above, and ownership was transferred to the state. In the second situation, suppose that the state took over a farm of 60 hectares which included 49.5 hectares of agricultural land. In that case, the state did not assume its property from the former owners, but unlawfully seized the owners’ property, because that property was not subject to the agricultural reform. The right of ownership remained with the private owner.

The state could be entered as the owner in the land and mortgage register and, as the apparent owner, further dispose of the property. If that occurred, return became impossible. In such cases, restitution can only take the form of monetary compensation. The possibility of return exists only where a public entity, i.e. the state or a local government unit, is still the holder of the property.

Rights to Warsaw tenement houses and plots of land

These are probably the cases that attract the most attention. Criminal proceedings are under way against several former public officials and lawyers. A Verification Commission has been set up which has repealed a number of decisions under a special procedure and on specific grounds.

But in Warsaw there are no reprivatisation cases as such. Each proceeding is really a case seeking possession of property, where the owner demands the release of his real estate and not the release of municipal or state real estate.

Even the largest tenements and houses were not subject to nationalisation (with the exception of landowners’ houses on rural farms). A special solution was adopted for Warsaw and introduced in 1945 in the so-called Bierut Decree (the Decree on Ownership and Usufruct of Land in Warsaw of 26 October 1945). Only land was nationalised, without houses—small or large—and the former owners had the right to apply for *in rem* rights to urban land. Houses remained private, and became state-owned only when the deadline passed and no application for rights to nationalised land was filed.

rule of law

reprivatisation
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rights
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Before the war, the city owned about 4% of some 40,000 properties. As a result of the decree in 1945, the city became the owner of all the land. Applications for granting property rights (then known as “temporary ownership,” later known as “perpetual usufruct”) could be filed in 1948–1949, and about 17,000 applications were filed. Thus, in relation to more or less 23,000 properties, representing about 60% of the real estate, the claims for land rights expired and the city became the owner of the buildings on that land.

The decree stated that the application would be granted if “the use of the land by the prior owner could be reconciled with the designated use of the land according to the development plan.” But instead of examining whether such uses could be reconciled, the applications were simply denied. Only a few owners had the courage to appeal, but none of the appeals were successful. This way, the city cleared out for itself almost the entire area within the former boundaries of Warsaw.

With the end of communism, some former owners applied for the return of real estate or for compensation. There have been around 7,000 such cases in Warsaw, of which about 4,000 have been resolved. The return of tenement houses and land is made on the grounds that in the course of the review proceedings, the administrative authorities considering the case in accordance with the rule of law, i.e. in accordance with the terms of the decree and the administrative procedure, find that the decisions refusing to grant *in rem* rights were taken in flagrant breach of the law. The annulment of a negative decision issued in the past means that it did not have legal effects, i.e. ownership of the building did not expire, but over the decades ownership has in fact remained private, nor has the claim to obtain *in rem* rights to the land expired. If re-examination of the case shows that “the use of the land by the prior owner could be reconciled with the designated use of the land according to the development plan,” then the authority is obliged to grant rights to the land (from January 2019, ownership).

flat for 10% or 20% of its value, i.e. generating an immediate profit of 500% to 1,000%. This is where the public authorities must step in, but not as in communist times by foisting lodgers on private owners through a billeting system, but with a sensible housing policy. If it is recognised that a certain group of people should pay less for housing than others, the burden should be borne by the whole society, and not by the individuals who happen to own specific real estate. Owners should receive market rents, not only enabling them to maintain the building but also generating a fair return. A 400% rent increase may seem drastic, but it may mean only a monthly increase from PLN 4 to PLN 16 per square metre. An increase of PLN 12 per square metre no longer seems so spectacular, and falls within the limits established in the Tenants Protection Act.

Harassment of tenants, forcing them to move out, must be unequivocally condemned. The law does not allow depriving people of water or heat, and does not allow barring access to premises. When this happens, it is tortious or constitutes a petty offence or even a crime. On the other hand, it cannot be denied that there are objective circumstances that require tenants to cooperate. In the case of returns, we are talking about houses built before the war, and the youngest of them are 80 years old. All of these buildings will require a thorough renovation, when it is impossible to avoid lengthy and arduous work also requiring the premises to be vacated. Also in the case of municipal buildings, this causes protests by tenants, resistance to the need to change their residence or endure inconveniences during the construction work. Those problems should be solved according to the law, and it is the task of municipal authorities to implement the necessary measures in the least burdensome manner possible, but in a way that produces a positive effect. Treating tenants’ peace of mind as a good protected to the highest degree, above all other rights, will lead us to extreme depletion of housing stock and make it impossible to carry out any urban development requiring demolition of residential buildings and resettlement of residents. There have been countless such necessities in the past and somehow it was arranged.

Do not return?

Some claim that real estate must not be returned because it leads to pathology: tenants are harassed, rents are raised, inhabitants are expelled, corruption and forgery occur. The city loses property, and speculators trading in property claims get richer and richer.

The basic problem is the natural conflict of interests between municipal tenants and private owners who have a right to obtain market rents. Tenants who have been paying understated rent for decades do not feel satisfied that they have saved a lot of rent over the years, but feel a sense of injustice. They are afraid of the challenges the rest of society has to face when paying off their mortgage loans or renting apartments on the free market. A sense of injustice is also caused by the loss of the possibility to purchase a municipal

Urban areas are deteriorating and need to be revitalised to a greater or lesser extent. The Urban Renewal Act of 9 October 2015 and the Zoning Act address those issues. It is important to keep them in mind and be guided by their regulations.

The claim that returning real estate impoverishes the city and strips it of funds for development is a misunderstanding. After all, the properties being returned do not generate income, but on the contrary are a burden on the municipal budget, as their maintenance costs exceed inflows. In this respect, the return of tenement buildings tends to increase the city’s development opportunities. Above all, returns do not reduce the city’s assets, as those properties were and are private, so the city is returning someone else’s property, not giving up its own property.

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Trading in property claims is treated as reprehensible. In some cases, claimants sold their rights cheaply to people who later obtained the return of the real estate and sold it on at a multiple profit. However, the market in property claims arose because people could not wait for their cases to be considered and lost their faith that they would ever see it happen. Justice is blind and should not see whether a right or claim is being asserted by a meritorious veteran of the Warsaw Uprising or by a greedy speculator. I am referring to transactions undertaken in good faith. Some frauds do occur, and when they are committed they should be prosecuted.

Returning property is really the only option

Returning real estate is not an act of will by administrative bodies or the courts. These are not allocations of plots or premises as in communist times, where candidates often had to demonstrate their “impeccable moral and political attitude,” and obtaining an allotment carried the right to *de facto* inheritance of the premises (entering into a lease relationship), low rent, and later the right to buy out the property for next to nothing. Under the current regulations, the return of real estate is not a privilege, nor is it handing out state property, but the return of something that was not state-owned or communal. The rule of law requires the return of real estate to its owners. This is the duty of public authorities in a democratic state governed by law. We are

not talking here about new solutions, because there are no such solutions. We are talking about applying the regulations that have been in force for more than 70 years. If the city or the state still wants to hold other people’s real estate, it must acquire lawful title, e.g. by buying or leasing it. If there is no such offer or the owner does not agree to it, the property must be returned.

The City of Warsaw could set up an organisational unit with professional trustees for claimants whose whereabouts are unknown and for inheritances not covered by essential regulatory procedures. Instead of being a passive addressee of claims, the city could be involved in buying out claims, join difficult multi-stakeholder cases and see them to completion. Regulation of legal status is a condition for the city’s development. It is impossible to institute proceedings indefinitely blocking sites for development and freezing the possibility of revitalisation of neglected buildings and areas.

Just as accidents are not combated not by banning driving but by enforcing the traffic code, irregularities in return cases must be combated by observing the law and not by eliminating the return of property. If the rule of law is the touchstone for all return issues, all aspects of the problem can be reconciled.

Stefan Jacyno, adwokat, partner heading the Real Estate, Reprivatisation and Private Client practices

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Medical devices: A global business with regional regulatory regimes

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There are more and more cases of Polish manufacturers of medical devices becoming market leaders not only in Europe, but on the global market as well. There is a lot of interest in investing in a business that has grown to that scale. In 2018, an investment fund was able to acquire all the shares of a renowned medical technology company specialising in manufacturing products for diabetics. Following a merger, an international player was formed offering a broad range of medical devices spanning a hundred countries. These were products that patients themselves, and healthcare professionals, could use for controlling diabetes. The number of regulatory challenges this entails is huge.



Joanna Krakowiak

A single product and many requirements

In central Poland, close to Łódź, the company operates two modern production plants. The manufacturing and marketing process for products intended for the Polish market conforms to requirements under the Medical Devices Act of 20 May 2010, implementing the Medical Devices Directive (93/42/EEC) (known as MDD). The company's products are mainly safe blood glucose meters, lancets, and insulin injection pens. Due to the medium-level risk connected with using them, they are deemed Class IIa or IIb products. For this reason, compliance with the directive and the provisions implementing it in particular EU countries is fundamental for marketing the products in Europe.

On the other hand, the company has a global reach, which means that its products also have to meet requirements in other regions, such as the US, Canada, Japan, Korea, Brazil, Israel, and Russia. In practice, this means that the company may be monitored not only by domestic regulators, but also by the FDA in the US, J-PAL in Japan, K-FDA in Korea, or Anvisa in Brazil. International inspections of this kind are conducted to confirm that the company manufactures products in accordance with the standards in effect in these countries.

Certification is the key to conformity

In practice, to meet these standards, ISO certification is needed, in particular the current version of standard ISO 13485 for the design and development, production, and distribution of sterile needles, lancets, and other injection products (Polish version PN, European version EN, or for example Canadian version CAN/CSA). The requirements under Annex II of the Medical Devices Directive, applicable to Class II and III medical devices, have to be met as well.

Obtaining certificates of this kind, issued by an authorised certification body, confirms compliance of the company's operations within the scope covered by the certificates on the date the certificates are issued. This means that for the certificates to be valid for the entire period for which they are issued, for example three years, the company has to conduct regular internal and external audits to determine on an ongoing basis that the company meets the standards. Conformity processes require constant measures to keep internal procedures up to date, training of employees on these procedures, and above all the ability to respond to any crises occurring on the many markets where the company's products are offered.

In-house manufacturing and contracted manufacturing

There are a number of business models for placing products on particular markets, from working with distributors or importers of a company's own products to contract manufacturing. The choice of the optimal model is usually deter-

mined by the particular mix of commercial and legal conditions on the market in question. As a rule, the regulatory risk connected with the company's operations depends on the business model adopted for the particular market.

The scope of a company's responsibility to regulatory authorities and users of the products, including patients, depends on whether the products are marketed as the company's own products or under another company's brand. In principle, whenever the company operates as a manufacturer (in a factual and legal sense), it is fully responsible for the product. By contrast, when the company manufactures medical devices to order, in particular under a contract manufacturing arrangement, it can only be contractually liable to the firm that markets the brand externally.

A contract manufacturer commissioned by another company is classified as an "original equipment manufacturer" (OEM), while an entity that places an order for manufacture under its brand name is an "own brand labeller" (OBL). In general, under the law, it is the own brand labeller, and not the original equipment manufacturer, that is considered to be the manufacturer. The entity that places an order for contract manufacturing is thus completely responsible for the medical device placed on the market in question. But if that entity is held liable by regulators or users, or a risk of such liability materialises, it will seek recourse against its subcontractor, i.e. the contract manufacturer, such as the company near Łódź. In practice, therefore, the risk borne under these two business models can be similar.

CE mark confirms product quality and safety

In the EU, products placed on the market have to conform to the "essential requirements." Before a product is placed on the market, the company, as the manufacturer, has an obligation to assess the product to ensure that it conforms to those requirements. Depending on the procedure employed, the manufacturer conducts a conformity assessment itself or in cooperation with the notified body. Whenever a conformity assessment procedure involving the notified institution is successful, a certificate of conformity is issued. This is a document certifying that a conformity assessment procedure has been conducted, and that it confirmed that the product, design, type, manufacturing process, sterilisation or inspection, and final tests conform to the essential requirements.

A declaration of conformity is a statement made by a manufacturer that a product conforms to the essential requirements. A manufacturer issues declarations of this kind to its business counterparties, i.e. other links in the delivery chain, including importers in particular countries, distributors, and also healthcare facilities.

Marketing products in EU countries is conditioned on labelling with the CE mark. This mark confirms that the relevant conformity assessment procedures have been con-

compliance
assessment

CE mark

EU's new
Medical Device
Regulation

ducted and the product has been found to meet the applicable essential requirements. This means the product is safe and is of the appropriate quality.

Representations and warranties in the case of purchase

As a standard element of share transfer agreements, representations and warranties should also be included in an agreement for purchase of 100% of the shares of a medical device manufacturer.

With regard to regulatory issues, the crucial representations are those concerning such matters as:

- Conformity of medical devices to the qualitative requirements applicable on particular markets
- Correct labelling of products, in particular placement of the CE symbol on medical devices offered in the EU
- Correct review of the assessment of conformity of products to the essential requirements and storing the documentation relating to that process
- Meeting product registration or notification obligations before products are placed on a particular market for the first time, and continuously updating those data
- Validity of ISO quality certificates and ensuring that there are no grounds for revoking them
- Statements that no administrative proceedings have been instituted regarding compliance by the company and the products it manufactures with regulatory requirements
- Statements that no regulatory inspections are being conducted and there is no risk of such inspections, which in particular could lead to the company being fined.

Proper drafting and review of the representations is crucial. If any of the representations proves to be untrue, this can be grounds for the buyer to hold the seller liable for breach of the agreement or even to allege mistake in conclusion of the agreement. In extreme cases, this can result in invalidation of the agreement.

Evolving regulatory environment

Representations and warranties concern a specific date tied to the moment of closing of a transaction, but the administrative and legal climate surrounding manufacture and marketing of medical devices is constantly changing.

In the EU, from May 2020, the Medical Device Regulation (2017/745) (known as MDR) will take effect, replacing the Medical Devices Directive. The regulation provides for changes in classification of medical devices and the rules for assessment of the risk connected with placing products on the market. It also introduces a new Unique Device Identification (UDI) system for products on the EU market. Similarly, standards PN-EN ISO 13485:2012 and PN EN ISO 13485:2012/AC:2012 cease to be applicable on 28 February 2019. Certificates issued according to those standards have to be replaced by certificates confirming conformity to more recent versions of the standards (2016).

Ensuring compliance with regulatory provisions is a continuous process. There are indications that there will be a lot of work ahead adapting to the new rules on the European medical devices market. The company near Łódź will be involved in this as well, but now within a new capital group.

Joanna Krakowiak, attorney-at-law, Life Science & Regulatory practice, M&A and Corporate practice



Clinical trial fraud

A pharmaceutical company contracts a number of independent sites to conduct clinical trials of a promising new drug. During the trials, it begins to suspect that one of the trials is not being conducted properly. In such a situation, what can be done to keep from ruining the chances of obtaining marketing authorisation?



Łukasz Lasek



Jakub Barański

Clinical trials are crucial in modern medicine. They enable ever more efficacious medicines and forms of treatment to be placed on the market, while ensuring that they are safe. Pharmaceutical companies order clinical trials from independent investigators, usually physicians at independent sites. The division of roles is intended to ensure that the trials are conducted objectively. The investigators should be immune to pressure from the pharmaceutical companies, which are obviously hoping for favourable results. Under this arrangement, physicians can develop their knowledge and skills, and the sites—hospitals and other medical facilities—gain additional revenue.

The global research market is estimated to be worth some USD 50–80 billion, according to various sources. In Poland alone, according to a PwC report from November 2015, the research market was worth about PLN 950 million in 2014. But, unfortunately, whenever large amounts of money are at stake, fraud can also occur. Fraud in clinical trials usually takes the form of fabricated data supplied to pharmaceutical companies and published in renowned medical journals.

Until recently, it seemed that clinical trial fraud was a marginal problem, but in recent years there has been a wave of reports of falsification of clinical trial findings. This was detected using modern technology, particularly as IT tools for analysing large amounts of data came to be commonly used by contract research organisations (CROs). These tools can detect unusual connections or patterns without disclosing the data or employing complicated audit measures against the site. Use of these tools indicates that fraud is occurring on a much larger scale than supposed.

The interest of sponsors and CROs in preventing fraud

The primary aim of the sponsor of a clinical trial is to obtain marketing authorisation for the drug, and thus gain commercially from the results of lengthy and expensive research. Any irregularities in the data could ultimately ruin the chances of obtaining marketing authorisation. It is therefore in the interest of pharmaceutical companies to combat fraud effectively, regardless of their regulatory obligations in this regard.

In practice, most fraud and irregularities take the form of fabrication of data by investigators in order to obtain extra funds. A warning sign might be for example if the reported data coincide in an unusual way, or the reverse—a site providing data hugely inconsistent with that generated at other sites. Low use of drug packaging, or hindering the sponsor's access to source documentation, is also telling. Of course, these are only indirect indications that need to be investigated before a decision is made on remedial measures of any kind.

Clinical trial agreements: the principal preventive measure

The main legal instrument that can be used to do this is a properly formulated clinical trial agreement between the

sponsor or the CRO and the site. A clause merely requiring the investigator to conduct the trial properly will not be enough, as it is crucial to ensure that mechanisms are in place in practice for monitoring and verifying that the trial procedure is conducted correctly. At the same time, these mechanisms have to give investigators appropriate guarantees to prevent pressure being applied by sponsors. It is easy to imagine results unfavourable for the drug being tested being rejected based on a claim that they are false.

