WARDYŃSKI + PARTNERS

2014 YEARBOOK

Print run:
800 copies

Publisher:
Wardyński & Partners

Production:
Aleksandra Włodarczyk, Justyna Zandberg-Malec

Translation:
Christopher Smith

Graphics:
Magda Wiśniewska, Bazyli Krasulak

Layout and printing:
Drukarnia Piotra Włodarskiego

Dear Readers,

The economic forecasts for 2014 inspire cautious optimism, but the conditions for doing business in Poland and around the world continue to be less than ideal.

For obvious reasons, the law never quite keeps pace with commercial practice. This means that innovative businesses must sometimes step on uncertain ground.

Changes are planned in a number of areas of the law. Some of these changes are welcome and long overdue, while others are cause for concern. In some other fields there is legislative stagnation, so businesses must operate within a legal framework built many years ago, under entirely different realities.

But even the best-known and most firmly established laws continue to reveal new surprises. Some offer opportunities worth exploiting, while others generate risks to be aware of and avoid.

In the labyrinth of old and new regulations, a guide can come in handy. We hope that this, the fourth edition of our *Yearbook*, will serve as that guide for you.

Tomasz Wardyński

The riddle of trial costs

Monika Hartung

Themis, the Greek goddess of justice, law and custom, is traditionally depicted blindfolded and holding a scale and a sword—symbols of equal but implacable justice. Practice shows that Themis is indeed blind to many things, not always just, and rarely admits when she is wrong. This applies as well to judgments and decisions concerning trial costs.

According to Art. 98 §1 of Poland's Civil Procedure Code, trial costs in civil cases are the costs necessary for proper pursuit of rights and a proper defence.

They include court costs, comprising different court fees, expenses (e.g. the costs of experts), and costs of a party appearing *pro se* or through an attorney who is not an advocate, legal adviser or patent attorney, or the costs of representation by professional counsel. In order to obtain a ruling on reimbursement of costs, a request must be made (with certain exceptions) before the close of the case at the instance for which the award is made.

A ruling on costs is made in the ruling ending the proceeding at the given instance. An exception is when a judgment is overruled by the appellate court and the case is remanded to the lower court for reconsideration. Then the court of first instance rules on the costs, including the costs of the appeal.

The loser pays…

Reimbursement of trial costs is governed by defined rules. In practice, the rule most often applied is the rule of responsibility for the result of the trial, which means that the party losing the case is required to reimburse the opponent for its trial costs, covering the costs necessary for the opponent to properly pursue or defend its rights.

When a party loses a case that was considered at several instances, the party is responsible for the costs at all levels. This means that if the plaintiff won at the first instance but lost at the second instance, and its cassation appeal was dismissed by the Supreme Court, the plaintiff must reimburse the defendant for the trial costs the defendant incurred at all three levels. In that case, the costs will include the fee on the appeal, all expenses incurred by the defendant, e.g. for expert opinions, and the costs of representation at trial by professional counsel at both instances and before the Supreme Court.

…even for the court's mistakes

Unfortunately, the party that loses the case also pays for the court's mistakes. Imagine that the defendant won in the first instance, but in an appeal by the plaintiff, the judgment was set aside due to an error by the court of first instance (for example, the court failed to rule on the merits because it found that the claim was time-barred, but without determining whether the claim existed at all, or found incorrectly that the plaintiff had no standing to assert the claim). Then, on remand, the court of first instance upheld the claim, but on another appeal by the defendant the appellate court amended the judgment and denied the claim. In that case, as the loser of the case and pursuant to the principle of responsibility for the result, the plaintiff would be required to reimburse the defendant for the costs at all four instances—including also the court fee on both appeals by the defendant.

The Act on Court Costs in Civil Cases does provide that the court shall, on its own initiative, reimburse the fee paid by a party for an appeal, interlocutory appeal or cassation appeal if the appellate court or Supreme Court granted the appeal because of plain error by the lower court. However, this regulation is very rarely applied in practice. This is because appellate courts assume that plain error means a violation of fundamental regulations which are not open to any differing interpretations, where the defect in the ruling appealed against is apparent without the need for more thorough analysis. This concept is interpreted very narrowly. In our practice, for instance, there have been cases where the appellate court did not find plain error even when the lower court entered judgment against the wrong person, who was not a party to the case.

The court did not find plain error and grant the request for reimbursement of the fee on the appeal in a case where A commenced the proceeding as the plaintiff, but then assigned the claim in question to B, which sought to enter the case in place of A. Because the defendant did not consent, B ultimately did not join the proceeding, but when the court entered judgment denying the claim, it identified B as the plaintiff. B, which was not a party to the case, filed and paid for an appeal against the judgment, exposing itself to dismissal of the appeal because B was not a party to the proceeding before the court of first instance. The court of appeal heard the appeal and overruled the judgment below, but denied B's request for reimbursement of the fee on the appeal because it did not find plain error by the court of first instance.

So what regulation would have to be violated, and in what manner, for the appellate court to find that the lower court had committed plain error? The case law does not say.

As interpreted, the principle of responsibility for the result of the trial is unfair because the party that ultimately loses the case is charged with the trial costs of the opponent even for instances which the opponent lost, and because the regulation requiring reimbursement of court fees in a case of plain error by the court is a dead letter. This shows that Themis can be unfair and will rarely own up to her own mistakes.