For example, it might be important for the agreement to provide for an option of conducting audits at the investigator's premises. This has to afford a realistic chance of checking whether data have been fabricated, and in justified cases it should also be possible to conduct an audit for cause. Only when suspicions can be investigated, and any evidence regarding fraud collected, can the appropriate remedies be undertaken. These might be withdrawal from the agreement or reporting an offence to the competent criminal and regulatory authorities. It is difficult to pursue court proceedings based solely on vague information or statistics. Another difficulty in cases of this type is confidentiality of data and information subject to a client privilege (for example restrictions on examination of physicians on the medical services they have provided).

Another issue that should be addressed in the agreement is stopping payments to the site if it is suspected that data have been fabricated or wrongdoing of some other kind has occurred. This ensures cooperation on the part of the investigator in cases where measures are needed to verify suspicions. The option of stopping payments may also be relevant from the point of view of compliance in a broad sense. Continuing to make payments despite irregularities on the part of the site could give rise to suspicions that the sponsor or CRO is involved in the fraud in an effort to produce favourable results.

The last issue that needs to be considered is a potential means of exiting an agreement with an unethical investigator. Fabrication of even a small portion of the data essentially renders all of the data gathered useless when applying for marketing authorisation. For example, the agreement can state explicitly that reasonable suspicions that the investigator has committed fraud are separate grounds for the sponsor or CRO to withdraw from the agreement, and even grounds for seeking contractual penalties. The agreement could also provide where applicable for refund of payments already made to the investigator if data are found to have been fabricated.

Reaction in cases of fraud

Even the best-drafted agreement does not guarantee that fraud will not ultimately occur. What measures should be taken therefore if warning signs appear?

First and foremost, the procedure to be followed in the case of uncertainty about the integrity of data collected during

conduct of
clinical trials

fraud in
clinical trials

fabrication and
manipulation
of data

a trial should be laid down in detail in standard operating procedures approved by an independent quality assurance team.

Ensuring that the data collected are reliable and of high quality is a fundamental regulatory responsibility of the sponsor. Any suspected wrongdoing and ensuing action must be documented and then described in detail in the clinical study report which must be submitted with the application for marketing authorisation.

Usually, the first indications of possible irregularities in data are indirect; for example, they may be found in a statistical analysis using specialised software. These indirect indications then must be verified and confirmed by more substantial evidence. Regular monitoring visits to the site may be a good opportunity to perform initial verification, but the next step to be considered is a full audit. It is best for the audit not to be announced beforehand, thus increasing the chance of catching the investigator red-handed. An example is a situation where data from a supposed procedure are placed in a computer system used jointly by the investigator and the sponsor, and no patients are present at the site. However, the sponsor or CRO must have appropriate authorisation under the agreement or applicable law; otherwise, the investigator might assert allegations as grounds for contesting even the most compelling evidence of fraud.

In cases where trials are conducted at multiple sites, any adverse impact of suspicious conduct on the part of one investigator on the results of the entire trial has to be mitigated. If evidence is gathered supporting suspicions that data have been fabricated or other wrongdoing has occurred, a particular option that must be considered is excluding those data from the overall trial results. This decision, and the grounds for the decision, must be properly documented. The circumstances in which the decision is made cannot give rise to suspicions that it was made in an attempt to manipulate the trial results. As most trials conducted today are blind and randomised, above all suspicious data have to be excluded from the overall trial prior to unblinding.

Disputes concerning clinical trial fraud

We know from experience that suspicions that a site conducting clinical trials might be fabricating data pose a major risk to the integrity of the entire trial and the reputation of the pharmaceutical company. For this reason, measures to verify suspicions of fraud have to be carefully considered and decisive. At the same time, the integrity of the data from the other sites must be preserved. Verification of suspicions of fraud has to be well-planned and comply with best practices, while ensuring the safety of patients and respecting their dignity. Verification also serves to exclude certain data from the overall trial. To avoid any suggestion of an attempt to manipulate the trial, any measures have to be taken before the clinical trial results are unblinded.

Such verification may also be useful if a dispute arises with a dishonest investigator. The dispute will usually involve payment for the trial. The investigator may seek payment of fees. The sponsor may wish to recover funds paid to an unreliable investigator, and may seek compensation for loss incurred from having to commission a different site to conduct the trial, or from late completion of the trial. Prolonged clinical trials usually shorten the crucial period of exclusivity in marketing a patented drug. It is only during this period, before generic equivalents are placed on the market, that the developer of the drug can recoup its R&D outlays.

Due to the sensitive nature of this subject and the complex legal context, a special approach is needed for cases of this kind, combining know-how in commercial disputes, criminal cases, and ongoing advice on regulatory matters. Although such cases cannot be entirely prevented, adverse consequences for the sponsor or CRO can be mitigated, if not eliminated completely, with proper preparation and response.

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conduct of
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Nicotine: A difficult subject for lawmakers

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Stimulants have always been a part of human life, but their use has only been regulated for a very short time. Tobacco products did not even become a serious issue for legislators until the 21st century. One result of this is doubt about whether a particular nicotine product can be brought into Poland.



Dr Ewa Butkiewicz

“Innovative” tobacco products

Scientific progress and ingenuity on the part of manufacturers launching various “innovative” or even “alternative” tobacco and nicotine products means that in principle the relevant legal provisions are continually being redrafted to keep pace with the commercial reality.

Some new nicotine products that have been released on the US market are tobacco-derived nicotine chewable discs and chewing gum. The ingredients of these products include tobacco-derived nicotine, polymer, non-tobacco cellulose fibre, mild or strong mint flavourings, texture modifier, binder, and colourant. Each disc or stick of gum contains about 1.5 mg of nicotine. The US Food and Drug Administration requires a warning to be placed on the packaging saying that the product contains nicotine and is addictive. The product is intended for adults as an alternative to smoking cigarettes. The product does not help smokers quit, and therefore is not registered as a medicinal product or medical device. The product is available in selected stores or online in four US states.

A client intended to transport a number of packets of this product to Poland for an industry conference, and then, having presented it and possibly consumed it in person while in Poland, transport the rest of the product back to the US. The question arose whether the product should have been declared when it was brought into Poland, and if so, how it should have been classified.

For smoking and chewing

There is now a broad range of products on the market that meet or might meet expectations of consumers with various levels of addiction to nicotine. These can be classified according to the terminology used in the Tobacco Products Directive (2014/40/EU).

This directive and the member states’ national legislation implementing it draw a distinction between tobacco products for smoking (traditional cigarettes) and smokeless tobacco products, which do not involve a combustion process. This category includes chewing tobacco, nasal tobacco, and tobacco for oral use. It also includes cigarettes that heat but do not burn tobacco, which means that they can be presented as reduced-risk tobacco products. Electronic cigarettes are treated as a separate category of “related products” under the directive.

Nicotine is also available for oral use, mainly as chewing gum. These products appeared on the market in the 1980s as a means of alleviating nicotine craving and an aid for quitting smoking. These are authorised for sale as medicinal products under the relevant provisions and used to treat tobacco addiction. For a long time, these products were only manufactured by pharmaceutical companies.

However, for a number of years, the tobacco industry has been interested in nicotine products for oral use. One large US tobacco company has recently been granted marketing authorisation for chewing gum used in the treatment of addiction.

An elusive product

The product that was intended to be brought to Poland for a conference did not fit the definition of a tobacco product or tobacco for oral use, and was not authorised for sale on the market as a medicinal product.

The directive defines a tobacco product as a product that can be consumed and consists, even partly, of tobacco. The client’s product does not contain tobacco as such. The connection with tobacco is the main ingredient of the disc, which is nicotine obtained from tobacco. The question is whether that connection is sufficient to establish that the product contains tobacco, as required by the definition. An ordinary analysis of the language used in the definition reveals that the ingredient in the product is not tobacco. Therefore the Tobacco Products Directive, and corresponding national laws, do not apply to the product in question.

As the product is not intended as an aid for fighting nicotine addiction, it is not subject to the Pharmaceutical Law or requirements applicable to medical devices.

The product could be classified as a borderline product. It has the principal properties of a tobacco product because it delivers nicotine to consumers. It is not a medicinal product, despite being sold in the same or similar form to anti-nicotine drugs. At the same time, the product fulfils a range of requirements for tobacco or related products, with respect for example to the amount of nicotine in a unit packet, warnings on the packaging, and warnings about the harm done by nicotine that are required on the US market. Presentation of the product at the conference in Warsaw could indicate that the manufacturer is considering launching the product on the European market as well.

Minor issue, and plenty of questions

In articles in the industry press, the product is referred to as a “nicotine product,” to emphasise that it is unique. Is the client’s product the start of a new category of product? The question of how the US regulator, and European lawmakers, will approach products of this kind remains unanswered. The European Commission has an obligation to monitor implementation of the Tobacco Products Directive and present a report in May 2021, with an assessment of whether the directive needs to be amended. The Commission can be expected to note the presence of nicotine products on the market and evaluate whether they require special regulation. By the time an amendment to the directive comes into force, another new smokeless product may be on the market which is not covered by the new regulation.

stimulants

alternative tobacco products

smokeless tobacco products

nicotine products

WARDYŃSKI & PARTNERS

This may not seem to be a very serious topic, but the presence of a billion smokers on the planet demonstrates the gravity of the issue. This makes it worthwhile for tobacco companies to continue devising new products to meet consumers' need for nicotine. At the same time, they should be safer and reduce

the risk connected with using this stimulant. Is it possible for legal provisions to rein in the ingenuity of the sector?

Dr Ewa Butkiewicz, attorney-at-law, senior counsel, Life Science & Regulatory practice



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Communicating with the contracting authority—and avoiding litigation

Public contracts often provide for much more severe sanctions for improper performance than private contracts. They also expressly define situations where modification of the contract is permissible due to difficulties encountered by the contractor during the course of performance. When relations between the parties become strained, while seeking the good will of the contracting authority the contractor must also remember the formal limitations binding on public entities.



Anna Prigan

Our client, a large international company specialising in design and implementation of IT systems, won a contract to implement a system with a Polish contracting authority. The contract covered a wide area, including IT services but also supplies. Performance of the contract required cooperation with subcontractors.

Change in business assumptions before conclusion of the contract

In the tender phase, the contracting authority established specifications for the IT system general enough that several different suppliers of the technology could be considered. Our client assumed that the technology would be supplied by one of its subcontractors, but it quickly turned out that the contracting authority had other plans. Before signing the contract, the contracting authority announced that it expected implementation of a specific technology, which it decided to identify in an annex to the contract at the time of signing of the contract with our client.

Our client faced a tough choice. It had to reorganise its entire, carefully thought-out structure for performance of the contract and include a subcontractor it had not considered before. The client nonetheless decided to assume the task and sign the contract immediately, including the annex identifying the technology indicated by the contracting authority. The client expected that everything would proceed smoothly and the contracting authority would help work out its arrangements with the supplier of the technology. It didn't realise how difficult the cooperation would prove.

An uphill climb

During the course of contract performance, our client had to clear a number of hurdles involving changes in ownership structure and the bankruptcy of certain subcontractors. This caused delays in contract performance and required tasks to be shifted between entities. This saddled the contractor with unforeseen costs and problems in coming to terms with the new owners of the companies involved in performance of the contract. On top of that, the contracting authority pressed for timely completion of the project and imposed sanctions in the form of contractual penalties. Meanwhile, the supplier of the technology proved unreliable and unprofessional.

Several times the parties managed to agree on modifying the method, scope and deadline for performance. But our client had much greater expectations for flexibility in the contracting authority's approach to performance of the contract. The client did not understand that in each instance, the contracting authority must justify any modification to the contract in compliance with the terms of the contract and the terms of reference in the tender. The client took the view that the contracting authority should bear responsibility for the problems caused by poor cooperation with the supplier of the technology—particularly consider-

ing that at a certain stage of advancement of the IT work, it was no longer possible to change subcontractors, and earlier requests to change the technology had been denied.

Lack of mutual understanding

At a certain moment, the situation between the parties deteriorated to the point that our client even considered abandoning the contract. Then the client turned to us. Our task was to examine the risks and find an approach to improve the dealings with the contracting authority, which at that stage had ceased to meet with our client and refused to even discuss any postponement of the deadline for completion of the contract.

But after a discussion with our client and a review of the documents, we were surprised that the parties could not come to terms. The project was well-advanced, and the quality of the work was high. We were shocked that in this situation the communications between the parties were so hostile and exchanges were so categorical and emotionally charged.

At the first meeting with the client, when the history of the dispute between the parties was presented, we learned of a number of allegations our client had against the contracting authority. The client felt it was being treated unfairly and even that the contracting authority was taking advantage of it. The client interpreted the failure to agree to successive modifications to the contract as a hostile act on the contracting authority's part, because in our client's view, it is normal for parties to adjust the rules for their cooperation to suit changing conditions. Meanwhile, the anticipated completion of the system to be executed under the contract had been delayed by a year and a half, and the party responsible was essentially the supplier of the technology—an entity indicated by the contracting authority.

From our client's perspective, the reason for the breakdown in the project was the cooperation it was forced to pursue with an unreliable company which not only failed to complete its work on time but also underwent several reorganisations disrupting its normal operations. According to our client, the contracting authority's poor choice of the supplier of the technology forced our client to incur project implementation costs for an extra year and a half, without any right to adjust its fee accordingly, while additionally being saddled with contractual penalties. This was not a risk it took into account when filing its offer in the tender, and thus, at the present stage, performance of the contract was generating a loss for the client.

Yet from the contracting authority's perspective, the situation looked totally different. The contracting authority blamed our client for the situation. It believed that our client could do a better job of managing contract performance and supervising the progress of the subcontractor's work. The contracting authority did not understand how design-

ing the system could last so long, and no longer believed any of the assurances from the contractor, which by this stage had come to be seen by the contracting authority as highly unreliable. When the parties had concluded an annex a year earlier extending the period for performance of the contract, the contracting authority believed that the provisions of the annex would be implemented according to schedule. But many months later, the advancement of the project was still unsatisfactory.

A court case

Following the advice of their previous lawyers, our client had filed a case with the court, using the procedure of summoning the other party to attempt to reach a settlement. But filing of the application was not accompanied by settlement talks, as the parties were cooperating poorly at that time and not discussing any good methods for completing the project.

Moreover, the application for a summons to attempt to reach a settlement did not present a proposed settlement, but contained a number of allegations against the contracting authority, repeating the position our client had presented for a long time. Apart from statements expressing its differing view on the reasons for the problems with completion of the contract, the application also included allegations unrelated to the status of the case, reflecting the client's personal views and complaints.

Based on the wording of the application for a summons to attempt to reach a settlement, and because filing of the application in court had not been agreed between the parties, the relations between the parties festered even more. The exchange of hostile letters continued, with the two parties blaming each other. Any vision of an understanding retreated further and further. Meanwhile, the relations with the subcontractor, whose role in completing the contract was crucial, also deteriorated.

On the right path

Although the client was convinced that it had already reached a dead end in its contacts with the contracting authority and had to consider abandoning the project, we persuaded the client to take a more optimistic view of the project, and that the right path to resolving the problem was a settlement. We were quite certain of this, particularly considering that we had succeeded in reaching amicable resolution of disputes in even more difficult cases. Moreover, in this case the facts were on our side, and we were also familiar with the other party's legal advisers. We knew that like us, they would also put emotions aside and look to the client's best interests.

We convinced the client that the form of communications should be changed diametrically. We limited our correspondence to a bare, objective minimum, and persuaded

the contracting authority that it was necessary to meet. We managed to arrange a meeting where we stressed the shared interests of the parties connected with the project and the benefits that would flow to both sides from reaching an understanding. We also involved the key subcontractor in the negotiations with the contracting authority.

We manage to persuade the contracting authority to enter into a series of discussions, where the lawyers and the business and technical people from both sides developed possible scenarios for solutions. After the second meeting, an idea for a possible understanding began to sprout in the heads on both sides of the table.

When the parties ceased exchanging letters studded with accusations, and began to communicate their interests openly, it turned out that the form of understanding being drawn up would bring each side much greater benefits than a judicial dispute would. First and foremost, in this manner the contract could finally be completed, which would be a huge success for all of the parties.

Key rules

Our client learned along the way of certain conditions it had not been aware of—first and foremost that a public contracting authority is bound by the provisions of the contract as concluded and cannot freely amend it, as would be possible in the case of a typical commercial agreement. Second, we convinced the client that in exchanging documents on the causes for the problems with the project, it was better to stick to the facts, while avoiding issues that might personally affect the other party but were unrelated to the regulations binding on the parties.

The client learned from us that the contracting authority's decision to charge the contractor with the sanctions specified in the contract was dictated not by spite, but by the obligations imposed on the authority by the principle of public finance discipline. Thus, instead of ascribing bad faith to the authority, the contractor should present objective arguments demonstrating how the authority can lawfully waive the right to charge penalties.

But perhaps most importantly, our client needed to understand that the contracting authority's primary interest was in completing the project as quickly as possible, in compliance with the guidelines for the project. For this reason, the contracting authority was open to any proposals allowing achievement of this goal, as long as they were consistent with the framework for the project implemented in accordance with the terms of reference defined at the stage of the tender.

In turn, including the subcontractor in the talks raised the credibility of the contractor's actions in the eyes of the contracting authority and positively contributed to the subcontractor's commitment. As an equal partner, the subcon-

public
procurement
contract

contract
amendments

settlement
with contracting
authority

tractor felt more responsibility for the results. The subcontractor also began to treat the situation as a business opportunity for cooperation between the parties in other areas.

So how should the parties communicate?

When undertaking performance of a public contract, it is always worthwhile to communicate with the contracting authority. A better understanding of the other party provides knowledge of the acceptable methods for resolving matters, even though the framework of a public procurement contract is quite rigid. In the event of various hurdles that appear on the contractor's path, its lines of communi-

cation with the contracting authority should always remain open, and solutions proposed should be realistic.

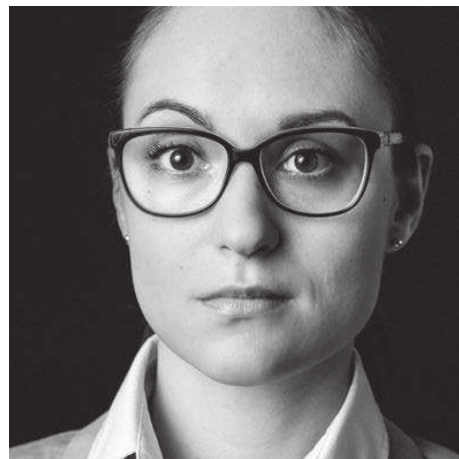
Sometimes the only feasible route left to a party is to pursue its rights through the courts. But before going to court, it is worthwhile to analyse the arguments objectively. It can help to consult a legal adviser who is not emotionally involved in the dispute and can coolly assess the chances for a settlement. In this case, the parties ultimately succeeded in reaching an agreement.

Anna Prigan, attorney-at-law, Infrastructure, Transport, Public Procurement and PPP practice



Ten years after delivery of a bridge, the contracting authority demands that the contractor cure a structural defect

In a public procurement, the parties concluded a contract for construction of a bridge. The contractor executed the structural elements of the bridge pursuant to the contract and granted a guarantee of 36 months from contract completion and acceptance of the work. The final acceptance protocol was signed on 30 July 2008. A breakdown in one of the structural elements was found in October 2018, and a technical analysis determined that the breakdown was due to defective execution of a structural element of the bridge by the contractor.



Katarzyna Śliwak

As the contract had been performed through construction of the bridge, acceptance of the work without defects, and payment of the price, the contractual relationship between the parties was no longer in force. The warranty and guarantee periods had also expired. But because the contract had allegedly not been performed properly, the contracting authority asserted a claim against the contractor under Art. 471 of the Civil Code to redress the injury caused by the contractor's improper performance of the contract. The contracting authority summoned the contractor to cure the defect in November 2018, after learning from an expert report that the cause of the breakdown was a defectively executed structural element of the bridge. The contractor asserted that the contracting authority's claim for improper performance of the contract became time-barred on 30 July 2011, i.e. three years after acceptance of the work. The contracting authority disagreed, arguing that the limitations period did not begin to run until November 2018, when it learned of the defectiveness of the execution of the structural element of the bridge and summoned the contractor to redress the injury.

When did the limitations period on the contracting authority's claim begin to run?

The length of the limitations period on claims for contractual liability connected with the conduct of economic activity was three years (Civil Code Art. 118). The dispute centred around determination of the start of running of the limitations period.

Under Art. 120 §1 of the Civil Code, the limitations period runs from the time when the claim becomes mature, and if the maturity of the claim depends on specific action to be taken by the claimant, the limitations period runs from the date when the claim would become mature if the claimant had taken the action at the earliest possible time. To establish the earliest possible date when the contracting authority could assert the claim for redress of the injury, it was necessary to determine the time when the grounds for contractual liability arose under Civil Code Art. 471, i.e. an injury, improper performance of the contract, a causal connection between the improper performance and the injury, and the contractor's responsibility. The existence of these circumstances was not disputed by the contractor. What was disputed was only the time when the injury arose in the form of the defectiveness of the structural element of the bridge.

The contracting authority argued that the injury arose when the breakdown of the defectively executed structural element occurred. It pointed out it was only then that it learned of the occurrence of the injury, pursuant to the expert report, and thus it could not have demanded earlier that the defect be cured. The contractor disagreed, pointing out that the injury already existed at the time of delivery and acceptance of the work performed by the contractor, on 30 July 2008. According to the contractor, the limita-

tions period on the contracting authority's claim for redress of the injury should be counted from that date.

Contracting authority's injury

To determine the date when the claim became mature, as the point when the limitations period began to run, it is necessary to examine the concept of injury. This concept should be understood to mean a detrimental change in the sphere of the plaintiff's property rights, responsibility for which can be attributed to the defendant. In the case of the contract for construction work between the contracting authority and the contractor, the injury would be the difference in value between the bridge commissioned by the contracting authority and the bridge delivered by the contractor.

The contractor argued that the injury in this sense already existed in the bridge at the time of delivery and acceptance of the construction work performed by the contractor. At the time, the defective construction identified in the expert report as the objective and verifiable cause of the breakdown already existed. The contractor claimed that the defect should have been found by the persons making the delivery and acceptance of the work. According to the technical report, the fact that the construction work was executed improperly could have been discovered at the stage of performance of the work. Even though this defect was not noticed at the time, it already existed and the contracting authority had the ability to assert a claim to repair it. Moreover, it was foreseeable that irregularities in execution of the construction work might cause a breakdown in the bridge after years of operation. Also, the defect had not been deceitfully concealed by the contractor. Consequently, in the contractor's view, the start of the running of the limitations period on the claim for redress of the injury coincided with the date of improper performance of the contract, as the detriment to the contracting authority's property already existed at that time.

Maturity of claim for improper performance of contract

Determination of the maturity of the claim is essential from the plaintiff's point of view, as it sets the time from which it may demand performance by the defendant, which also constitutes the start of running of the limitations period on the claim.

It presented no difficulties in this case to specify the date when the claim arose for delivery of the principal consideration, i.e. construction of the bridge, as the deadlines for performance of the construction works were specified in the contract (where performance was fixed for a specific time—*terminowu*). It is different when it comes to the date of maturity of a claim for redress of an injury, which only becomes relevant in the event that injury occurs as a result of improper performance of the contract. The period for redress of the injury is not stated in the contract itself, and

contractual
liability

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of claims

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of claims
not due at
a specific time

thus such a claim is not tied to performance by a specific time (*bezterminowy*). To place that claim in a state of maturity, it is necessary to summon the defendant to redress the injury in accordance with Art. 455 of the Civil Code and set a specific deadline (falling within a few days or a couple of weeks after the date of the demand) by which the plaintiff expects the injury to be redressed.

But the second sentence of Art. 120 §1 of the Civil Code ties the state of maturity of the claim to the possibility for the plaintiff to take action, not the actual taking of action by the plaintiff. The contractor argued that under the facts of this case, the ability for the contracting authority to issue a demand to redress the injury already existed as of the date of improper performance of the construction contract. Thus it could not be found, as the contracting authority argued, that the claim to cure the defect did not become mature until the date specified in the demand to redress the injury issued in November 2018.

Objective and subjective grounds of maturity

For these reasons, to determine when the claim for redress of injury became mature, it was not sufficient to accept the date when the contracting authority issued a demand to redress the injury, as it also had to be considered whether the contracting authority could have issued the demand earlier. This is because if the maturity of the claim depends on performance of certain actions by the plaintiff, the plaintiff should be deemed to have taken those actions at the earliest possible time (Supreme Court of Poland resolution of 22 November 2013, Case III CZP 72/13). The contractor was right in this case in arguing that the point when all the

grounds for contractual liability should be deemed to have been fulfilled was the time of delivery and acceptance of the construction work, as at that time the contracting authority could already learn of defectiveness of the work and demand that the contractor repair the defectively executed element (Supreme Court of Poland judgment of 12 February 1991, Case III CRN 500/90). The time when the contracting authority's claim became mature should have been determined according to objective criteria. It was irrelevant that the contracting authority was not actually aware of the defect in the structural element at the time of delivery and acceptance. Consequently, it was found that the claim for redress of the injury in the form of the structural defect in the bridge became time-barred on 30 July 2011.

Conclusions

Commencement of the running of the limitations period for claims that are not fixed to a specific deadline, including a claim for improper performance of a contract under Civil Code Art. 471, depends on circumstances of an objective, not a subjective character. It is necessary to determine the earliest possible time when the plaintiff could objectively have asserted the claim for redress of injury. The plaintiff's awareness of the existence of the injury is unverifiable, and thus cannot play a deciding role in determining the limitations period. This eliminates situations where the plaintiff can arbitrarily decide to postpone the start of running of the limitations period. Otherwise the potential defendant could be left uncertain of its legal situation for many years.

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contractual
liability

limitation
of claims

maturity
of claims
not due at
a specific time

The year of the simple stock company

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Polish companies operate under the rigorous restrictions of the Commercial Companies Code. Far-reaching changes can be expected soon. One major change may be introduction of the simple stock company (PSA).



Krzysztof Libiszewski

To date, the rules for operation of companies and partnerships in Poland have evolved slowly.

The types of companies, their managing bodies, their manner of operation, and rules concerning liability for the company's obligations and protection of creditors, derive primarily from the 1934 Commercial Code and have changed little since that time. The 1990s saw a switch to contemporary regulation of the capital market in Poland. In the decades that followed, the Commercial Companies Code was passed and corporate law was gradually brought into line with EU standards. Laws were also passed allowing use of IT systems for founding limited-liability companies and conducting certain operations of companies of that kind.

In the course of these changes, more provisions were introduced adding new areas of regulation to the legal system, and allowing for more forms for partnerships. However, there was no major revision at any stage of these changes of the basic principles for operation of companies. Nor was any consideration given to creating any type of company (the group referred to in the code as "capital companies," as distinct from partnerships) other than the limited-liability company (sp. z o.o.) and the joint-stock company (SA).

This situation can be expected to change significantly in 2019.

At the initiative of the Minister of Investment and Economic Development, the Council of Ministers is working on a proposal to introduce a "simple stock company" (*prosta spółka akcyjna* or PSA) into the Polish legal system. This would be an amendment to the Commercial Companies Code, which is to be submitted to the Sejm in the first half of 2019 and come into force during the first quarter of 2020. Work on the bill is at an advanced stage.

According to data released by Statistics Poland (GUS), at the end of 2017 there were almost 550,000 companies and partnerships of various forms in the country, of which more than 450,000 were limited-liability companies and 12,000 were joint-stock companies. At this stage, lawmakers are deliberately not interfering in the operations of currently registered companies. Introducing new, substantially updated provisions could destabilise firms operating according to regulations that have existed for decades.

On the other hand, in the near future, a large portion of new companies may be founded as simple stock companies. In time, the provisions governing simple stock companies may form the basis for amendment of the Commercial Companies Code with respect to limited-liability companies and joint-stock companies as well.

What is a simple stock company?

The simple stock company is being created as a vehicle for investing in innovation and new technologies. It provides the flexibility necessary to use electronic communications

and other information and communications tools at every stage of a company's operations.

There is every indication that the simple stock company will prove to be no less suitable, and probably more suitable, than a limited-liability company for conducting business of all kinds. The only exception is large-scale activity and activity subject to industry-specific regulations. This is because the simple stock company is designed to have attributes similar to other companies, but the rules for the functioning of the company's managing bodies would be less formal, it would be easier to trade in the shares of this kind of company, and the rules on protection of creditors' rights and use of corporate assets would be substantially revised.

With all of this, the proposal for simple stock companies also clarifies rules that have caused problems of interpretation affecting the functioning of the existing forms of companies.

Trading in PSA shares

One of the main advantages of a simple stock company will be the ease of disposing of shares in the company and issuing new shares.

Shares in a simple stock company will not be in material form, and it will be possible to sell them in document form, as a condition for validity of the sale. "Document form" for legal transactions was introduced into the Polish legal system in 2016. It is the proper form for making declarations of intent using data carriers and means of communication of any kind other than declarations of intent drawn up in "written form."

Consequently, it will be possible to sell and encumber PSA shares using declarations of intent recorded and submitted remotely using electronic communications. A share document will not need to be issued, and it will not even be necessary for the signatures by the parties to the sale transaction to be notarised, as is required in the case of disposal of shares in a limited-liability company.

In a PSA, it will also be possible to conduct new issues of shares solely using electronic communications, as the share capital could be increased based on the current articles of association without amending them, and at most document form would be stipulated for the declarations of intent by the company and the shareholders, and adoption of resolutions by managing bodies.

To keep trading secure, issues and trading in PSA shares will have to be recorded in a share ledger. The company will be required to commission a notary or licensed operator of securities accounts to maintain the share ledger. The share ledger could be maintained electronically, including in a distributed, decentralised database. The obligation to outsource the maintenance of the share ledger to a third party could be an extreme practical limitation on the functioning of a sim-

simple stock
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protection
of creditors

ple stock company, but it is likely that most banks will provide this service in connection with operation of the company's bank account. If that is the case, this restriction will not be troublesome.

Disposal of PSA shares will be effective when the relevant entries are made in the share ledger.

At the same time, PSA shares will be dematerialised according to simplified rules, substantially similar to dematerialisation of shares in public companies. It will be possible to trade shares and register a shareholder's rights online or using a blockchain.

While PSA shares will not be admitted to organised trading, there will be nothing to prevent a company from allowing online subscription for its share issues, and for offers to sell shares held by a shareholder in the company to be made in the same way, especially in situations where there is no requirement under capital market regulations to draw up a prospectus or information memorandum for a public offering.

Assets, contributions, shareholder rights, and protection of creditors

Under the proposal, in a simple share company there will be share capital created from shareholder contributions of PLN 1 or more. The PSA shares will not have nominal value and will not be part of the share capital. Unlike in the current types of companies, in-kind contribution of an inalienable right or labour will be permissible.

These rules will allow persons contributing nothing but information and skills to also become shareholders. This extensive freedom in establishing share privileges and personal rights in the company will mean flexibility in tailoring corporate relationships to the company's circumstances, regardless of the nature of the company's operations. This flexibility will be a major attribute of the simple stock company as a vehicle for any structured investments.

Shareholders will be able to withdraw share capital contributions and the entire undistributed profits without calling on creditors to submit claims. Such payouts would be impermissible only when in normal circumstances it would put the company at risk of not being able to meet its due and payable monetary obligations within six months after the payout was made. Similar protection would be achieved by a rule requiring 8% of the annual profit to be applied to increasing the company's share capital to cover future losses, until the share capital reaches a minimum of 5% of the company's total liabilities listed on the most recent annual financial statement.

As is currently the case with members of the management board of a limited-liability company, management board members or directors of a simple stock company would be liable for the company's obligations if they fail to apply for bankruptcy within the required time.

Other important features of a simple stock company

It will be possible for a sole shareholder to establish a simple stock company, including through the use of a template for the articles of association on the S24 online system, once the articles of association are signed using a qualified electronic signature or trusted signature. The articles of association will have to be notarised only if the PSA is incorporated solely through in-kind contributions, but the value of the in-kind contributions will not have to be verified by an auditor.

In a PSA, a supervisory board will be optional, and the management board can be made up of one person. The articles of associations may provide for a board of executive and non-executive directors, in place of a management board and supervisory board. This means that the bodies of a simple stock company could be established in accordance with the monistic (one-tier) corporate governance model common in Anglo-Saxon legal systems as well as China, France, India, Russia, and certain other countries.

It will be possible for all of the meetings of managing bodies of the PSA to be held via electronic communications.

A simplified form of liquidation would be available, not requiring liquidation of the company's assets and paying off its obligations, if one or more shareholders assume the company's assets and liability for its obligations.

Is the simple stock company needed?

The rules for operation of companies in Poland need to be relaxed.

The share capital of a limited-liability company or joint-stock company, and the rules for protecting it, do not provide sufficient commercial certainty under the existing system. At the same time, they are a practical hindrance to a company's normal operations.

The same applies to rules for issuing and trading in shares. The PSA proposal offers an appropriate compromise between today's corporate law rules and the needs of a modern economy.

It is also a good idea that the reform of the rules for operation of companies is being divided into phases linked to the introduction of the new type of company. This enables lawmakers to act more quickly while allowing time to evaluate which of the new rules should be carried over to other types of companies.

Overall, the new rules will be beneficial to everyone, as the simple stock company is more flexible than the existing corporate forms.

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simple stock
company

issue and trading
of shares

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protection
of creditors



Why does a listed company need target capital?

Companies listed on foreign stock exchanges often use legal constructions allowing them to raise equity funding from their investors rapidly and without excessive formality. Authorised but unissued capital is an instrument particularly attractive to companies with high market liquidity and widely dispersed ownership. Companies listed on the Warsaw Stock Exchange appreciate more and more the advantages of its Polish equivalent, “target capital” (*kapitał docelowy*).



Danuta Pajewska



Marcin Pietkiewicz

When is target capital useful?

Larger companies may have business plans with implementation divided into stages extending over many years, and the companies need to adapt their sources of financing to suit such plans, especially if they use different types of financing combining debt financing (mainly sourced from banks) with equity financing. In many cases, it is difficult to determine the financing of particular investment stages far in advance, and the possibilities and conditions for raising equity financing depend on many variables, including the company's market valuation, which is a benchmark for stock market investors. It also happens that a company gains an investor but a condition for the investment is that it will be carried out under certain market conditions and within a short time-frame. In such case, the issue of shares may be conducted swiftly and efficiently on the basis of target capital.

When can the company's management board act without seeking shareholder approval?

The target capital structure allows the management board to conduct an offering of new shares at an express pace. For companies listed on the stock exchange, time is of the essence when conducting an offering of shares, and target capital allows them to shorten the process by about one month, i.e. the time that would be necessary to convene a general meeting of shareholders to adopt the resolution that would ordinarily be needed to raise the company's share capital.

For the management board to take swift action to recapitalise the company, the articles of association must authorise it to increase the company's capital, while setting two boundary conditions: a limit on the value of the increase of the company's capital to a maximum of three-fourths of the company's capital as of the date the authorisation is issued, and the period of validity of the authorisation—no longer than three years. Under this framework, the management board will be able to take a decision to issue new shares and offer them in a time convenient to the company.