When ruling on costs, the court may also supplement the general rule of "loser pays" by applying the principles of culpability, setoff and equity.

The principle of culpability

The principle of culpability means that the plaintiff is required to cover the defendant's trial costs even though the plaintiff's claim is upheld if the defendant did not give the plaintiff cause to commence the proceedings and acknowledged the claim at the first procedural step (typically in the response to the statement of claim, or at the first hearing if the defendant did not file a response to the claim). In such case, it is assumed that the plaintiff filed the claim in order to harass the defendant, and is "punished" accordingly by being required to reimburse the defendant for its trial costs. Acknowledgement of the claim does not require that the defendant actually pay or even offer to pay the plaintiff or provide the other relief sought by the plaintiff. Conversely, actual performance by the defendant during the course of the trial is insufficient to justify ordering the plaintiff to reimburse the defendant's trial costs. If the defendant is represented by professional counsel, the principle of culpability will be applied only if the defendant applied for judgment of costs against the plaintiff. If the defendant is not represented by counsel, the court will apply the rule on its own motion.

The principle of culpability may also be used by the court—at its own motion—to charge costs to a party or intervenor which acted improperly or in bad faith, for example by providing untrue statements or concealing material facts or evidence. The threat of assessment of costs is supposed to discourage the parties from dilatory or dishonest litigation practices.

The principle of setoff

The principle of setoff allows the costs of the proceeding to be allocated fairly between the parties when claims are partly upheld and partly denied. In that case, the court may not make an award of trial costs at all. In consequence, each party may bear its own costs, or the costs may be divided proportionally. The court will refrain from awarding costs when the parties have both won and lost the case in equal or similar measure, and also incurred trial costs in similar amounts. However, the result of a refusal to award costs should not be different than it would be if the court awarded costs proportionally, reflecting the degree to which each party had prevailed.

For example, the court may refuse to award costs if the plaintiff paid the court fee on the statement of claim and attorneys' fees, while the defendant paid the cost of an expert opinion in an amount similar to the amount of the court fee and attorneys' fees incurred by the plaintiff, and the plaintiff prevailed on 50% of the dispute. If the plaintiff prevailed to a greater degree than the defendant (e.g. 70/30), the court should add up all of the costs incurred by the parties and divide them percentagewise, requiring the defendant to make up the difference by paying the plaintiff 40% of the costs.

Because the principle of setoff is applied on equitable grounds, the courts need not assess the costs with mathematical precision in proportion to the amounts of the claim granted and denied.

The principle of equity

The principle of equity allows the court in particularly justified instances not to charge the losing party with all or part of the trial costs if to do so would be incompatible with a sense of justice. This provision should be interpreted narrowly, but there are no guidelines concerning the situations in which it should be applied. The possibility of applying this rule therefore lies within the discretion of the court. The case law mostly indicates instances in which the principle of equity should not be applied.

The principle of equity is not applied very often. An example where the loser is not charged trial costs might be where the eventual victory by the other side set a new legal precedent, or where there was a change in regulations while the litigation was underway.

Overall, rulings on trial costs should be based on considerations of fairness, and the court should state the justification for its order on costs. In practice, however, the courts most often simply indicate the article of the Civil Procedure Code which is the basis for the ruling on costs, without providing a detailed explanation for the award. This can make it difficult to seek review of the order on trial costs.

It appears that the "loser pays" rule, which is predominant in rulings on trial costs in civil cases in Poland, should also reflect the result of the proceedings at specific instances, which would make the rule work more fairly. And certainly the parties should no longer bear financial responsibility for errors by the courts.

Monika Hartung, legal adviser and partner, co-heads the Dispute Resolution & Arbitration Practice.

BIN sponsorship

Krzysztof Wojdyło

An indirect consequence of the boom in payment services is the creation of complicated new legal structures enabling entities to provide payment services even though they don't hold a licence to perform such services. Licences held by professional entities operating on the payment services market are used for this purpose, through a structure known as BIN sponsorship.

The contemporary payment services market poses two main challenges to entities seeking to participate actively on this market. First, modern payment

instruments involve increasingly sophisticated technological solutions, which require the commitment of many costly resources. Preparing the proper infrastructure enabling performance of payment services requires establishing relations with many different entities, including payment organisations, acquirers, merchants, providers of IT solutions, and so on. When there is no assurance of a minimum number of payment transactions, investing in such a complex infrastructure may not be economically feasible.

Second, the flood of regulations governing the payment services market present a higher and higher barrier to market entry. Every new regulatory package helps establish the legal framework for providing payment services—including legal guarantees for consumers—but also contributes to the incredibly complex regulatory environment for payment services. Payment service providers are subject to increasingly rigorous regulatory supervision. They must comply with regulations not only governing payment services as such, but also money laundering, data protection, foreign exchange, and so on. Complying with all these regulatory requirements poses a bigger and bigger burden for the industry.

Market with great opportunities and threats

Despite the significant challenges connected with performance of payment services, it is undoubtedly a highly attractive market segment. The volume of payment transactions is steadily growing and seems likely to continue doing so for the foreseeable future. Meanwhile, with dynamic changes in the technological environment, payments are shifting more and more from a cash basis to the world of virtual, cashless trade. Anyone wanting to benefit from conducting payment transactions has no choice but to implement new technological solutions, whatever the cost. The payment services market is apparently undergoing a paradigm shift at this time—a new deal, offering opportunities for redistribution of market share among existing players and for entirely new players to enter the market.