Target capital can be an effective tool providing the management board the agility needed to direct an offering of new shares to selected investors, disregarding some or all of the current shareholders. It is important to provide for this possibility at the stage of adopting the resolution amending the company's articles of association at the general meeting, and to exclude pre-emptive rights, i.e. existing shareholders' priority in acquiring new shares of the company. In the case of target capital, however, this exclusion is not unconditional, as the process of issuing shares by the management board is subject to oversight by the supervisory board in this respect. Targeting specific investors with share subscription offers, while excluding all current shareholders, will require the approval of the supervisory board in each instance to strip the existing shareholders of their pre-emptive rights. This is a specific safety measure allowing the shareholders' representatives to indirectly control the

process of the capital increase conducted by the management board.

The possibility of adopting a resolution amending the articles of association, i.e. authorisation for the management board to increase the company's capital while excluding pre-emptive rights to the new shares, will to a large extent depend on the relationship between the shareholders and the management board, and the shareholders' structure. The requirements are set high, as a minimum of four-fifths of the votes cast is required to effectively adopt such a resolution at the general meeting.

Offering of new shares: who is it targeted to?

Management boards of public companies usually direct subscription offers for new shares issued within target capital to a closed group of specifically identified investors, or exclusively to financial investors.

Regulations governing the public offering of securities do not require the issuer to prepare a prospectus for approval by the Polish Financial Supervision Authority when the offering of securities is addressed to fewer than 150 specific investors (i.e. a private placement) or only to professional investors such as investment funds, insurance companies and pension funds. Conducting a share offering based on one of these exceptions shortens the time required for the offering and reduces the costs of the offering.

The regulations do not specify the number or frequency of successive private placements. Sometimes companies issue several private placements in a row within a short time span, within the limits of the target capital, acquiring several investors in each offering. But this manner of conducting securities offerings is expected to be significantly constrained, as a draft of legislation to this effect has already been circulated for consultation.

Even easier to admit shares to trading

Most investors expect that the shares they buy in a private placement will be immediately admitted to trading on the stock exchange and it will be possible to treat them like any other company's shares. As in the case of a private placement of shares, a prospectus will not always be required for admission of the shares to trading on the stock exchange.

The conditions for raising share capital in private placements have become even more attractive under the EU's new Prospectus Regulation (2017/1129). Since 20 July 2017, listed companies may apply for admission to exchange trading within the following 12 months, without drawing up a prospectus, of shares representing less than 20% of the number of shares admitted to trading on that stock exchange. On one hand, this is a great convenience and encouragement for management boards to issue shares without a prospectus. On the other hand, it is important

target capital
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public company
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to be aware that an issue of shares corresponding to 20% of the current share capital could significantly alter the balance of power in the company's shareholder structure.

How to safeguard the shareholders' interests?

An authorisation for the management board to increase the share capital can make the issue of shares quicker and easier, but it should be remembered that in accepting the introduction of target capital into the company's articles of association, the general meeting is placing great trust in the management board, and the shareholders should consider mechanisms minimising the risk of abuse of this trust.

The shareholders might introduce into the process of the increase of share capital a rule subjecting some of the decisions of the management board to review and approval by the supervisory board. In addition to the supervisory board's consent to exclude pre-emptive rights, the articles of association may provide that decisions of the management board setting the issue price, as well as the issue of shares in exchange for in-kind contributions, also require the consent of the supervisory board.

The target capital provided for in the articles of association may prove to be an excellent tool for a company to defend itself against an attempted hostile takeover. In such a case, the management board may use target capital to take defensive measures aimed at weakening the voting power of the would-be acquirer. By issuing shares quickly, the management board can effectively increase the total number of shares, and consequently the pool of shares needed to obtain control of the company, which also raises the cost of taking over the company.

The shareholders may introduce mechanisms in advance for control over the management board in the event that

it tries to defend itself against a hostile takeover. Under the principle of neutrality enshrined in common-law jurisdictions and expressed in the restriction on the possibility of taking defensive measures by the management board (and possibly also the supervisory board) when facing a hostile takeover, an obligation may be introduced into the articles of association to obtain the consent of the general meeting to take such measures. The shareholders should be aware that if the articles of association of a listed company do not contain such restrictions, the management board will be able to implement reactive defensive measures against tender offers without the shareholders' approval. For example, the management board will be able to increase the share capital within the limits of the target capital and offer the newly issued shares to a favourable company or an investor of the management board's choice.

Aftermath

The decisions of the management board during the process of issuing shares based on target capital must always be taken in the interest of the company. This applies among other things to such important issues as the selection of investors, setting the issue price, and determining the number of investors to whom the shares will be allotted. Consequently, the actions of the management board carry a risk of liability for damage caused to the company, especially when the management board and the shareholders perceive the interest of the company differently. A separate question is whether the regulations equip shareholders wishing to assert claims in this respect with effective remedies.

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target capital
authorised capital
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authority of
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How to distribute dividends while avoiding the pitfalls

Over the last year or so the key provisions governing the process of distributing a share of corporate profits to shareholders have undergone several major changes. It is important to remember about these changes and not underestimate them, as failure to comply with the statutory requirements can have serious consequences—and it is not hard to make a mistake.

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Maciej Szewczyk



Izabela Zielińska-Barłózek



Anna Dąbrowska

In the practice of some companies—whether a limited-liability company (sp. z o.o.) or a joint-stock company (S.A.)—the issue of division of the profit and distribution of dividends is a crucial matter (as a lot of money is involved) yet is regarded as a mere technicality. Consequently, sometimes the related activities, from drawing up the financial report through adoption of the shareholders' resolution, are carried out as a matter of routine. But following well-worn practices developed over the years creates a risk of failure to account for changes in law introduced from time to time. And when lawmakers pile up numerous changes in a brief period, as they have done over the past year or so, a catastrophe can happen.

So below we will track the process of the division of profit of a sample limited-liability company in Poland. We will assume for this purpose that the company (which we will call Example sp. z o.o.) has at least two shareholders.

Drawing up the financial report

Before the shareholders of Example sp. z o.o. can decide what to do with the profit earned by the company, the management board must draw up the financial report for the past financial year. This should be done within three months after the end of the financial year. Under the Accounting Act, the financial report should be signed by the person entrusted to maintain the company's accounting books, and by all the members of the management board.

Already at this stage the management board faces a danger from possible routine treatment of the matter of the financial report. Not long ago this document could be prepared in written form (and usually was). But if the management board prepares the financial report for the financial year ending (for example) on 31 December 2018 in paper form, the document will not be regarded as a properly prepared financial report. This carries with it a flood of further consequences, the last of which will be the inability to make an effective division and distribution of the company's profit. But we will consider each of these in turn.

From 1 October 2018, a financial report must be prepared in electronic form and bear a qualified electronic signature or signature confirmed by a trusted profile in the ePUAP system.

Thus, in order to prepare such a financial report, the members of the management board of Example sp. z o.o. will first have to obtain qualified electronic signatures or (exclusively in the case of management board members with a PESEL personal identity number) an ePUAP trusted profile.

Once these requirements have been met, but before signing the financial report, the management board should agree on a recommendation for how the profit should be applied. The recommendation is not binding on the shareholders'

meeting, which is free to dispose of the profit within the bounds established by the law (more on that below), but the recommendation itself should be included in the additional information section of the financial report.

Selection of audit firm for at least two years

As we assume in this case that Example sp. z o.o. meets at least two of the following conditions:

- Average annual employment (full-time equivalent) of 50 or more
- Balance-sheet total at the end of the financial year in the Polish zloty equivalent of EUR 2,500,000 or more
- Net revenue from sale of goods and products and financial operations for the financial year in the Polish zloty equivalent of EUR 5,000,000 or more,

its financial report must be audited.

Here we reach one of the key issues for the procedure leading up to distribution of the company's profit. Namely, it is not only necessary for the financial report to be audited, but the auditors (audit firm) must be properly selected.

To this end, first, the shareholders' meeting of Example sp. z o.o. should adopt a resolution on selection of an audit firm. An essential statutory limitation in this respect is that the management board cannot make this choice (although it may provide a recommendation).

Second, based on that resolution, the management board should conclude a contract with the selected firm to audit the financial report.

The contract with the audit firm must be concluded for a period of no less than two years. It should be mentioned by the way that the amended Accounting Act is worded somewhat poorly here, as it states that the "first" contract with the audit firm must be made for that length, but adds that the contract may be extended "for further periods of at least two years." This means in practice that the provision applies not only to the "first" contract but also each subsequent contract.

Consequences of irregularities in selection of auditor

What if the management board of Example sp. z o.o. signs a contract with an audit firm but the shareholders' meeting has failed to adopt a resolution on selection of that firm?

First it should be pointed out that because the act allows such a contract to be concluded only with the audit firm selected by the company's shareholders' meeting, conclusion of an audit contract with a different audit firm, or with any audit firm in the absence of a resolution of the shareholders' meeting on this subject, will generally render the contract invalid by operation of law.

dividends
liability
of management
board
liability
of shareholders

A further consequence would be the defectiveness of the actions taken by the auditor.

Finally, payout of the dividend would be classified as a payment made in violation of law. This follows directly from the Accounting Act, which requires that (in a situation where, as in the case of Example sp. z o.o., the entity is required to have its financial report audited) the distribution of profit be preceded by approval by the relevant body of a financial report that has first been examined by the auditor.

Thus if the company does not comply with these requirements, its shareholders (who receive the payments from the company) will be obligated to return the payments, jointly and severally with the management board members responsible for the unlawful payment.

Similar consequences, i.e. invalidity of the contract, will occur in the event of conclusion of a contract with the audit firm for a period that does not comply with the act. It should be mentioned that in this case, the act also provides for criminal liability of the person who concluded the contract on behalf of the company.

dividends

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of shareholders

Adoption of resolution on division of profit

Assuming that the shareholders' meeting of Example sp. z o.o. has properly selected an audit firm and the management board has then concluded a proper contract with the audit firm, the next step is for the auditor to examine the financial report. The auditor will prepare an opinion from the audit and submit it to the management board.

It is only at this time that the shareholders' meeting can adopt a resolution approving the company's financial report and a further resolution on division of the profit. The regular (annual) shareholders' meeting for this purpose should be held within six months after the end of the financial year.

This resolution then provides the basis for the entitled shareholders to seek payment by the company of the dividends owed them.

In adopting the resolution on division of the profit, the shareholders of Example sp. z o.o. must bear in mind the statutory limitations on the amounts they can receive. The amount designated for distribution among the shareholders may not exceed the profit for the last financial year, plus any undistributed profits from prior years and amounts transferred to reserve and supplementary capital which may be earmarked for distribution.

But that is not all. This amount must also be reduced by the amounts of uncovered losses, own shares, and amounts which under the law or the articles of association must

be transferred from the profit for the last financial year to reserve or supplementary capital. (The articles of association may provide that a specified portion of the profit for the given year must be transferred for example to reserve capital until such capital reaches a defined value, to be used to cover potential losses in future years.)

Who is entitled to receive a dividend, and when?

The last issue to be examined is determination of the group of persons entitled to participate in the profit, and the time when the profit designated for distribution in the resolution of the shareholders' meeting of our sample company will be paid out to them.

The persons entitled to a dividend will be the shareholders holding the shares as of the date of adoption of the resolution on division of the profit, or on the record date for the dividend (if the articles of association authorise the shareholders' meeting to set a record date). If there is a record date, it must fall no later than two months after adoption of the resolution on division of the profit.

The payment of the dividend, in turn, should be made on the date specified in the resolution, or if no date is indicated, promptly following the record date.

This is crucial, as possible sale of shares by any of the shareholders of Example sp. z o.o. during the period between the record date and the date when the dividend is paid does not affect their right to participate in the profit.

The conclusion that we hope can be drawn from this discussion is that while participation in the profit earned by the company is one of the rights of the shareholders (expressly recognised in the Commercial Companies Code), nonetheless it is a right subject to numerous formalities (designed to protect the interests of the shareholders as such, e.g. minority shareholders, but also the company and its creditors). In light of the far-reaching consequences of failure to comply with the statutory requirements connected with the process leading to distribution of the profit, it is essential to ensure that in every company, this process is conducted with due care on the part of all persons involved.

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Redemption of shares as a method for a shareholder to exit a company

In our M&A practice, we often encounter the issue of a shareholder's exit from a company. The simplest solution is to sell the shares to another shareholder or a third party, which generally requires the consent of the competent authority of the company (depending on the articles of association). However, the solution is not as simple as this for family businesses generating high profits retained in the company for investment, when one of the shareholders seeks to exit the company and the other shareholders are not eager to allow an outsider to join the company but do not have sufficient funds to buy out the shareholder.



Dr Kinga Ziemnicka

Unwillingness to continue cooperation in a prosperous family business: what next?

This situation was the basis for a transaction handled by our firm. The case concerned a group of companies set up by two families, which for years had successfully grown their businesses, as a result of which the equity in the companies had reached a total of many millions of zloty. The corporate rights in the companies were framed in a balanced way for both families: neither of them could make crucial decisions without the other party. At the same time, restrictions on disposal of shares were included in the articles of association of the companies, granting other shareholders the right of priority to acquire shares offered for sale and making the sale of shares dependent of the approval of competent corporate bodies.

corporate rights

voluntary
redemption
of sharesacquisition
of own shares

right of priority

spare capital

reserve capital

net profit

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The problem arose when the two families started to have disparate visions of how to continue doing business, which led to conflicts and also had a negative impact on the management of the companies. Finally, one of the sides was ready to sell its shares in all the companies, so that it could reinvest the proceeds elsewhere. In that case, the other party had priority to acquire the shares, but could not exercise it due to a lack of sufficient funds. The party also did not want to take the risks associated with obtaining a loan, which would require it to offer its own assets as collateral.

The companies in question had generated high profits allocated to spare capital and reserve capital, which could be used to pay money out to the shareholders. But the companies' profits did not mean that they had free funds in their accounts, as the funds were intended for investments. In practice, external financing was required, this time not by the shareholder but by the companies themselves, to allow the funds to be paid to the shareholders. However, this could not happen through a payment of dividends, as all the shareholders would then be entitled to obtain due amounts. The aim was to allow the payment of consideration for shares only to the party that wanted to leave the company.

Therefore, the parties agreed that the shareholder would withdraw from the companies based on a voluntary redemption of shares. Under Art. 199 §1 of the Commercial Companies Code, after the company's registration, shares may be redeemed when so provided by the articles of association. Shares may be redeemed with the shareholder's approval by way of a purchase of shares by the company (voluntary redemption of shares) or without the shareholder's approval (compulsory redemption of shares). To voluntarily redeem the shares of a shareholder who wants to leave the company, the company acquires the shares from the shareholder at an agreed price.

By the way, it should be noted that a shareholder has no claim against the company for redemption of shares. In

practice, shareholders generally try to force the redemption of their shares when the balance sheet value of their shares is higher than their market value.

Under Art. 200 §1 of the code, it is possible for a company to acquire its own shares. This article provides that in principle a company may not acquire its own shares, but with certain exceptions, one of them being acquisition for the purpose of redemption. It should be noted that this provision does not allow the management board to conclude such an agreement. Since redemption of shares requires a resolution by the shareholders' meeting, which should specify in particular the legal basis for redemption of shares and the amount of consideration the shareholder is entitled to for the redeemed shares, it should be assumed that the management board should be duly authorised by the shareholders' meeting prior to the acquisition of its own shares. Such power might be granted by way of an authorising resolution, specifying the terms and conditions for the acquisition of shares, including the consideration to be paid to the shareholder. The necessity to adopt such a resolution is not expressly provided for in the law, but considering that the management board may be criminally liable under Art. 588 of the code for allowing the company to purchase its own shares, it would be advisable to obtain a relevant authorisation from the shareholders before the purchase, or to make the acquisition subject to the condition precedent of obtaining such authorisation.

As mentioned earlier, voluntary redemption of shares takes place with the shareholder's consent through acquisition of his shares in the company. The code does not specify the amount of consideration due to the shareholder in the case of voluntary redemption. Therefore, lawmakers have left freedom to the parties to determine the amount paid for redeemed shares when the redemption takes place with the consent of the shareholder. The amount of the consideration or the method for calculating it may be specified in the articles of association, but in the absence of a relevant provision it should be specified each time in a resolution of the shareholders.

Redemption of shares out of profit does not make it necessary to amend the articles of association and does not require a decrease in share capital (Art. 199 §6 of the Commercial Companies Code), which consequently means there is no obligation to conduct convocation proceedings under Art. 264 of the code by announcing a reduction in share capital and calling on creditors to object.

In case of redemption of shares out of profit, the payment of consideration may be made from the profit from the last financial year, supplemented if necessary by profits from previous years allocated to the company's capital.

Profit from previous years may be used to pay the shareholder's consideration even when there was a loss in the last financial year.

Payment of consideration owed to the shareholder

In light of the above, the question arises when the consideration due to the shareholder for the redeemed shares can be paid, if it is made out of net profit. In the event of voluntary redemption, the consideration due to the shareholder may be paid after conclusion of a share purchase agreement by the company (subject to the comments regarding authorisation of the management board to dispose of profit based on an appropriate shareholders' resolution).

Therefore, once the share purchase agreement is concluded, the existing shareholder transfers his rights to the company to which the acquired shares are transferred. As a result, the acquired shares are booked at the acquisition price in the company's assets, and, at the same time, a liability arises in its balance sheet towards the shareholder for payment of the due consideration.