These rapid changes also present major threats. Entities that do not adapt their operations quickly enough to suit the new methods for providing payment services risk losing market share and customers. On the other hand, players who invest heavily in new technological solutions are also at risk because the solutions they invest in may not win broader popularity.

The concept of BIN sponsorship

All of this puts companies in an awkward situation when their business profile calls for them to participate in the payment services market but they do not have sufficient resources to perform these services by themselves. This is often the case for entities that already provide certain types of financial services, for whom payment services, particularly payment instruments, would be just an added service. This might be the case, for example, for entities providing consumer loans, for whom payment instruments could simply be an attractive distribution channel for their loan products. Entities organising various types of loyalty programmes, or issuing coupons for food or other goods, are interested in issuing payment instruments without at the same time taking on the regulatory burdens and investments connected with payment technologies. Such entities typically seek cooperation with a more experienced partner from the payment services field, already holding the required licences to perform payment services.

On the other hand, entering into cooperation with another entity may also prove attractive for licensed payment service providers, enabling them to directly or indirectly expand their customer base. The partners will also promote the specific payment solutions introduced by the payment service provider, e.g. for mobile payments.

This partnership is known as "BIN sponsorship" (from the abbreviation for "bank identification number"—the unique identifier of a bank in the numbers on a payment card).

Models for BIN sponsorship

Our practice shows that there is no one universal model for BIN sponsorship. The details of the solutions applied depend on the nature of the specific payment services and the needs of the entity which is entering into a legal relationship with the licensed payment service provider. Generally, most of the models are based on the assumption that the specific payment service (e.g. issuance of payment instruments) is formally performed by the licensed payment service provider. The provider is therefore a party to the agreement with the user of the payment services. The provider is responsible to the user for fulfilment of all regulatory requirements. Depending on the specifics of the payment service, the provider may also be responsible for compliance with anti-money laundering obligations.

Meanwhile, the factual actions in preparation for performance of the payment service, and often also the handling of numerous technical aspects of performing the payment service, are conducted by entities providing services in cooperation with the licensed payment service provider. For example, in the case of the service consisting of issuance of payment cards, such entities are responsible for contacts with users (who most often are their customers), and in the case of prepaid instruments, they make the actual payments into the prepaid accounts and deliver the payment instruments to the users.

In Poland, BIN sponsorship structures are not directly regulated by current law. Therefore, the general provisions governing outsourcing, data protection, copyright and so on apply.

At the image level, payment services performed through BIN sponsorship are usually presented as co-branded services, but very often the logo of the entity cooperating with the payment service provider is displayed more prominently.

What to watch out for?

The lack of direct regulations governing BIN sponsorship and the frequently innovative nature of the services performed present many legal challenges. Based on our experience, we can mention a few selected issues that appear to us to be particularly interesting.

Determining the legal nature of the relationship between the BIN sponsor and the entity using its services through BIN sponsorship is not all that obvious. The regulations concerning outsourcing present a particular challenge in this respect. In most instances, the active participation of the entity commissioning the performance of the payment services implies that it should be treated as an outsourcer of the BIN sponsor. This will entail certain legal consequences for this entity. First and foremost, at least in the context of the Banking Law regulations on outsourcing, it may be held responsible for the payment services formally performed by the BIN sponsor.

In practice, however, it appears that some BIN sponsorship models involving prepaid bearer payment instruments are not based on an outsourcing model. In that case, the BIN sponsor only fills an order from another entity and provides it with a specific number of bearer cards, which are then distributed further by the entity. The entity then acts as a customer of the BIN sponsor, not an outsourcer of the BIN sponsor. In the case of such models, it is worthwhile to conduct a more thorough analysis of the relationship between the BIN sponsor and the commissioning entity to determine the scope of activities which the commissioning entity will perform for the users of the payment services, or if the potential access to data covered by banking secrecy should nonetheless result in application of the outsourcing regulations.

BIN sponsorship concerning prepaid bearer payment instruments may raise another interesting issue. Models assuming that the commissioning entity is a customer of the BIN sponsor also assume that the payment instruments are issued to the commissioning entity. Because this is most often a business entity, with respect to such instruments BIN sponsors establish conditions for performing the payment services that are legally less rigorous (which is permitted by the applicable regulations with respect to users who are not consumers). In practice, however, the commissioning entity passes these instruments on to individuals, who use them for non-business purposes. This aspect means that this type of model should be approached with great caution. There is a risk that because the conditions for performing the services are not tailored to the characteristics of the end user of the services, the services may be found not to comply with the law.

BIN sponsorship is undoubtedly a very attractive solution for unregulated entities which want to benefit from the rapidly growing market for modern payment services. It is worth remembering, however, that the solutions used with BIN sponsorship business models should undergo a thorough legal analysis, because the innovative nature of many of these solutions may generate various legal risks.

Krzysztof Wojdyło, adwokat*, is a member of the Payment Services Practice.*

Criminal liability of managers — is it enough?

Janusz Tomczak

When the media report on corruption, they usually just mention that someone was arrested for giving or taking a bribe. But we rarely hear about who actually stood to gain from the corruption—who was behind the corrupt proposition.

The title of this article may suggest that it concerns the criminal consequences of actions by a manager, an individual professionally involved in managing the affairs of companies. That is an issue addressed in previous editions of the *Yearbook*.

This year I would like to draw attention to a deeper problem: namely, how the existing regulations and practice of applying the law are out of tune with the nature of commerce. The criminal justice system is unable to respond properly to corrupt practices endemic to commercial organisations.

Polish criminal law is based on the responsibility of individuals, and takes only a marginal interest in legal persons.

This approach shapes the thinking of lawyers beginning during their legal studies, and also shapes the practice of the legal system. Prosecutors and judges often repeat that a criminal trial is about individual responsibility. The circumstances in which the individual acts and the indirect consequences of his actions are secondary issues.

Thus when the media report on corruption of public officials, they usually mention that one person was arrested for allegedly giving a bribe and another person was arrested for allegedly taking it. Rarely, somewhere in the background, does information appear concerning the entity that was going to profit from the corruption—and where the money for the bribe came from.

For the individual offender, conviction is a disaster in every sphere of life. But under current law and practice, the legal persons involved (regardless of their specific legal form) suffer much lighter consequences for benefitting from offences committed by persons acting for them or on their behalf—for being the instigators and sponsors of illegal actions.

It is clear that when big business is involved, and a contract worth many millions can make or break a company, the pressure on the people immediately involved in the project to get results is not just a matter of personal motivation, but emerges from various levels of the organisation.

Here, the criminal law specialists will say that there are criminal law categories that capture various forms of behaviour by individuals, such as liability for aiding, abetting and soliciting the commission of offences by other individuals. But in practice, identifying the perpetrators, aiders, abettors, conspirators and so on boils down to a search for a scapegoat, and does not reach the heart of the problem, which often is a corporate culture that fosters actions close to the line or crossing over the line into illegality. In too many companies, employees are encouraged to act aggressively against the competition, or illegal behaviour is condoned because "that's the way the market works" and "everybody else is doing it."

But in legal systems which have always operated under the conditions of a free-market economy, the battle against economic crime now works quite differently. There is a strong tendency there to impose sanctions not only on individuals, but also on enterprises as organisations.

Moreover, such legal systems force companies to take preventive measures within the organisation and base the level of potential sanctions on the organisation's response to irregularities when they are discovered. If the organisation truly draws conclusions from its past and learns from its mistakes, the sanctions may be lower.

It is true that a law has existed in Poland for over a decade which provides for quasi-criminal liability for companies and other organisations (the Act on Liability of Collective Entities for Punishable Offences of 28 October 2002). Unfortunately, this act does not provide solutions such as those described above. It focuses on the grounds for liability, procedure and punishment. The act lacks mechanisms for mitigation of fines or measures for encouraging cooperation with law enforcement authorities, which would enable development of corporate policies and operations to reduce the risk of undesirable (criminal) behaviour in the future—leading in turn to mitigation of the penalty or avoidance of a penalty entirely, as is possible in some jurisdictions, such as the United States.

The model adopted in Poland for criminal liability of collective entities is also commonly criticised because it is so time-consuming. In order to hold a company responsible, a separate proceeding is required, and it cannot even begin until after the criminal proceeding against the individual whose actions are tied to the involvement of the collective entity has ended.

On top of this, the act from 2002 is rarely applied in practice, and meanwhile economic crime continues to be a burning issue (according to a report published by the Prosecutor General and available online). Clearly, the law should change.

This need was also raised by the OECD in its *Phase 3 Report on Implementing the OECD Anti-Bribery Convention in Poland* (June 2013, available at www.oecd.org), which criticises Poland for its ineffectual system.

For a punishment to be effective, it should be swift and sure. It is common knowledge that enforcement of criminal law in Poland is neither.

Serious consideration should be given to calls to exchange criminal sanctions for administrative sanctions. In some areas of the economy, such as securities trading, this move is already visible. This does not rule out punishment of the most serious offences by the criminal courts, but the shots are being called by the market regulator, which often selects the route of administrative proceedings. Of course, this move cannot come at the expense of due process rights, which must be guaranteed whether the punishment is administrative or criminal.

The arguments in favour of this approach include the speed of administrative proceedings as well as the ability to enforce systemic changes across an entire organisation, not just against specific individuals operating within the organisation.

The criminal liability of managers is based on the assumption that imposing a criminal sanction on a specific individual is not just a punishment, retribution for a specific act, but also teaches a lesson and sends a message to others that the state will not tolerate certain types of behaviour. It is doubtful whether convicting the individual perpetrator of an economic crime—usually years later, with a suspended sentence—will achieve the desired effect of education and deterrence.

While retaining the criminal liability of the individual as an essential element of the legal system, it should be pointed out that sanctions targeted to businesses, enforcing compliance, prevention and elimination of risk factors, could be much more effective. When it no longer pays for enterprises to encourage their employees to pursue illegal practices, the criminal liability of managers will be less of an issue than it is now.

Janusz Tomczak, adwokat*, is the partner in charge of the Business Crime Practice.*

IP protection policy: Don't wait for infringement to start gathering evidence

Włodzimierz Szoszuk Lena Marcinoska

Disputes over infringement of intellectual property rights more and more often reach the docket of Polish courts. This trend should be expected to continue, particularly given the growth of the internet and new technologies. Their expansion opens up new opportunities for unlawful use and easier copying of others' creations, for example using 3D printers.