In the transaction in question, the parties agreed, in principle, to redemption of shares out of net profit and to the amount of consideration paid to the shareholder leaving the companies, but this did not mean that the companies had sufficient funds to pay the consideration. It is important to differentiate the profit made by the companies, which over the years had been allocated for investment purposes, and the cash at the companies' disposal at that time. The

consideration for the shareholder was set in an amount of several hundred million zloty. Thus it was necessary for the companies to obtain external financing.

The transaction was structured to reflect this need, as the parties entered into a preliminary share purchase agreement committing themselves to enter into final agreements to transfer title to the shares to the companies under the condition precedent of conclusion by the companies of loan agreements raising the necessary funds to finance the transaction. After signing the agreements with the bank, the sides finalised the transaction.

Summary

This example shows that in prosperous family companies that are reluctant to sell shares to third parties, it is possible to finance a shareholder's exit from the company from profits retained in the company, which reduces the risk for the shareholders compared to a situation where they would have to finance the exit directly from their own assets. At the same time, this solution avoids the liquidation of the company in a situation where, for whatever reason, the shareholders no longer wish to cooperate.

Dr Kinga Ziemnicka, attorney-at-law, Corporate Accounting practice



Eat your cake and have it too: Financing through subparticipation in receivables

Increasing sales of goods and services, or loans made, testify to the growth of a firm. But deferred payment or repayment terms tie up cash in the enterprise and hurt cash flows. A solution can be financing based on assignment of receivables. This allows the enterprise to receive payment earlier, in exchange for transferring its claims against the debtor/contractor to the financing party. Receivables can also serve as a means for obtaining financing without having to transfer them to a third party. An instrument enabling enterprises to eat their cake and have it too is subparticipation.



Daniel Smarduch



Marcin Pietkiewicz

When subparticipation in receivables should be considered

Subparticipation is an attractive solution when for various reasons an assignment of receivables would not be appropriate. This would be the case when receivables are subject to a prohibition against assignment (statutory or contractual). Then assignment will not be possible, or will require the consent of the debtor under the receivable, i.e. the counterparty. Another example might be holding receivables that are secured so that assignment must be postponed. Assignment of security may also not be feasible, or is too time-consuming or expensive. An example of this in Poland would be receivables secured by a mortgage. The date when such claim is transferred to the acquirer will be deferred until the acquirer is entered in the land and mortgage register, which might take several months.

It is also in the interest of the enterprise to maintain direct and current dealings with business partners, not interfering with them by submission of assignment notices (at an earlier or later stage) and without alerting them to the method used by the enterprise to raise funding for continued operations. It is also important to maintain flexibility in modifying the terms of contracts with debtors. Assignment may also not be the most efficient solution in the case of receivables with deferred but nonetheless quite short payment terms.

An additional strength of subparticipation for the enterprise is the possibility of shedding the credit risk of the enterprise's counterparties. Consequently, the enterprise may not only receive earlier "payment" (in the economic sense) of its receivables, but also limit the impact of payment gridlock on the business.

The essence of subparticipation—what is our commitment?

Subparticipation agreements are regulated to a certain extent in Art. 183 of the Act on Investment Funds and Management of Alternative Investment Funds of 27 May 2004.

Such an agreement is concluded by the creditor, also referred to as the initiator of the securitisation (the entity holding a receivable or portfolio of receivables), and a securitisation fund.

As a rule, such an agreement creates two fundamental obligations for these parties. The initiator undertakes to transfer to the fund all collections related to the specified receivable or portfolio of receivables, including all fruits of such claims (e.g. interest), principal, and proceeds obtained from the initiator's exercise of security for the receivables. In exchange for the right to receive the collections from the receivables, the fund agrees to pay the initiator a price.

One of the key consequences of this arrangement is that receivables that are the subject of a subparticipation agreement remain the property of the initiator. The initiator remains the creditor with respect to the debtors, and the

party to all the underlying contracts, and it is the initiator that is entitled to seek enforcement of the receivables. No legal relationship arises between the debtor of the receivable and the fund, nor does the fund acquire any rights previously included in the initiator's assets. One might rightly ask what, in that case, the fund is paying the initiator a price for, since the subparticipation agreement does not cause the transfer of any assets? The answer is that the fund is paying for the initiator's undertaking, as the agreement creates an obligation by the initiator to transfer to the fund the collections related to the specified receivables.

The securitisation fund's obligation to pay the price to the initiator is one of the aspects covered in the regulations governing subparticipation agreements. While the parties are free to set the price to be paid by the fund, the act tightly limits the possibility for contractual agreement on the payment term. In the case of a subparticipation agreement governed by the Investment Funds Act, it is not possible to defer payment of the price or schedule payment of the price in instalments. This rule sometimes complicates the simple implementation of mechanisms for payment of the price familiar from factoring contracts or assignment-based securitisation. This is particularly evident in the solution sometimes applied involving building up a reserve (withheld from the price) or in the purely organisational manner of processing the payment of the price (which can be time-consuming for the fund, particularly if it is to be tied to the issue of investment certificates).

The construction described above enables the initiator to improve its cash flows by providing earlier access to funds "frozen" in receivables, while maintaining the legal and business relations with its debtors. In return, the fund receives the opportunity to invest in assets that had previously remained outside its reach due to legal or commercial limitations.

With whom may a subparticipation agreement be concluded?

An agreement regulated in the Investment Funds Act is a subjectively qualified contract, meaning that it must be concluded with a securitisation fund. The act does not provide restrictions on the part of the initiator; it might be, for example, a bank, a nonbank lender, a manufacturer or a merchant. Although the matter is not entirely clear, the reference to a securitisation fund regulated in detail in the Polish Investment Funds Act appears to prohibit the exercise of privileges under the act by other entities, established under the regulations of other jurisdictions.

However, it is not excluded for a contract similar to a subparticipation agreement to be concluded between the initiator and an entity other than a Polish securitisation fund. The possibility of concluding such a "private subparticipation agreement" is founded on the general principle of freedom of contract. Unfortunately, such an agreement will only be similar to a subparticipation agreement governed by the

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Investment Funds Act. The mechanics of the agreement may function similarly, but the obligation may involve the initiator's transfer of the receipts to the other party which is not an investment fund. In the case of private subparticipation, however, the parties will not enjoy other privileges provided for subparticipation by a securitisation fund, for example under the Bankruptcy Law, which provides that receivables subject to subparticipation are automatically excluded from the initiator's bankruptcy estate, or in the Banking Law, which permits disclosure of banking secrets for the purpose of concluding such an agreement.

Subparticipation and the risk of the initiator's insolvency

One of the main risks with a subparticipation agreement is the initiator's insolvency. The initiator receives the full price for the rights to the collections related to the receivable, while at the same time the receivable itself remains the property of the initiator. Is the fund/investor left without any protection in that situation?

Retaining within the initiator's assets a receivable subject to subparticipation means that potentially the receivable could enter the initiator's bankruptcy estate or arrangement estate. The receivable might also be attached in execution proceedings by other creditors of the initiator. In such circumstances, unlike in factoring or assignment-based securitisation, where the receivable is "removed" from the initiator's assets, the interests of the fund could be threatened due to the loss of the stream of payments which the fund has already paid for the rights to. Payment of the receivables would then augment the bankruptcy or arrangement estate, or in execution proceedings could be used to satisfy the initiator's debt to the creditor conducting the execution.

The risk connected with declaration of the initiator's bankruptcy or opening of restructuring of the initiator was identified and addressed by lawmakers. If the subparticipation agreement meets the conditions set forth in the Investment Funds Act (i.e. is concluded with a securitisation fund), then, under Art. 65a of the Bankruptcy Law or Art. 243 of the Restructuring Law, the receivable subject to subparticipation does not enter the bankruptcy or arrangement estate but is shifted to the fund's assets by operation of law. The fund then becomes the creditor under the receivable that was subject to subparticipation, and will be authorised to enforce such receivable on its own, bypassing the initiator in bankruptcy or restructuring. This solution greatly improves the legal situation of the fund, but leaves a few aspects requiring specific analysis and consideration in each case. For example, a commingling risk may be created by mixing of the initiator's own funds with proceeds from the subparticipated receivables obtained by the initiator prior to the bankruptcy or restructuring. The fund acquires the receivables by operation of law in the condition they are in at the time of the change of creditors. This means that payments made to the initiator before that time have already partially satisfied the debt, and

thus recovering such payments from the initiator will not be obvious. The protection described here for securitisation funds in the event of the initiator's insolvency will not apply to private subparticipation agreements.

Unfortunately, the problem of attachment in execution proceedings of receivables subject to subparticipation has not been resolved in any specific manner. Because the receivable remains in the initiator's assets, potentially it may become property out of which other creditors obtain satisfaction of their claims, resulting in the funds being redirected: instead of reaching the initiator, they will go to the bailiff and then to the executing creditor. In such case protection for the fund should be sought in the general mechanisms for execution proceedings and in specific contractual solutions, which may be a useful addition to the subparticipation agreement itself.

Credit risk and servicing of receivables

It may happen that receivables subject to subparticipation are not paid by the debtor as agreed. Depending on the parties' intent, the risk of non-payment may be shifted entirely to the fund, or it may be shared between the initiator and the fund. Regardless of the model chosen, it is vital to pay attention to administration of receivables subject to subparticipation. Basically it is only the initiator that will be authorised to act on this issue, which is advantageous for the fund (as it will not have to hire specialised entities to handle these measures), but it may also happen that the initiator has limited motivation to act in this area. The possibility for the initiator to dispose of the receivables subject to subparticipation should also be regulated. There is nothing preventing the initiator from entrusting the administration of such receivables to a third party. It should be borne in mind, however, that the authorisation to act must always come from the initiator, because at all times—apart from cases of bankruptcy or restructuring—it remains the creditor in dealings with the debtor pursuant to the receivable subject to subparticipation.

Summary

While the use of subparticipation agreements continues to be limited, practical examples, including examples from our clients, show that this instrument may be effectively applied to the advantage of both initiators and investors. Although more demanding and less standardised than securitisation programmes based on assignment of receivables, the subparticipation agreement offers another instrument for improving the cash flow of enterprises. It allows the enterprise to raise financing based on assets whose potential is not being fully exploited. It also provides investors exposure to a broad range of assets which would not otherwise be accessible to them.

Daniel Smarduch, adwokat, Banking & Project Finance practice

Marcin Pietkiewicz, attorney-at-law, Capital Markets practice and Financial Markets practice

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Disputes over EU funding and competitions: A procedural minefield

It might seem that decisions by public authorities conducting and overseeing competitions awarding EU funds would be governed by standard procedural rules. But in fact the regulations governing such proceedings differ significantly from the regular administrative procedure. This came as a big surprise to an undertaking that was suddenly excluded from a competition for funding of its project.



Dr Maciej Kiełbowski



Agnieszka Kraińska

Protest instead of appeal

The first discovery, which was not obvious for our client, was the manner in which it could raise its objection to the ruling excluding it from the competition. Cases of this type do not offer the better-known avenues for administrative review known as appeals (*odwołanie* or *zażalenie*), but a specially regulated form of “protest.”

It's a good thing that the client brought the matter to us soon enough to prepare and file a timely protest. This is because in cases of this type, it is recognised that once a deadline has passed, no application to reinstate the deadline will be entertained, as the provision of the Administrative Procedure Code permitting such a request is not applicable. As the Province Administrative Court in Szczecin held in its judgment of 11 January 2018 (Case I SA/Sz 937/17), “Under Art. 50 of the Implementation Act (the Act of 11 July 2014 on Rules for Implementation of Cohesion Policy Programmes Funded in the 2014–2020 Financial Perspective), the Administrative Procedure Code ... does not apply to proceedings for application and award of funding under that act, except for provisions concerning exclusion of employees of the authority, service of documents, and the method for calculating time limits. Division I, Chapter 8, of the Administrative Procedure Code (Art. 39–49) does apply to service of documents and notices. However, the phrase ‘method of calculating time limits’ used in Art. 50 of the Implementation Act indicates that in such instances, the institution of reinstatement of a deadline, provided for in Art. 58 and 59 of the code, does not apply.”

This was particularly vital because the Implementation Act relaxes the rigours of the Administrative Procedure Code, advantageous to the parties to administrative proceedings, concerning notice to the party of its rights. Unlike the general rule that failure to provide notice of the party's rights must not prejudice the party or the legal steps taken by the party, here Art. 63 of the Implementation Act states that the lack of such notice shall not affect in any manner the possibility of filing a complaint with the administrative court. In other words, even if the client did not know that it was entitled to file a complaint with the court (because that right was not mentioned in the notice), the period for filing a complaint would commence running and could expire without the client's knowledge. Fortunately, however, immediately upon receiving the ruling on the protest, the client forwarded it for analysis of the possibility of further appeal.

Specific allegations must be asserted

Art. 54(2)(4)–(5) of the Implementation Act requires the protest to set forth specific allegations against the resolution by the authority, and more precisely the project selection criteria, which the applicant disagrees with (together with a justification), as well as allegations of a procedural nature affecting the evaluation, if in the applicant's view

such violations occurred (also with a justification). The wording of these allegations is thus critical, as it carries over to the rest of the proceedings in the case. If the applicant does not raise an allegation in the protest, it will be difficult to demand that it be considered during the judicial phase (unless it involves actions taken in considering the protest as such, when it is obvious that it will be considered).

Cases involving EU grants generally present a whole group of exceptions. When reading the Implementation Act, we often encounter exemptions from application of parts of the Administrative Procedure Code, or provisions requiring application of only certain parts of the code. Unfortunately this generates problems in practice, such as the inability to apply provisions on reinstatement of deadlines.

Watch out for time limits

Another surprise for our client was the shortening of the time limits for acting in subsequent stages of the proceeding, particularly the deadline for filing a cassation appeal. The client was accustomed to the 30-day time limits in administrative court proceedings.

But the procedure involving EU funds also provides for a different rule in this respect: merely a 14-day period for filing court pleadings (Art. 61(2) and 62(1) of the Implementation Act). The shortened time limit is provided for both a complaint to the province administrative court and for a cassation appeal against an unfavourable ruling at that level to the Supreme Administrative Court.

In addition, in order to draw up the complaint, the client had to adequately prepare and enclose the full documentation of the matter. This is another difference from ordinary administrative court proceedings, where it is the administrative authority that compiles and submits the case file to the court. Here this obligation rests on the party filing the complaint (Art. 61(4) and (2) of the act).

Rules for selection of projects

Under Art. 37 of the Implementation Act, the selection of projects must be made in a manner that is transparent, objective and impartial and ensures the applicants equal access to information about the conditions and manner of selection of projects for funding. For our client, which qualified for the first stage of the competition but did not qualify for the second stage, the margin of discretion left to the authority in terms of the possibility of extending deadlines for filing of documents by an applicant for funding came as a great surprise. In the case of some applicants the authority agreed to extend the deadlines, but refused to extend the deadlines for other applicants, which resulted in their failure to qualify for the second stage of the competition.

Under the case law of the administrative courts, the principle of objectivity imposes on the competent institutions

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a duty to evaluate projects taking into account all circumstances arising out of the documentation presented by the applicant, and thoroughly analysing the information contained in the documentation. An arbitrary—and thus non-objective—evaluation comes into play when no legal standard imposes an obligation on the authority to act in a specified manner under a given state of facts, but enables the authority to take varying (lawful) positions. Thus an objective evaluation, within the administrative discretion vested in the authority, does not allow the competent institution to resolve the matter arbitrarily. Nonetheless, during the course of the administrative court proceeding in this case, the manner of action by the authority was not found to be arbitrary and non-objective, and its position was upheld.

In many competitions for EU funding, the principle of the cost-effectiveness of the expenditure of funds takes precedence over the already slender guarantees of the applicants' rights. It is indicated in the legal literature that exclusion of the Administrative Procedure Code from proceedings for the award of EU funding results from a mistaken belief on the part of lawmakers that cases involving evaluation and selection of such projects are not typical administrative cases (R. Poździk (ed.), *Komentarz do ustawy o zasadach realizacji programów w zakresie polityki spójności finansowanych w perspektywie finansowej 2014-2020* (Commentary on the Implementation Act), p. 282).

This situation raises doubts in the context of the EU principle of sincere cooperation, which requires national procedures in fields governed by EU law to afford persons the same solutions, or at least no less favourable solutions, than in procedures in fields governed exclusively by national law.

Constitution remains supreme

Generally, this is all intended to ensure that EU funds are spent quickly and efficiently—and if the funds are spent

improperly, the authorities can quickly recover them. But these aims should not overshadow the supreme principles of the Polish legal system enshrined in the Constitution.

Provisions of the Implementation Act must not create traps for applicants seeking funds or for beneficiaries who have already received funding. This is prohibited by the principle of proper legislation drawn from Art. 2 of the Constitution, and the principle of proportionality (Art. 31(3) of the Constitution), under which administrative authorities must apply means adequate to the aim of regulations and not needlessly burdensome to the parties.

As the Supreme Administrative Court pointed out in its judgment of 20 April 2018 (Case I GSK 1963/18), "It cannot be concluded from the wording of Art. 58(1) of the Implementation Act ('The applicant shall be notified in writing of the result of consideration of its protest. Such notice shall contain in particular the substance of the resolution, consisting of upholding or denying the protest, together with a justification.') that in the notice containing an evaluation of the results of consideration of the protest, there is no duty to state the reasons resulting in denial of the protest. Such an interpretation of Art. 58(1) of the Implementation Act would be contrary to Art. 2 of the Constitution, considering that the Implementation Act provides for a specific, modified manner of proceeding and that the notice of evaluation is the subject of review by the administrative courts."

Such views, recalling the primacy of the Constitution over statutory regulations, have been stated more than once in the case law. It is worth bearing them in mind when dealing with resolutions issued under the Implementation Act.