A prudent and farsighted business must develop a policy for protection of intellectual property by deciding what to protect—trademarks, industrial designs, inventions and works—how to do so and in what areas. A consistently implemented policy for protection of these intangible goods can prevent squandering of intellectual and financial investments in designing new solutions and maintaining the reputation which the business has spent years building.

A prudent business should follow the market, observe the actions of its competitors, and determine whether their actions pose a threat to its own interests. Tolerating infringements can dramatically worsen the situation of the rightful holder or prevent it from enforcing its rights altogether. If an infringement occurs, the chances for success of possible countermeasures should be weighed, pursuing the customary solutions: calling on the infringer to cease and desist, entering into negotiations, and, as a last resort, commencing judicial proceedings.

With this in mind, a farsighted business should gather the evidence that may prove essential if the matter does go to court.

Admission of evidence in cases seeking protection of intangible rights is subject to the general rules in civil proceedings, under which the plaintiff should present all of its evidence in the initial pleading, that is, in the statement of claim. This should include evidence not only concerning the infringer, but also concerning the holder and the protected rights.

A self-portrait of the holder

The holder should thus document its actions in introducing the product onto the market, for example goods bearing the trademark for which it seeks protection or embodying the protected industrial design. This may be done through materials illustrating how the product is brought to market and how it functions in trade, advertising initiatives and related expenditures, promotions, sales, distribution channels, awards and distinctions, certifications, and market research or consumer surveys concerning the product and its functioning on the market. Such evidence may be needed to show, for example, prior use of certain packaging, or the renown of the specific trademark—important and necessary conditions for the claims being pursued.

When going to court, it may be necessary to present materials going back several years, particularly when showing that a trademark is renowned.

If the plaintiff wishes to raise new evidence later in the proceedings, it will have to show why the evidence could not be presented with the statement of claim.

Know thy enemy

It is crucial to document the infringement from the time it is first discovered. Ideal proof of infringement is to purchase the infringing goods. Preparing for litigation often lasts a long time, so it is important to obtain up-to-date evidence of infringement. It is good to depict the scale of the infringement, e.g. by showing infringing samples purchased at different places and times. This approach also gives the plaintiff a wider selection of the court where it will file its claim. The infringer's offers and advertising should be documented, e.g. through brochures, online offers, and photographs from stores and billboards. Sometimes it is necessary to produce evidence showing that the disputed goods were not produced by the holder. Usually a statement by the holder will suffice for this purpose, but the practice of the courts can vary.

Assertion of a claim to cure the effects of the infringement generally does not require additional evidence. The very fact of committing an infringement provides sufficient grounds for the court to order, for example, publication of an apology or publication of the substance of the judgment. But it is necessary in this respect to demonstrate the scale, duration and intensity of the infringement, because these circumstances will determine the location, form, frequency, etc., of the publication. The practice of the courts is to order publication in the same media through which the infringement occurred, or media that are likely to reach the same potential customer base (e.g. trade magazines or local newspapers). For this purpose, it is important to present evidence concerning such aspects as the points of sale of the infringing goods, exports, and the infringer's advertising scheme. The most costly and painful for the infringer is publication on television or radio, but here the holder needs evidence that the infringing products were advertised on those media. Online infringements are generally the simplest to document. Then the publication of the apology or the judgment will most likely be ordered through placement on the infringer's website.

If it can be shown that the infringement was culpable, whether intentionally or unintentionally, the infringer may be ordered to pay a sum of money toward a worthy social cause. It is sufficient to show that the defendant failed to exercise due care to avoid the possible infringement and that the defendant acts as a professional with experience in the field. When relevant, the holder may also present correspondence or agreements showing that the defendant was in contact with the holder or cooperated with the holder in the past, and therefore was aware of the holder's rights and knowingly violated them.

In intellectual property cases, financial claims are generally of secondary importance. They lead to demands for redress of injury under general rules or for disgorgement of unlawfully obtained gains. But such claims are typically pursued in a separate proceeding, after the infringement has been determined. One problem with pursuing financial claims is the difficulty in calculating the amounts involved. This often requires an examination of the defendant's accounting books for the period in question. This is usually done by an auditor appointed during the trial, and it is an arduous, costly and slow task. Putting off the pursuit of financial claims until later is therefore a tactical issue. It provides an opportunity to gain a better assessment of the situation and to gather additional evidence, or to negotiate a settlement and avoid involving the efforts of the courts a second time.

Evidence from the infringer

When pursuing claims for infringement of intellectual property rights, it may be difficult to establish certain factual foundations, such as the extent and scale of the infringement or the source of the infringing goods. Often the essential documents are in the possession of the defendant. It may be difficult or impossible to determine these issues on the basis of publicly available sources. In practical terms, only the infringer has access to this information.

A tool for obtaining information about the infringer is the institution of information claims, introduced through implementation of the IPR Enforcement Directive (2004/48/EC) in Art. 286^1(1)(2) and following of Poland's Industrial Property Law. This shifts to the alleged infringer the burden of producing certain information, making litigation easier for the holder. In the request for information, the applicant must indicate the intellectual property rights it holds and substantiate (not prove) the infringement of the holder's rights, and also indicate the information sought, such as the names and addresses of producers, manufacturers, distributors, suppliers or other persons in possession of goods or providing services, wholesalers and retailers, quantities produced, delivered, received, ordered or sold, and prices. An application may be filed at any stage of the proceedings, including before filing of the statement of claim.

The holder may also rely on general rules of civil procedure to request the court to order the defendant to disclose orders, contracts, invoices, and accounting records documenting production and sale of infringing goods.

Summary

Under current practice, a statement by the holder and presentation of the circumstances of the dispute, particularly the circumstances surrounding use of the infringing trademark, industrial design or invention, often proves insufficient. The holder of intellectual property rights must show initiative in providing evidence. Increasingly often, claims are denied for evidentiary reasons—for example, because the plaintiff "did not present evidence of the repute of the trademark," "did not prove that the defendant's actions directly violated its economic interests," or "did not show the extent of its recognition in Poland."

In practice, the courts understand the purpose of information claims and are quite willing to grant information requests by holders, even before a claim is filed. But it is the alleged infringer who decides the extent to which it will comply with the court order, if at all. Execution procedures do provide instruments to assure enforcement of court orders. But resorting to such enforcement measures may be more trouble than it is worth for holders of intellectual property rights, defeating the purpose of information claims, which is to obtain evidence quickly to prepare a statement of claim.

Therefore, it is only careful and systematic gathering of evidence that can ensure enforcement of intellectual property rights. This weapon is in the hands of the rights holders themselves.

Włodzimierz Szoszuk, adwokat *and partner, co-heads the Intellectual Property Practice.*

Lena Marcinoska is a member of the practice.

A shareholder has the right to check how the company is doing

Jacek Bondarewski

Any shareholder in a limited-liability company—regardless of the number of shares held—has the right at any time to review the company's books and records, prepare a balance sheet for the shareholder's own use, or seek clarifications from the management board. In this examination, the shareholder may be assisted by its own experts, such as lawyers and accountants. But the right of inspection cannot be assigned to third parties.

The management board of any Polish limited-liability company (sp. z o.o.) whose operations have not been suspended is required each year to prepare a financial report and a management board report on the business of the company in the previous financial year. These documents serve as the fundamental sources of information about the financial condition of the company and the commercial and organisational affairs of the company. This information is available to all shareholders, but also to third parties, because the financial report and the business report must be submitted to the company's registry file, which is generally publicly available for review.

However, the annual financial report and business report do not contain all of the information that may be pertinent to the shareholders as persons with capital and organisational involvement in the company's affairs. Moreover, the periods between annual reports may be too long for shareholders who require current or periodic information about the state of the company's affairs or selected aspects of its operations.

Individual company inspection

In this respect, the Commercial Companies Code provides for the ability of any shareholder of a limited-liability company to inspect the company, regardless of the number of shares the shareholder holds. To this end, the shareholder, along with persons appointed by the shareholder, may at any time review the company's books and records, prepare a balance sheet for the shareholder's own use, or request clarifications from the management board.

When introducing this right, the drafters of the code expressly indicated that the party actively conducting such inspection is the shareholder, while the management board of the company is the addressee of the demand to conduct the inspection and the supplier of the information. This means that if the shareholder does not demand any information, the management board has no duty to prepare any additional information for the shareholders.

This is clearly different from the approach set forth in the code concerning annual financial statements, which the management board is required to prepare regardless of whether shareholders show any interest in this information.

Moreover, when the management board receives a request for information from a shareholder, it should provide the information to the specific shareholder that requested it, not to all of the company's shareholders.

Right of refusal

However, the management board is not always required to provide the shareholder any and all information the shareholder requests. Under the Commercial Companies Code, the management board may refuse to provide clarifications to a shareholder or open the company's books and records to the shareholder if there is justifiable concern that the shareholder will use them for purposes conflicting with the interests of the company and thus expose the company to a significant loss.

This does not mean that the shareholder will ultimately be unable to exercise its right to inspect the company. If the management board refuses the shareholder's request, the shareholder may seek to settle the matter through a shareholders' resolution. This means that the authority to determine the correctness of the management board's refusal to provide specific information is vested in the shareholders as a body. The code provides that the shareholders should adopt a resolution within one month following the request.

Judicial review

If the shareholders' resolution upholds the position of the management board or the shareholders fail to adopt a resolution on the matter within the one-month period provided by the code, the shareholder which has been denied clarifications from the management board or access to the company's books and records may file an application with the registry court for an order requiring the management board to provide the clarifications or open up the books and records to the shareholder. The application should be filed within 7 days after the shareholder receives notice of the shareholders' resolution or 7 days after the deadline for adoption of the resolution.

The registry court will evaluate the justification of refusal to provide the information individually requested by the shareholder or the refusal to provide access to the company's books and records. In the judicial proceeding it should also be possible to clarify whether there is truly a justified concern that the shareholder will use the information for purposes contrary to the interests of the company. The court should also determine whether such use of the information by the shareholder would expose the company to a loss, and if so whether the loss would be significant. Factors which may influence this evaluation would include such considerations as the specific situation of the company (e.g. the scale of its operations) and the circumstances surrounding the relations between the shareholder and the company (e.g. the existence of a dispute with the company).

Personal, unassignable right

A shareholder's right to inspect the company is vested in each of the shareholders personally and therefore may not be assigned to other persons. The code does provide, however, that the shareholder may exercise the right of inspection together with another person appointed by the shareholder. Such person could be a lawyer, auditor, or other specialist whose knowledge may be necessary or useful for the shareholder to properly understand the information about the company or to properly interpret the documents containing data concerning the activity of the company.