Dr Maciej Kielbowski, adwokat, Administrative Disputes practice, Dispute Resolution & Arbitration practice

Agnieszka Kraińska, attorney-at-law, EU Law practice

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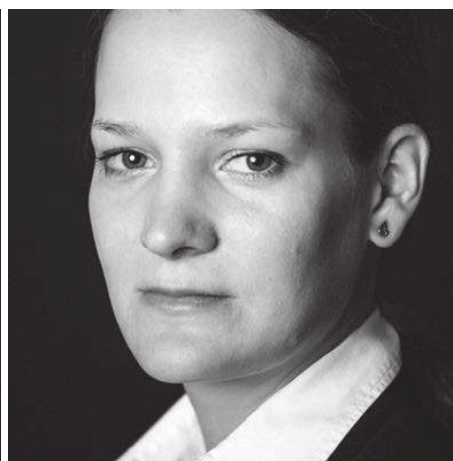
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The artist in the gallery

The Polish art market has blossomed in recent years. Turnover of auction houses rose by 28% in 2017, to PLN 214 million. There were 13,479 pieces auctioned, and the record was set by Stanisław Wyspiański's *Motherhood* at over PLN 4.3 million. The art market is also becoming more and more accessible. According to art-info.pl, nearly a third of transactions were concluded at PLN 1,000 or less, and three-fourths at PLN 5,000 or less. This situation creates many possibilities for buyers, auction houses, art dealers, and artists themselves.



Włodzimierz Szoszuk



Monika Dynowska

But auctions aren't the only way to make a name in the art world. Direct cooperation between artist and gallery still enjoys huge popularity. Unfortunately, many artists don't know how to properly secure their interests in dealings with gallery owners. Everything seems obvious, but our practice shows that many "obvious" issues must be precisely nailed down.

From the general to the specific

First, the parties' obligations should be defined in detail. It should be ensured that the contract contains provisions obliging the dealer to display the works and specifying where they are to be shown and how they are to be promoted. It would also be good to establish from the start whether the dealer will organise events connected with the artist's work, whether there will be openings devoted solely to a single artist, and how many times the artist's works will be included in shows during the term of the contract. It should also be noted whether the artist wishes to authorise the dealer to consign the works to other shows, allowing them to reach a broader audience, or require separate approval in each such case.

The dealer's duties

It should be ensured that the contract contains provisions on the dealer's responsibility for proper storage of works, and to bear the costs of packing and transport of the works. It is essential to specify how and when the dealer will notify the artist of a sale, as well as the dealer's obligation to present relevant documents confirming the sale (e.g. contract, invoice or bill).

The artist should also take care to secure the artist's own interests in the event that the buyer cancels the sale due to actions or representations by the dealer. In such situation, the artist should be entitled to the price obtained, and the amount already paid out should not be refundable.

The artist also has obligations

It is a widely followed practice to prohibit the artist from attempting to sell works entrusted to the dealer without the dealer's intermediation. But it sometimes happens that the artist directs the buyer to the gallery. It should thus be established in advance what the gallery's commission will be in the case of such transactions, as clearly the work required on its part will be less in such cases.

It is also in the artist's interest to share with the gallery all relevant information about the artist's career and the works themselves. It has long been obvious that the more intriguing the story behind the artwork, the greater its chances of attracting the interest of buyers. It should be ensured that the gallery owner has the full history of the work: where it has been exhibited or published, what prizes it has won, and so on. All such aspects have some impact on the price,

and it is in all the parties' interest to ensure that the price is properly justified.

Price

Pricing practices vary. But to best secure the artist's interests, we suggest that the price be covered in the information provided to the dealer by the artist when concluding the contract. The artist may not wish for the work to be sold at less than the indicated price. It is well-known that prices of works shown in galleries are often subject to negotiation, and thus it is worthwhile to stipulate that any change in the previously established price must be approved by the artist. But this does not mean that the price should be treated rigidly. It is in both parties' interest to obtain the highest price for the work, but we suggest stipulating that if the gallery sells a work at a price less than the minimum set by the artist, the dealer will refund the difference to the artist.

The manner and timing for paying out the sale proceeds to the artist should be agreed. If the gallery does not comply with these terms, the artist will have a right to seek interest on the delay. It must also be remembered, however, that the dealer is entitled to a commission on the sale, which will be deducted from the gross sale price. We advise including a stipulation that out of the commission the gallery will cover all costs connected with performance of the contract, such as transport and promotional expenses.

The cautious are always insured ...

When entrusting works to a dealer, the artist should verify that the dealer has valid insurance covering loss to works of art in the gallery's possession. It is also worth confirming that the dealer is required to use professional service providers. When hiring a specialised firm to handle packing and transport of works of art, it should be determined whether they have a valid insurance policy for an amount exceeding the value of the transported works. To fully secure the interests of the parties, we suggest that they be required to verify this before releasing works for transport, and hold insurance up to the declared value of the goods being shipped.

Despite exercising due care, it may happen at any time that due to fortuitous events a work is for example damaged. It is worthwhile to establish in advance who bears responsibility for accidental damage or loss. Typically, upon delivery of the work by the artist, the risk of accidental damage or loss passes to the dealer, and remains there until the work is delivered to the buyer or returned to the artist. If a work is damaged when responsibility for the work rests with the gallery, we believe it is appropriate to require the gallery to repair the damage at its own cost, but under the artist's supervision.

... and secured

We have indicated a list of provisions that should be includ-

art market
contract with
art dealer

ed in the contract. But to ensure that they are enforceable, contractual penalties should also be included.

If the dealer shows the work at a location not approved by the artist, it would be reasonable to impose a contractual penalty for each day of such violation.

For certain other actions, such as returning works or releasing the purchase price, appropriate deadlines should be set. In case they are not met, the parties may set a penalty payable for each day of delay.

What about a situation where a work in the dealer's care is so badly damaged that it cannot be repaired or it would not be feasible to do so? Then we would suggest requiring the dealer to pay a penalty equal to the agreed value of the work. If the dealer lives up to this obligation, the gallery should expect to become the owner of the remnants of the work. However, if a work is damaged and can be repaired, but the repair will reduce the value of the work, the dealer should pay the artist a contractual penalty in a corresponding amount.

Can works delivered to the dealer be withdrawn?

For various reasons, during the term of the contract the artist may wish or be forced to withdraw works from the gallery. It is worthwhile to include a provision in the contract that the dealer will not charge the artist with the costs incurred for promotion, and to specify who in that situation will be responsible for packing and transport of the works.

Immediate termination

Bearing in mind all darker scenarios, situations should also be provided for when the parties will be entitled to terminate the contract with immediate effect. This may happen for example if:

- The dealer sells a work at a price lower than that agreed with the artist

- Works are damaged or destroyed
- The dealer fails to maintain valid insurance
- The artist sells works on his own at significantly lower prices than those of the gallery.

Any such occurrence should warrant immediate termination of the contract.

What should be enclosed with the contract?

The most important appendix to the contract is the protocol of delivery and receipt under which the works are transferred. Plenty of time should be devoted to drawing this up, so that for example if a work is damaged its previous condition can be demonstrated. The main protocol should contain the title of the work, the year it was made, the medium, dimensions, a description of the condition of the work, and additional information such as publications or prior exhibitions, the price of the work, and any other information such as whether the painting was delivered in a frame. To avoid doubts in identifying works, photos of the works should be enclosed with the protocol of delivery and receipt.

Summary

Cooperation with a well-known gallery can be a great way to launch an art career or capitalise on the accomplishments of an artist who is already well-known. But before entering into such cooperation, all the risks should be weighed. A well-constructed contract addressing all the key issues in day-to-day dealings between the artist and the dealer, and also providing for unforeseeable circumstances, can save a lot of trouble and disappointment.

Włodzimierz Szoszuł, adwokat, partner in charge of the Intellectual Property practice

Monika Dynowska, Intellectual Property practice





When does a journalist infringe a company's reputation?

The press enjoy the constitutional freedom of expression and fulfil citizens' right to objective societal information, oversight and criticism. Where is the boundary the media must not cross before colliding with the personal rights of others? Can journalists report news derived from third parties, and are they required to report only true information?



Dominika Kwiatkiewicz-Trzaskowska

A TV programme in Poland broadcast a report stating that a company had brought hazardous waste into its manufacturing plant with the intention of using it for production of construction materials. The basis for the report was an investigation by a detective bureau commissioned by another company.

The broadcast was illustrated with passages from video recordings made by a detective using a hidden camera. The detective traced suspicious cargo on its way from a waste incineration plant, where the material supposedly originated, to the manufacturing plant, where it was unloaded. Voices of company officials (distorted to disguise their identity) were accompanied by ominous music, along with speculations and insinuations painting a picture of a company involved in illegally processing hazardous waste and using it in the production of its goods.

In the subsequent months, the company in question and other entities connected with the matter underwent a range of inspections. In administrative and criminal proceedings, attempts were made to reconstruct the events described in the news report. It was unequivocally determined that no waste was brought into the plant, and the reliability of the detective's investigation left much to be desired. What relevance do these findings have for the responsibility of the journalist reporting the story?

Journalist's obligations

In Poland, the Press Law imposes obligations on journalists directly affecting their liability to third parties. The press are required to present events accurately, and among other obligations the journalist must:

- Maintain particular care and diligence in collecting and using press materials, especially to verify the accuracy of the information or indicate the sources, and
- Act in accordance with professional ethics and principles of social coexistence, within the bounds defined by provisions of law.

The requirement for "particular" care by journalists is further-reaching than the ordinary care required in civil dealings. Care and diligence in this instance are interpreted to mean integrity, reliability, conscientiousness, specificity, and responsibility for the choice of words. Significantly, the degree of this exceptional care must be adjusted to suit the nature of the source of the information, particularly when it concerns sensational news. If the source is not very reliable, is not an authority in the field, is pursuing his own interest (e.g. commercial interest), or is emotionally involved in the matter, journalistic vigilance and diligence should be heightened.

Apart from verification of the source of the information, the following aspects are also relevant:

- Seeking out all available sources to verify the truthfulness of the information obtained
- Ascertaining the consistency of the information with other known facts
- Enabling the interested person to address the information.

At the stage of making use of the materials gathered by the journalist, it is important to present the information and circumstances of the matter thoroughly (and not selectively), and also to weigh the seriousness of the allegation, the significance of the information from the perspective of a legitimate social interest, and the need (urgency) of publication. The journalist should not prejudge the nature of the matter described and create slanted material, even if initially it seems accurate and reliable.

The form of the publication may also be relevant when assessing the fairness of how the information is used.

Does a journalist have to tell the truth?

Sometimes a journalist acts with diligence and care but nonetheless the information published turns out to be untrue. Does this mean that the journalist has unlawfully infringed the interests of the persons reported on in the publication? These doubts were resolved by the Supreme Court of Poland in a resolution from 2005 (Case III CZP 53/04), where it held: "A showing by the journalist that in collecting and using press materials he acted in furtherance of a socially justified interest and fulfilled the obligation to act with particular care and diligence eliminates the unlawfulness of the journalist's action." The journalist's compliance with these obligations thus excludes unlawfulness even when the statement asserted by the journalist proves to be untrue. This is an entirely correct position, as journalists do not have the instruments and competencies at their disposal that are available to prosecutors, courts and administrative authorities. Journalists cannot be expected to determine beyond any doubt that the assertions in their reports are true.

But this does not release the journalist from the obligation to strive to present truthful information, in compliance with the greatest diligence and integrity. This is particularly relevant in the case of activist journalism, raising the alarm about undesirable activity of societal relevance. This is tied to the second aspect which should exist for the journalist's action to be found not to unlawfully infringe the personal interests of the subject: acting in furtherance of a social interest.

In furtherance of a social interest

In the case described here, the furtherance of a social interest would be for the journalist to strive to realise the principles of transparency of public life, the society's right to information, and to reveal and publicise an undesirable phenomenon threatening human life or health. But it would be woefully inadequate for the journalist to make

personal rights

reputation of legal person

particular care and diligence of journalists

acting in the social interest

a bare assertion that he is acting in the social interest simply because the topic discussed may be important for society.

Criticism pursued in the social interest is a beneficial activity when it presents facts that have actually occurred. But when the critic departs from the truth or presents facts ignoring relevant circumstances or failing to verify them thoroughly, such criticism cannot be regarded as fair, objective, and helpful. The judicial rulings concerning activist journalism take the view that it is better to withhold publication of unverified material than to publish falsehoods. Acting in the public interest means first and foremost reporting the truth; spreading falsehoods is more harmful than deciding not to report on the topic.

When mistakes are made

So where did the journalist go wrong in this case? First and foremost, he placed too much trust in the source of the sensational claim. As it turned out, the detective hired by another business (perhaps a competitor of one of the companies presented in the report) was himself acting without due care, erroneously making fundamental findings for the case. Thus the detective was a source of information who required a sceptical approach, which the journalist lacked. The reporter accepted the detective's findings as true, making only haphazard efforts to verify them. Nor did the journalist verify the reports about the alleged waste by following up all available sources.

The seriousness of the phenomenon described and the negative consequences that could arise if the allegations were true—for the society and for the entities involved—warranted a thorough analysis of the circumstances of the case, even at the cost of requiring more time to present the material. Haste in preparing and broadcasting the report certainly did not demonstrate diligent and careful action by the journalist. The form of the report, highlighting the sensationalism of the topic, combined with the shortcomings identified above, only add to the picture of how a reporter should not perform his duties.

Reputation of legal person

It is thus justified to state that in this case the journalist unlawfully injured the reputation of the company which was the subject of the report. And reputation (also referred to as renown or good will) is one of the interests most frequently injured by journalists in practice.

A company's reputation is injured by information which, viewed objectively, ascribes to the company improper behaviour, potentially causing a loss of the trust it needs to properly function and perform its tasks. It can be assumed with a high degree of likelihood that information that a company was acquiring and using hazardous waste could negatively impact the company's reputation, i.e. its perception by third parties. It is not necessary in this respect to prove that the company suffered an actual loss to its reputation. It is sufficient to show the potential for such injury.

Conclusion

When the topic is weighty, journalism—especially activist journalism—requires rapid action aimed at stirring an intense societal reaction. But it is also essential to respect the rights, interests and reputation of the subjects. The journalist must know how to strike a balance between these two aspects. The news reported should be true, but when it is not, the journalist will not be blamed if he can show that he acted with the greatest care and diligence, and performed his duties in furtherance of a social interest. This means thorough verification of all aspects of the matter, with all available sources. It is not sufficient to rely on someone else's findings, particularly when they come from an unverified source. Acting in the public interest does not mean simply tackling a socially important topic, but first and foremost reporting carefully checked facts. Failure to comply with these obligations may mean unlawful infringement of the subject's reputation, resulting in civil liability.

Dominika Kwiatkiewicz-Trzaskowska, attorney-at-law, Intellectual Property practice

personal rights

reputation of legal person

particular care and diligence of journalists

acting in the social interest

Sham outsourcing of employees

Businesses optimising their operations often cease employing some of their staff in favour of outsourcing services. Sometimes, for this purpose, they transfer their employees based on Art. 23¹ of the Labour Code to an outsourcer, most often without transferring any other assets. The main economic motive for such measures is savings on social security and health insurance contributions. However, in the opinion of courts ruling on cases in similar factual circumstances, often at the request of tax or social insurance authorities, this may be only a sham transfer of the workplace, and as a consequence Art. 23¹ of the Labour Code does not apply. What does this mean for the original employer?



Dr Szymon Kubiak



Kamil Jabłoński

From the perspective of the developing case law, a model example of a sham transfer of a workplace is a situation where the employer enters into an agreement on the transfer of its employees under Art. 23¹ of the Labour Code to an outsourcing company, which becomes the new employer on the same terms and conditions for work and pay as at the former employer. It is also important that the subject matter of the contract is not the transfer of any tangible or intangible assets of the company. On the basis of such an agreement, the outsourcing company undertakes to provide the same services to the former employer which were previously performed by the transferred employees. The agreement also usually stipulates that the activities will be performed by specific employees, who in practice are former employees of the previous employer.

Thus in practice almost nothing changes. Such “contractors,” when providing services, are obliged to comply with the former employer’s internal rules and regulations, including work organisation, occupational health and safety, protection of trade secrets, and protection of personal data and IT systems. And it may happen that the former employer also provides access free of charge to property which will be used to perform the services. Often, temporary employment agencies, authorised to conduct regulated activities, play the role of such outsourcers and formally act as the staff’s new employer.

A court ruling on such a case must determine whether what is being transferred constitutes a “workplace” or “part of a workplace” in accordance with Art. 23¹ of the Labour Code. Considering the factual circumstances, the basic question is whether such a workplace can be made up of employees alone, if nothing else, in particular assets, is transferred along with them.

The EU’s Transfer of Undertakings Directive (2001/23/EC), which is the source of implementation of the rules on the transfer of a workplace in the Polish Labour Code, uses a broader term than a workplace, namely an “economic entity.” The directive applies to “any transfer of an undertaking, business, or part of an undertaking or business to another employer,” and a transfer occurs for purposes of the directive “where there is a transfer of an economic entity which retains its identity, meaning an organised grouping of resources which has the objective of pursuing an economic activity, whether or not that activity is central or ancillary.” Taking into account the EU origin of national rules on the transfer of a workplace, it is legitimate to refer to EU case law in this area when interpreting the national rules.

EU case law

The Court of Justice of the European Union has repeatedly addressed the question of whether the transfer of tasks (functions) of one undertaking to another undertaking constitutes a transfer of a business or part of a business. It

was originally accepted that an activity itself, as an autonomous function (task), might be equated to a business or part of a business, so that the transfer of tasks alone could be considered the transfer of a business. This view was rather radically revised, however, and finally it was accepted that the notion of a transferable unit refers to an organised group of persons and means facilitating the pursuit of an economic activity aimed at achieving a certain objective.