Limitation of audit rights

The right of individual inspection of the company by the shareholders may be limited or even entirely excluded. However, the code provides that limitation or exclusion of this right is permissible only if a supervisory board or audit committee has been appointed in the company, and the limitation or exclusion must be expressly provided in the company's articles of association. This means that if the shareholders are to be deprived of the right to inspect the company, or such right is to be restricted, this function must be exercised within the company by a supervisory body, and the articles of association must specify the scope of the limitations or exclusions of the shareholders' rights. Regulation of the shareholders' rights to inspect the company solely through a resolution of shareholders is insufficient to limit or exclude the shareholders' right to examine the company's affairs individually.

Therefore, if a supervisory body has been appointed in a limited-liability company but the articles of association do not limit or exclude the shareholders' inspection rights, the shareholders are entitled to seek information individually about the company's affairs, and also to review the results of examinations conducted by the supervisory board or audit committee as presented in the reports issued by these bodies.

By establishing the ability to monitor the company by shareholders individually or by supervisory bodies in place at the company (or by both shareholders and supervisory bodies independently), the code enables persons with capital involvement in the company to review the actions of the management board and examine the company's affairs, notwithstanding the company's other reporting requirements.

Jacek Bondarewski, legal adviser and partner, co-heads the Corporate Law, Corporate Restructuring & Commercial Contracts Practice.

Compensatory payments also for distributors?

Dr Ewa Butkiewicz

A recurring question from clients who distribute products through a highly developed sales system is what consequences would follow if the legal relationship with a commercial intermediary ended. They are particularly concerned about the financial ramifications, and especially whether there are grounds for a compensatory payment (indemnity).

An answer cannot be provided without examining the specific facts, even in the case of a commercial agent, because the agent's right to a compensatory payment depends on fulfilment of several essential conditions.

It might seem easier to answer the question in the case of a distributor, which unlike a commercial agent cannot rely on specific code provisions. A distribution agreement is an unclassified contract which is not regulated in detail under Polish civil law. This is also the case in most national legal systems in the European Union (and elsewhere), although there have been efforts to introduce regulations governing distribution agreements in some countries. For example, a proposal for a new Civil Code was presented in Spain in June 2013 containing extensive regulations on distribution. And a new Commercial Code introducing regulations on distribution and franchise agreements goes into effect in Hungary in March 2014.

But whether a distributor in Poland can demand a compensatory payment to reflect the value of the customer base the distributor has helped build, and whether a Polish court would be inclined to grant it, requires deeper analysis. First, the precedent in other countries should be considered. Another source to consider is the Draft Common Frame of Reference (2009), an attempt to consolidate the law of contracts in Europe, of non-binding force, covering distribution agreements alongside agency and franchise agreements.

What is compensatory payment for commercial intermediaries?

Compensatory payment in this sense is a fairly new institution introduced in 1986 by the Commercial Agents Directive (86/653/EEC). This institution was introduced into the Polish Civil Code in a 2000 amendment.

An agent is entitled to a compensatory payment after termination of the agency agreement if:

- During the term of the agreement he has brought the principal new customers or has significantly increased the volume of business with existing customers
- The principal continues to derive substantial benefits from the business with such customers, and
- The payment is equitable considering all the circumstances, particularly the commission lost by the commercial agent on the business transacted with such customers.

In other words, this is regarded as "an original mechanism assuring participation by the former agent in the benefits (in the words of the law, 'substantial benefits') received by the principal after the end of the agency relationship, if these benefits are derived from the activity of the agent when the agreement was in force" (Supreme Court of Poland judgment of 29 September 2011, Case No. IV CSK 650/2010). This mechanism was introduced through the Commercial Agents Directive in order to protect the weaker party to the agency agreement, i.e. the agent. These provisions of the Commercial Agents Directive, as well as the national laws implementing them, are mandatory and cannot be contractually excluded. Moreover, as held by the European Court of Justice, application of the provisions on compensatory payment is "forced" in the sense that they guarantee protection of agents operating within the European Union even if the agency agreement is governed by the law of a country which is not an EU member state.

It should be stressed, however, that an agent's right to seek a compensatory payment does not mean he will automatically receive it. It may be difficult for the agent to find admissible evidence to prove the existence of the conditions required by law for the agent to be entitled to a compensatory payment, particularly to show that the principal has derived "substantial benefits" from the agent's activity. It may also be difficult to prove that the amount claimed reflects the agent's contribution to the benefits obtained by the principal (Case No. IV CSK 650/2010).

Case law of courts in EU member states

The laws of the EU member states do not provide distributors express grounds for seeking any compensatory payment comparable to that which commercial agents may seek. An exception is Belgium, where a provision has been in force since 1961 guaranteeing this right to distributors. Notwithstanding the practically uniform regulations in EU member states on distributors' right to a compensatory payment (or rather the lack of regulations), there is not a consistent line of precedent in cases seeking compensatory payment for distributors after the termination of a distribution agreement.

The German courts have taken a well-established line for many years, even cited by the European Commission's report of 23 July 1996 on the application of Art. 17 of the Commercial Agents Directive. They apply the provision on compensatory payment for commercial agents to distributors as well, by analogy, if:

- The distributor was integrated into the supplier's sales network in a manner comparable to an agent, and
- At the end of the distribution agreement the distributor provided the supplier data concerning the distributor's customers.