The nature of an economic entity’s activities must also be taken into account when assessing the entity: whether it is an activity based on tangible components, or whether people are its main “asset.” In the first case, the takeover of material resources is decisive, while in the second situation, it has been accepted that a team of employees who are permanently engaged in joint activities may form an economic unit. These views were crystallised in the now-famous decision by the Court of Justice in *Spijkers* (Case 24/85). That judgment sets forth a list of factors that need to be taken into account when assessing whether part of a business has actually been taken over in a given factual situation.

Polish case law

Polish courts are equally often confronted with the problem of an illusory transfer of a workplace—especially recently. The case law of the Supreme Court of Poland has so far followed the current approach presented by the CJEU.

In the judgment of 27 January 2016 (Case I PK 21/15), the Supreme Court examined a factual situation in which two companies orally agreed that there would be a transfer of employees between them. The acquiring company was to provide the other company with primarily HR and payroll tasks. Immediately after the transfer of employees, it delegated those employees to service the company from which they had been acquired. In other words, the same employees performed the same work at the same place for the same entity, and only the identity of the employer formally paying their salaries changed. The only purpose of this measure was to save money by reducing social insurance contributions.

In its justification of this ruling, the Supreme Court also made a difficult attempt to define “outsourcing.” It said outsourcing is an undertaking consisting of separating from the organisational structure of the parent enterprise functions performed by it and transferring them to other economic entities for implementation. The main difference between employee outsourcing and employment of one’s own employees or performance of work by temporary employees is the lack of direct and permanent subordination of contractors to the entity where their work or services are performed.

Ultimately, the Supreme Court held that there was no transfer of a workplace or part of a workplace in that case.

transfer
of a workplace
or part
of a workplace

combining
resources

maintaining
identity

people
as an asset

outsourcing

Spijkers case

The Supreme Court took a similar view in the judgment of 8 February 2017 (Case I PK 72/16). In that case, the court had to assess whether, in the given state of facts, the takeover of employees only, without taking over tasks and assets, constituted the transfer of a workplace or was merely sham outsourcing. The case concerned a situation in which a sewing plant (operated by a natural person conducting economic activity) transferred all its employees to a limited-liability company under Art. 23¹ of the Labour Code. For its part, the company committed itself to provide sewing services through the delegated employees (the same ones who were “transferred”). Moreover, the employees were to work on the equipment owned by the sewing plant.

In this case, the court also held that there had been no transfer of a workplace, but only sham outsourcing of the employees. In the justification of the ruling, the court explicitly pointed out that the key issue is the transfer of a workplace, understood also to mean an organised part of a workplace, which also includes assets and never employees only. The court also drew attention to the nature of the activity of the sewing plant, which cannot function without specialised equipment—so it is not a workplace whose main “asset” is people.

Consequence of the sham transfer of a workplace

A finding by the court that the transfer of a workplace was illusory, and therefore did not really take place at all, has spe-

cific, often very severe consequences. First of all, the contract between the entities which was the basis of the transfer of a part of the workplace is invalid. Therefore, there is no real change of employer. In such situation, the Social Insurance Institution will issue a decision finding that the previous employer is the payer of contributions, and will order it to make up unpaid contributions. This means that the most common goal of transferring employees “outside”—i.e. savings on social insurance contributions—will be defeated.

Summary

The outsourcing services market is growing rapidly, and this trend is likely to continue. Reasonable use of such solutions results in measurable savings for employers. However, plans to make changes based on Art. 23¹ of the Labour Code should be approached with caution to avoid falling into the trap of the illusory appearance of a transfer of a workplace—especially if the acquiring party is a temporary employment agency. The case law of Polish and European courts, and a risk analysis, will certainly help in this respect, which should show whether the costs in the event of an unfavourable court ruling will outweigh the (apparent) benefits.

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Kamil Jabłoński, attorney-at-law, Employment practice



Pactical problems with transboundary shipment of waste

More and more often, companies transport waste from abroad into Poland. However, transboundary shipment of waste is not easy, and anyone interested in such an undertaking must complete a number of formalities and obtain approval from the competent authorities of the countries through which the waste is transported. Illegal transport of waste results in severe financial sanctions and strict criminal liability. The purpose of such restrictions is to protect the environment.



Dr Dominik Wałkowski



Martyna Robakowska

According to the proximity principle, one of the guiding principles of environmental law in the European Union and Poland, waste should be treated first and foremost at its place of origin. Long-distance transport of waste is an undesired phenomenon, as it is linked with the creation of transport emissions, nuisance related to storage, as well as risk to human health and the environment, especially in the case of hazardous waste. Therefore, the law imposes obligations on businesses to ensure that cross-border shipment of waste takes place only after strict requirements have been met, ensuring proper environmental protection throughout the process, i.e. from dispatch of the waste, through transit, to treatment in the country of destination. The regulations are also aimed at preventing uncontrolled removal of waste from one country in order to abandon it in another country.

In practice, businesses often fail to exercise enough due diligence when preparing documentation for cross-border shipment of waste, treating these requirements like the routine formalities preceding any transport of goods. The large number of objections by Poland's Chief Inspector of Environmental Protection (GIOŚ) against planned shipments of waste prove how many mistakes shippers make in this respect. And because in such situations proceedings are conducted before the regulators of multiple countries, the whole procedure is complex and time-consuming.

What does the law say?

Issues related to cross-border shipment of waste are regulated primarily in the Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal, the EU's Transboundary Waste Shipment Regulation (1013/2006), and the Polish Act on Transboundary Shipment of Waste of 29 June 2007.

The course of administrative procedures depends on the type of waste being shipped and the processes it will be subjected to. The procedure of prior written notification and consent is the one most often used. To ship waste under this procedure, the business intending to ship waste must submit a notification of the cross-border shipment of waste to the competent state authority of the country of shipment. This notification must indicate the type, weight and quantity of waste, information on the purpose of the shipment (recovery or disposal), routes, carriers, and how the waste will be used by the recipient. Appendices to the notification include copies of the waste management permits obtained by the notifying party and the recipient of the waste, as well as information on the security of transport of the waste and the established financial guarantee.

The authorities of the countries of shipment, transit and destination verify the documentation. Once this is completed, they may issue three types of decisions: consent, conditional consent, or objection. The shipment is only possible when all countries on the shipment route have given consent to the shipment of waste.

Classification of waste can be challenged

A company intended to bring to Poland many tonnes of waste classified with code 19 12 12 (other wastes including mixtures of materials from mechanical treatment of wastes other than those mentioned in 19 12 11). The company had incorrectly completed the notification form, mistakenly indicating that the waste to be shipped came from households. The documentation attached to the notification did not preclude that the waste was of this type. The company obtained the consent of the competent authority of the country of dispatch and the case files were transferred to GIOŚ.

After analysis of the case documentation, the Polish regulator found that the company had misclassified the waste. According to GIOŚ, the waste that the company intended to ship was supposed to be mixed municipal waste, classified under the 20 03 01 code. In case of such waste, according to Regulation 1013/2006, there is a possibility to express an objection to the planned shipment. GIOŚ exercised that opportunity, issuing a negative decision for the company.

The company disagreed with the decision. In challenging the decision of GIOŚ, the company explained that the indication that the waste originated in households was included in the application form by mistake. The company also submitted updated information showing that the waste covered by the notification was to be collected from industrial plants. Nevertheless, GIOŚ did not change its decision, and the administrative court examining the correctness of the authority's proceedings did not contest the GIOŚ evaluation.

This case shows how crucial it is to submit correct and consistent data in the notification documentation. Equally important, it is generally not possible to correct any errors at a later stage. If the correction were made only during the proceedings before the authority of the country of destination, it would mean that the notification was different from the one addressed by the regulator in the country of shipment, which had no opportunity to express an opinion on the amended notification. The priority of environmental protection and the broad competence of administrative bodies to assess the documentation presented demonstrate that any case of doubt in terms of the planned character of the waste shipment, its contents or characteristics, can result in classification of the subject matter of the shipment unfavourable to the notifying party, and thus issuance of an objection.

Compliance of the transported waste with the notification

In another case, a company obtained all necessary permits to bring waste with the code 19 12 10 (combustible waste—refuse-derived fuel) to Poland. The consent decision by GIOŚ indicated conditions that had to be met by

the shipped waste, including the percentage composition of particular waste fractions (metals, plastic etc).

The waste was transported by land. Officers of Poland's National Revenue Administration stopped for a routine check three trucks transporting waste covered by the notification. In the course of their inspection, the inspectors took samples of the waste for thorough examination.

The tests showed that the composition of the samples fell outside the limits indicated in the GIOŚ decision. Moreover, the inspection protocol stated that in one truck, the officers found two beverage packages, which could show that the waste should be classified as mixed communal waste and therefore could not constitute waste falling within the 19 12 10 code covered by the notification.

As a result, the authorities issued a decision requiring the notifying party to retrieve the waste from Poland at its own expense. Criminal proceedings were also initiated.

This case demonstrates that when shipping waste, the company needs to take care that the waste content in the various parts of the load complies with the requirements set out in the consents obtained for the shipment. The regulations do not specify precisely if the requirements set forth in the decisions regarding waste content apply to all waste covered by the notification (usually on the order of several thousand tonnes to tens of thousands of tonnes), or to individual shipments.

It is also worth bearing in mind that one of the grounds for objecting to a planned international waste shipment is that the notifier or the recipient has been held responsible for illegal shipment of waste or other violation of environmental law. Therefore, if it is found that the notifier has committed an infringement of environmental protection provisions in the past, this fact in itself may provide grounds for asserting an objection. For businesses regularly shipping waste, this

may in practice foreclose them from obtaining any consent in the future.

Shipment will be increasingly difficult

In 2018, the Polish waste management regulations were significantly tightened. The changes establish a number of additional obligations for waste management businesses. The amounts of financial sanctions for improper waste management have also been increased (to as high as PLN 1 million). Importing waste from abroad or shipment of waste in violation of law is also a crime punishable by imprisonment up to five years. The second example described above shows how a seemingly minor infringement of the provisions can lead to harsh criminal liability of the persons involved in waste shipment procedures.

Numerous cases of improper waste management covered by the media in Poland, in particular fires at landfills where illegal waste from other countries might have been stored, were an impetus for legislative changes. The number of inspections carried out has also risen noticeably. Inspectors, equipped with new competences and resources (including the possibility of using drones), identify more and more irregularities, and in practice any doubt as to the documentation or the transport may result in a negative decision by the administrative authorities, preventing the shipment from being carried out.

These circumstances, as well as the increasing number of businesses wishing to ship waste to Poland (especially as a result of the ban on imports of plastic waste introduced by China), mean that obtaining a positive decision from GIOŚ will become more and more difficult in practice.

Dr Dominik Wałkowski, adwokat, partner heading the Environment practice

Martyna Robakowska, Environment practice

environmental
protection

shipment of waste

illegal shipment
of waste

objection by
Chief Inspector
of Environmental
Protection

Poland fails to meet renewable energy targets. What then?

It's the start of 2019. According to Eurostat figures, at the end of 2016 the share of renewable energy sources in the generation of electricity in Poland was 11.3%. At the end of June 2018 the Energy Regulatory Office noted an increase in RES capacity from the start of 2017 of 170 MW (2% over a year and a half). Failure to meet RES targets for 2020 has become unavoidable. What is the threat to Poland for falling short? For one of our clients, we conducted a preliminary analysis of the risk of imposition of fines on Poland by the Court of Justice of the European Union.



Marek Dolatowski



Agnieszka Kraińska

The Renewable Energy Directive (2009/28/EC) sets a target for the EU as a whole of 20% of the overall share of energy from renewable sources in gross final consumption of energy in 2020, and 15% for Poland. In a 2015 report the European Commission warned Poland that it could meet the RES target only under optimistic projections. But the most pessimistic visions have come to pass, and the increase in the share of RES in the Polish energy mix came to a grinding halt after July 2016, when the new auction-based RES support system was introduced in Poland. It quickly turned out that the auction system required changes forced by the Commission, and announcement of auctions had to be postponed.

It wasn't until 2018 that the necessary changes to the Renewable Energy Sources Act were adopted, enabling the announcement of auctions for support of construction of new RES capacity. But it is not easy to repair the investment climate wrecked by other changes in law, particularly the "anti-wind farm act," as demonstrated by the results of the first announced auctions. Not only investors, but also lenders, gave clear signals that they expect guarantees of stability in the regulations before they decide to invest further in the renewables sector. In light of the stagnation of the RES market, we will not manage in the remaining two years to build sufficient new RES capacity to achieve production of energy from renewables at the required level of 15%.

Meanwhile, the new target for 2030 for the share of RES in production was raised to 32% for the EU as a whole. Poland's failure to meet the target for 2020 places the country in an even harder situation when it comes to achievement of the target for 2030, as it adopts the target from 2020 as a minimum baseline. While it lies within the competencies of the member states to set their RES targets for 2030, the Commission can intervene if the national targets will not suffice to achieve the target of 32% at the level of the EU as a whole. Moreover, the integrated national energy and climate plans of the member states should indicate a trajectory for achieving the target for 2030, with at least 18% of the target met by 2022, 43% by 2025 and 65% by 2027.

But the consequences for failure to achieve the targets for 2020 and 2030 may differ.

Failure to achieve RES target for 2020

The currently binding Directive 2009/28/EC does not indicate the mechanisms for settlement of the RES targets. But this does not mean that Poland can avoid expenditures of many millions of euro, whether in the form of "statistical transfers," where one country purchases another country's overachievement of its target to cover its own deficit, or fines for failure to achieve the RES target for 2020. Poland's Supreme Audit Office estimates the cost of transfers at as high as PLN 8 billion.

In terms of penalties, the procedure for sanctioning member states failing to correctly implement EU law is regulated by Art. 258 of the Treaty on the Functioning of the European Union.

This procedure is divided into an administrative phase and a judicial phase. The administrative phase is launched by the European Commission by issuing a communication to the member state containing allegations, with two months to respond. If the response is unsatisfactory to the Commission, it will prepare a reasoned opinion, for which the member state also has two months to respond. This first phase of the procedure typically takes a year or so.

If the response to the reasoned opinion is still unsatisfactory, the Commission will file a complaint against the member state with the Court of Justice of the European Union. Under Art. 260(3) TFEU, the Commission may apply to the CJEU to impose financial sanctions on a member state at this stage of the proceeding, but only when the member state has failed to make timely transposition into national law of all or part of a directive. Here, Directive 2009/28/EC has been transposed into Polish law, including through the Renewable Energy Sources Act of 20 February 2015, and Poland has notified the Commission of the measures undertaken to achieve the 15% target in reports filed every two years. Therefore, Poland's failure to achieve the 15% target set by the Renewable Energy Directive for 2020 would not entitle the Commission to seek to impose fines on Poland at this stage of the proceeding.

The judicial phase lasts 18 months on average and ends in issuance of a judgment by the CJEU finding infringement by the member state of its obligations under EU law, or lack of infringement.

If the member state does not comply with a judgment of the CJEU, the Commission may, after submitting a reasoned opinion to the member state and considering its position, bring the case before the court under Art. 260(2) TFEU, including a request to impose financial sanctions on the member state, in the form of lump sum or periodic penalty payments. The rules for calculating such sanctions are explained in communications from the Commission.

Periodic penalties accrue for each day the infringement continues following issuance of the second judgment by the court, and the lump sum is imposed for the period between the first and second judgments of the CJEU. The penalty is set based on the seriousness and duration of the infringement, and as a deterrent. For example, in 2014 the Court of Justice imposed a lump sum payment against Greece of EUR 10,000,000 and an additional EUR 14,520,000 for every six months of noncompliance with the judgment (Case C-378/13), and on Sweden a lump sum of EUR 2,000,000 and EUR 4,000 for each day of noncompliance (Case C-243/13).

failure
to meet
renewable
energy targets

consequences
for Poland

fines imposed
by the EU

In short, Poland may be punished for failure to achieve its RES target for 2020 only after issuance of two judgments by the CJEU.

Failure to achieve RES target for 2030

The wording of the new recast Directive (EU) 2018/2001, which replaces Directive 2009/28/EC from 1 July 2021, is much more precise on the issue of performance of the obligations imposed on the member states. The recast directive refers in this respect to the connected new Regulation (EU) 2018/1999, imposing on the member states the obligation to draft integrated national energy and climate plans by 31 December 2018. The next such plan is to be drafted by 1 January 2028, and subsequent plans each 10 years. By 15 March 2023, and then every two years, each member state will be required to submit a report to the Commission on implementation of its integrated national energy and climate plan, in the form of an integrated national energy and climate progress report. The member states' progress will be evaluated by the Commission, which may issue recommendations to member states to reduce the risk of failure to meet the targets for 2030.

If the Commission finds in its assessment of the integrated national energy and climate progress report and its revisions that the progress towards collectively achieving the Union's energy efficiency targets is insufficient, the Commission "shall propose measures and exercise its powers at

Union level ... to ensure that the Union's 2030 energy efficiency targets are met."

In light of the wording of these provisions, the Commission has secured instruments for enforcing the member states' achievement of the incremental targets over 10-year periods. In the event of integrated national plans inadequate to meet the targets for 2030, under the regulation the Commission will "exercise its powers" to ensure achievement of the targets.

Under the new regulations, it may be assumed that the Commission will recognise its authority to commence proceedings against the member states under Art. 258 TFEU in the event of failure to achieve incremental targets in 10-year periods.

Even though Poland's financial liability for failure to meet the targets specified in the directive is becoming a realistic possibility, we estimate that the potential imposition of the first financial sanctions on Poland by the CJEU for noncompliance with its obligations under the Renewable Energy Directive will not occur until about 2025 at the earliest.

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Agnieszka Krainśka, attorney-at-law, EU Law practice



Bankruptcy declaration in Denmark versus protection and liquidation of the debtor's assets in Poland

Bankruptcy proceedings were opened in Denmark with respect to an insolvent debtor with its centre of main interests in that country. For the effects of the bankruptcy to be extended to the debtor's assets in Poland, protect these assets against enforcement measures by creditors, and liquidate them, the ruling opening bankruptcy proceedings in Denmark first had to be recognised in Poland in a special procedure before a Polish court.



Karol Czepukojć

The administrator appointed for the debtor by the Danish court in the bankruptcy proceeding opened in Denmark (i.e. the person appointed to manage and liquidate the debtor's assets) took measures to liquidate the bankruptcy estate in Denmark by selling the debtor's enterprise. This included assets in Poland. The administrator also had to take measures to protect the assets in Poland against enforcement measures by creditors of the bankruptcy estate.

Recast Insolvency Regulation not applicable to Denmark

Although Denmark is an EU member state, under Art. 1 and 2 of Protocol 22 on the position of Denmark, annexed to the Treaty on European Union and to the Treaty on the Functioning of the European Union, Denmark is not a party to the EU's Recast Insolvency Regulation (2015/848). The regulation is not binding on Denmark and Denmark does not apply it. Meanwhile, the regulation allows the effects of the main bankruptcy proceedings initiated in a member state to essentially be expanded to cover the entire assets of the debtor located in the European Union. This means that the effects in Poland of declaration of bankruptcy in Denmark are not uniform at the level of Community law. As a result, the administrator appointed by the Danish court did not have the power to sell, in a manner legally effective in Poland, individual assets within the bankruptcy estate that were located in Poland without separate court proceedings first being conducted in a Polish court. In addition, the restrictions on enforcement measures taken by creditors against the debtor once it was declared bankrupt were not applicable in Poland.

Declaration of the debtor's bankruptcy by the Danish court and liquidation of the bankruptcy estate

In both Denmark and Poland, there were a series of enforcement actions pursued against the insolvent debtor. The debtor's centre of main interests was in Denmark. The bankruptcy court in Denmark declared the debtor bankrupt upon its request and appointed an administrator (trustee) for the debtor. The Danish administrator was responsible in particular for management and liquidation of the debtor's assets and satisfying its creditors' claims out of the proceeds.

Shortly after bankruptcy was declared, the Danish administrator commenced liquidation of the debtor's bankruptcy estate. An investor in the same sector, selected according to Danish bankruptcy procedures, expressed a wish to purchase the debtor's whole multi-branch business, including a shared services centre in Poland which provided IT services for all of the branches of the debtor's enterprise. The centre operated in Poland as a branch of a foreign undertaking. Among other things, the debtor had two pieces of real estate, a set of movables, and employees in Poland.

As the EU's Recast Insolvency Regulation was not applicable to bankruptcy proceedings instituted in Denmark, the effects of bankruptcy did not occur automatically in Poland. For this reason, the foreign administrator was not authorised, in particular, to dispose of the individual assets located in Poland, and could not sell them to the investor along with the assets located in Denmark.

Application for recognition of ruling opening foreign bankruptcy proceedings

The foreign administrator was required to file a motion with a Polish court for recognition in Poland of the ruling issued by the Danish court opening bankruptcy proceedings of the debtor in Denmark. The foreign administrator submitted the following with the application:

- Certificate issued by the Danish court confirming that the bankruptcy proceedings were being conducted and that an administrator had been appointed there
- List of creditors with their place of residence, registered office, or centre of main interests in Poland, and creditors whose claims were connected with the debtor's commercial activities in Poland
- Statement by the foreign administrator concerning other foreign proceedings conducted with respect to the debtor which the administrator was aware of
- Statement by the foreign administrator on the deadline for submission of claims, the address where claims should be submitted, the language in which claims should be submitted, and other vital details required for those filings
- Confirmation or payment of an advance against the costs of the proceedings
- Certified Polish translation of the foregoing documents.

The application was filed with the bankruptcy court with jurisdiction over the location in Poland of the debtor's shared services centre.

Stay of enforcement against the debtor's assets in Poland

As a result of the debtor being declared bankrupt, enforcement by creditors against the debtor's assets in Denmark was stayed. But due to the lack of uniformity described above, this effect was not attained in Poland. Creditors conducting enforcement as of the date of declaration of bankruptcy continued to seek enforcement, and new creditors joined in enforcement activities.

Thus, along with the application for recognition of the Danish ruling, the foreign administrator applied to the Polish bankruptcy court for an injunction securing the debtor's assets in Poland by staying enforcement

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proceedings against the debtor in Poland. The court promptly examined and granted the application.

Recognition in Poland of the ruling commencing bankruptcy proceedings in Denmark

A ruling instituting foreign bankruptcy proceedings is recognised in Poland on the following conditions:

- It concerns a case that does not fall under the exclusive jurisdiction of Polish courts, and
- Recognition would not violate fundamental principles of the legal system in Poland.

Bankruptcy cases fall under the exclusive jurisdiction of Polish courts if the debtor's centre of main interests is in Poland. In the case in question, the debtor had its centre of main interests in Denmark, where its registered office was located and it regularly managed its commercial operations. It was also a location recognisable for third parties.

In addition, recognition of the ruling opening bankruptcy proceedings in Denmark did not violate fundamental principles of the legal system in Poland. It did not violate fundamental constitutional principles in Poland or the basic rules governing Polish bankruptcy law.

The bankruptcy court therefore issued a ruling recognising the Danish court ruling instituting bankruptcy proceedings with respect to the debtor. It regarded the Danish proceedings as the main proceedings, because the debtor's centre of main interests was in Denmark. In the ruling, the court also called upon the debtor's creditors to submit their claims. The recognition ruling was published in the official gazette *Monitor Sądowy i Gospodarczy* and served on the debtor's creditors known to the court. The creditors were advised in particular that they could apply for institution of secondary bankruptcy proceedings in Poland. The foreign administrator and creditors could appeal against the recognition ruling, but the ruling was not contested and none of the creditors took measures to open secondary bankruptcy proceedings in Poland.

Securing the debtor's assets in Poland

Once the ruling instituting foreign bankruptcy proceedings was recognised, the Polish court secured the debtor's assets in Poland by appointing a temporary court supervisor. This was an obligatory measure on the part of the court in cases of this kind. Asset-related operations outside the ordinary course of business or removal of assets outside of Poland required the consent of the temporary court supervisor to be valid. The assets were secured by this measure until it became clear that none of the creditors had taken steps to institute secondary bankruptcy proceedings in Poland with respect to the debtor. The creditors were entitled to file such an application within 30 days after publication of the recognition ruling in *Monitor Sądowy i Gospodarczy*.

The previously stayed enforcement proceedings concerning assets in Poland which were part of the debtor's bankruptcy estate were also discontinued *ex officio*.

Governing law for assessment of the effects of bankruptcy in Poland

The Polish Bankruptcy Law was applicable to the effects of declaration of bankruptcy on the debtor's assets in Poland, obligations that arose or were to be performed in Poland, determination of the assets constituting the bankruptcy estate, inventory and valuation, items excluded from the bankruptcy estate, management of the bankruptcy estate in Poland, and liquidation of the bankruptcy estate here. The Polish court could also permit liquidation of the bankruptcy estate in a manner other than that provided for in Polish law, so long as it would not violate fundamental principles of the legal system in Poland.

Liquidation of the debtor's bankruptcy estate in Poland

Once the ruling was recognised, the foreign administrator drew up an inventory and valuation of the debtor's assets in Poland and published an announcement of their preparation in *Monitor Sądowy i Gospodarczy*. No proceedings were initiated by third parties seeking to exclude any of the listed assets from the bankruptcy estate.

The foreign administrator then drew up and filed with the Polish court a plan for liquidation of the assets in Poland and general information on how the creditors' claims would be satisfied. Under the plan, an organised part of the debtor's enterprise located in Poland would be sold to an investor from the same sector, according to the conditions specified in the liquidation plan. On this basis, the Polish court granted permission to liquidate the debtor's assets in the form of an unrestricted sale.

Conclusion of the proceedings

When the organised part of the enterprise had been sold and liquidation of the assets in Poland had been completed, the Polish court issued a ruling closing the proceeding.

The foreign administrator appointed in Denmark could not liquidate the assets in Poland under any procedure other than that described briefly above. In each case, a proceeding for recognition in Poland of the ruling instituting bankruptcy proceedings in Denmark had to be conducted, and the Polish court had to approve the liquidation plan for the assets located in Poland.

Main bankruptcy proceedings instituted in third countries

The procedure described above would also have applied if bankruptcy had been declared in a non-EU country, except where an international treaty regulating this matter was in

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force to which Poland and the third country in question were signatories. However, the author of this article is not aware

of any international treaty currently binding on Poland which is directly applicable to bankruptcy proceedings.

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plit payment: More questions than answers

Since 1 July 2018, a buyer of goods or services in a B2B setting paying the invoice in zloty may either pay the entire gross price to the seller's settlement account or use the split-payment mechanism. Below we examine problems related to the use of split payments in factoring and in payments to banks.



Patrycja Polasz

If the debtor decides to use the split-payment mechanism, the total amount of the payment is split for transfer into two accounts:

- The net amount to the creditor's settlement account
- An amount corresponding to all or part of the VAT (at the debtor's discretion) to the VAT account tied to the creditor's settlement account.

VAT accounts are opened automatically for every settlement account held in PLN, and crediting or debiting the VAT account is possible only under strict conditions set forth in the law. In practice, this means a serious limitation on disposal of funds transferred to the VAT account, which for certain companies (especially those already experiencing liquidity problems) can be a real shock.

For the time being, split payment is entirely voluntary and its use is left to the decision of the buyer of goods or services when paying each invoice. According to government pronouncements, the current regulations are a test to see how the market reacts to this mechanism. If it is a success, the introduction of mandatory use of this system, for example in certain industries, will be considered.

Now that the optional version of split payment has been in place for several months, we can see that it generates numerous practical problems, as illustrated in two examples below.

Case 1: Shared liability—split payment in factoring

Suppose that a factoring company (also called a factor) and a seller of goods or services have entered into a factoring agreement under which the seller's debtors pay invoices issued by the seller directly to the account of the factor (as the purchaser of the receivable evidenced by the invoice). Typically, 90% of the gross amount of the invoice is financed. The debtor makes a split payment, resulting in payment of the VAT equivalent to the factor's VAT account. What should the factor do?

Apart from other issues, split payment has caused two fundamental problems for factoring companies:

- *Expansion of liability.* By receiving the amount of VAT paid into their bank account by the seller's debtors, factoring companies that are VAT payers become jointly and severally liable with the seller (issuer of the invoice) for payment of VAT, up to the amount received in the factor's VAT account.
- *Difference in cash flow.* When a factor has been forwarded an invoice and, typically, has paid 90% in cash to the seller as an advance, but then receives a split payment from the debtor, the factor has limited access to the portion of the payment transferred to the VAT account. In practice, this may mean a major difference between the amount the factor has paid to the

seller and the amount it has received in its settlement account from the debtor using a split payment—and thus the amount that the factor can freely apply to covering the advance payment made to the seller.

Expansion of liability

A factoring company may discharge itself from joint and several liability by transferring the amount paid into its VAT account to:

- The seller's VAT account (i.e. the VAT account of the issuer of the invoice, who is jointly liable for payment of VAT), or
- The debtor's VAT account.

This second operation, which consists of transferring the VAT to the seller's debtor's account, will not be preferred on the factoring market, for obvious reasons. Therefore, the factoring company wishing to discharge itself from joint and several liability for payment of VAT will have to transfer this amount to the seller's VAT account, thus continuing to have a problem with the difference in cash flow.

To avoid the expansion of liability, it is also possible to change the account for transfer of the debtors' funds from the factor's account to the seller's account. If the seller's debtors pay directly to the seller's account, no amounts are transferred to the factor's VAT account, so the expanded liability provisions will not apply at all. However, in addition to other resulting problems, the factor loses direct control over the receipts, which is unacceptable to some factors (even if the risk is somewhat mitigated by a security interest on the company's account in favour of the factor and/or an irrevocable instruction to make a daily sweep of funds in favour of the factor).

Additionally, for factoring arrangements already in operation, the change in the income account is rather avoided in light of the relations with the seller's customers. In short, this is not a universal solution. Just as when the factor releases itself from liability by transferring funds from its VAT account to the seller's VAT account, the issue of the difference in cash flow still remains.

Difference in cash flow

If split payment occurs relatively rarely, and the seller has other (free) funds not derived from factored receivables, the solution may be to require the seller to cover the difference with those free funds. In other words, automatically after the seller's debtor pays any amount to the VAT account due to a split payment, these funds "exit" the factoring arrangement and should be replaced (covered) by the seller from its own resources, which would normally remain outside the factoring arrangement.

Depending on the size of the potential difference, the factor may consider additional security, for example a fixed reserve to cover it. However, balancing the amount of such

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a reserve may be problematic—ensuring sufficient comfort for the factoring company but also not causing excessive amounts of the seller's funds to be frozen. The factor should have secured access to the free funds from which the difference will be covered, which in practice often means an irrevocable power of attorney or right to withdraw the funds from the seller's current account.

Another way to reduce risk on the part of the factoring company is to reduce by several percentage points the size of advances paid out to the seller on account of its receivables owed by its debtors who use split payment, thus reducing or completely eliminating the potential difference in cash flow. However, it must be remembered that the decision to use split payment falls every time within the debtor's discretion, and for each advance it may be difficult to predict whether the given debtor will pay the invoice using a split payment. While some companies (linked to the State Treasury) have announced that they will use split payments whenever possible, other debtors may introduce such a policy on a temporary or entirely ad hoc basis.

The above solution may also not be satisfactory, especially with a larger number of split-payment transactions (or larger amounts received through split payment) and a shortage of free funds, or, leaving factoring issues aside for a moment, in the case of structures assuming the circulation of funds with minimal or zero margins, for example some securitisation structures. In extreme situations, it may be necessary to exclude VAT amounts from financing or consider other drastic solutions like moving the account outside of Poland (which usually is not an option due to the company's relationships with its customers and suppliers).

Certainly, the solution that is finally adopted must always be precisely adapted to the specific situation, in particular the business expectations of the parties to the transaction.

Case 2: Split payment to a bank's account

Suppose a company has taken a loan from a bank. It plans to sell a large asset subject to VAT. It has agreed with the bank that the funds from the sale will be used to repay the loan in part, and after the receipt of the proceeds from the sale is booked, the bank will release part of the security interest. The buyer of the asset informs the seller that it will pay with a split payment. What should the bank pay attention to?

The first question arising in such situation is whether split payment is possible here at all. From a technical point of view, a split payment may be made if the account to which the particular payment is to be made is an account for which the bank opens a complementary VAT account. In the situation described above, when the seller is a borrower, it is the market practice to pay the price directly to the account of the seller's bank, and not to the seller's account. Therefore, it should first be borne in mind that the Banking

Law explicitly states that a VAT account shall be opened not only for settlement accounts (bank accounts held by the bank's customer), but also for the account of the bank itself, kept as part of the bank's own activity.

Once it has been established that a VAT account may be opened for the bank's own account (and not only for the bank's customer), the question arises whether the bank should open a VAT account for the particular type of account (i.e. a technical account of the bank set up for receiving the sale price). This no longer stems from the regulations, but if, in the case of entities other than the bank, a VAT account is opened for accounts used for settlement purposes, and the point of the whole mechanism is to settle the proceeds from the sale, some of which correspond to VAT, it would be logical to conclude that the bank should open a VAT account for its own accounts when such an account is also used for settlements. Therefore, the account used for receipt of the price (i.e. settlement of the transaction), which is the bank's own account, should have a VAT account opened for it. In this context, a distinction should be made between the account for receipt of the price from another technical bank account, i.e. the loan account used to receive repayment of the loan. Usually, banks first accept payment to one technical (settlement) account and then reassign the amount to the loan account permanently used for the given loan. In short, from a technical point of view, split payment should be possible for such a payment, as there should be a VAT account opened for the bank account to which the payment will be made.

The second question that should be addressed relates to the effects of the receipt of such a payment by the bank. The first effect, of course, is the inability to apply the amount received in the VAT account to the bank's claim for repayment of the loan (unless the bank successfully applies for such consent from the tax authority). The second effect is extended liability: if the bank is a VAT payer, it is jointly and severally liable with the seller/borrower for the unpaid VAT on the sale, up to the amount received in its VAT account.

In practice, this means that the bank will usually transfer the amount received in its VAT account to the VAT account of the seller/borrower in order to discharge itself from joint and several liability for the VAT, and this amount will not be applied to repayment of the loan. Alternatively, the parties may agree that the amounts equal to VAT will be transferred via split payment immediately to the seller's VAT account (then the bank will not be jointly liable even temporarily, and no additional operations will be carried out). In theory, we can imagine a situation where the bank ensures that the borrower pays the tax by exerting other forms of pressure against the borrower, and then applies to the tax office for release of the funds from the VAT account. However, in most cases, it should be assumed that in the situation described, if the buyer decides to pay with a split payment, the part of the price equivalent to VAT should

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not be included when determining the amount that will be allocated to repayment of the loan.

What next?

The two examples above are just the tip of the iceberg. After several months of application of the split-payment regulations, we can see numerous practical problems resulting

from the use of split payment. However, the upcoming months are expected to reveal the results of this experiment, and also show how particular industries and businesses are adapting to the new mechanism.

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