German courts have found that this "integration" is demonstrated by such aspects as:

- Assigning a distributor exclusivity in a specific territory
- Allowing the distributor to use the supplier's trademark or logo
- Requiring the distributor to purchase a minimum quantity of products and to maintain a certain inventory
- Requiring the distributor to perform warranty and other after-sale services
- Instructing the distributor on how to conduct sales or maintain its own offices and warehouses
- Inspection of the distributor's commercial operations by the supplier
- Submission of market reports by the distributor
- Promotion of the distributor as an authorised seller.

The distributor has been found to have provided the supplier with data concerning the distributor's customers when, for example:

- The distributor was required to submit detailed sales reports
- The distributor submitted copies of invoices or other documents to the supplier containing customer data.

In addition to the two main conditions outlined above, the distributor also has to meet the conditions set forth for agents (i.e. that the supplier continues to derive substantial benefits) before the German courts will uphold the distributor's claim for a compensatory payment.

In Greece as well, the courts apply the regulations concerning commercial agents to distributors by analogy. Indeed, the regulations concerning commercial agents are applied to exclusive distributors directly, and not just by analogy, if such distributors are an integral part of the supplier's "sales organisation." The basis for the rulings is recognition of "compensation for clientele" as a fundamental principle of Greek law.

A similar line has been taken by courts in Austria, Denmark and Spain. Last year the first such ruling was handed down in Norway, but the case has not yet been decided by the Supreme Court of Norway. In 2008, the Federal Supreme Court of Switzerland revised the previous practice and held that an exclusive distributor may have a right to a compensatory payment if its activity was integrated into the supplier's distribution process and the distributor had limited freedom to act independently.

Courts in such countries as Italy and the Netherlands have taken the opposite view, relying on the formal difference between an agent and a distributor acting at its own risk.

Courts in Poland have ruled numerous times on claims by agents following the termination of an agency agreement, but so far have not addressed (at least in published decisions) any claims by distributors seeking compensatory payments. If such a case were presented, a Polish court would probably consider the German practice, as has been the case when determining the amount of the compensatory payment an agent will receive (Supreme Court of Poland judgment of 8 November 2005, Case No. I CK 207/05). The specific conditions which the Polish courts might consider relevant in deciding to award a compensatory payment to a distributor and the evidence that would be required remain open questions. It should be pointed out that so far the commentaries do not perceive any barrier to applying the existing regulations concerning agency agreements to distribution agreements by analogy.

European "soft law" in commercial intermediation cases

The Draft Common Frame of Reference mentioned above generally reflects the current state of national law across the EU member states, and thus it groups agency, franchise and distribution agreements together in Book IV, Part E, "Commercial agency, franchise and distributorship." In the general provisions under this part, Art. IV.E.—2.305, covering "indemnity for goodwill" (i.e. compensation for clientele) applies to all three types of contracts if:

- One party has significantly increased the other party's volume of business
- The other party continues to derive substantial benefits from that business, and
- The payment of the indemnity is reasonable.

Under this proposal—as under the Commercial Agents Directive—an agent's right to seek indemnity for goodwill may not be excluded contractually, but contractual exclusion is permissible with respect to a distributor or franchisee.

Although the Draft Common Frame of Reference is not binding, the solutions it proposes may nonetheless provide valuable guidance when establishing the rights and obligations of the parties within a distribution agreement.

What next?

The case law in certain countries and European soft law both seem to point toward an unavoidable expansion of the right to compensatory payment to include distributors. The rationale for this principle is to protect the distributor as the weaker party in dealings with the supplier, analogous to the position of an agent. But is this justifiable when both parties to the distribution agreement are businesses? If a consumer is regarded as the weaker party in a contract with a seller of goods because it lacks professional knowledge and skill, what would be the "weakness" of a distributor which is a business entity?

The debate on these issues is far from over. In the case of a distribution agreement, it is necessary to find an acceptable justification for providing protection to one party to the contract at the expense of the other. This seems hard to reconcile with the principle of the equality of the parties in commercial contracts.

Nonetheless, given the approach other courts have taken, it is recommended that in dealings between suppliers and distributors, the independence of the distributor as a business entity should be made clear. Then it would be difficult to show that the distributor was the "weaker" party to the contract, deserving special protection after termination of the distribution agreement.

Dr Ewa Butkiewicz, legal adviser, is the partner in charge of the Regulatory Practice.

What tax should be paid on capital gains from the Polish stock market?

Michał Nowacki

The Warsaw Stock Exchange is an increasingly important market for foreign investors. Are investors required to pay income tax in Poland on capital gains from the WSE? Does it matter where the investor is based? I will try to answer these questions using the example of capital gains by institutional investors, including investment funds located in tax havens.

In the case of Polish investors (Polish tax residents), the taxation of capital gains from investments on the Polish stock market is clear: profits are taxed at the rate of 19%, whether as corporate income tax or as capital gains for individuals paying personal income tax.

In the case of foreign investors (without Polish tax residence), the question arises whether their capital gains are covered by Polish tax laws at all. This is because under Polish tax regulations, it is not entirely clear whether such profits should be regarded as Polish-source income.

The basic income tax rules divide taxpayers into those with Polish tax residence (registered office or management in Poland) and those without Polish tax residence (no registered office or management in Poland). Polish tax residents are subject to taxation in Poland on all their income, wherever earned (unlimited tax liability). In the case of non-residents, only income earned in Poland is subject to tax in Poland (Polish-source income—limited tax liability). These basic rules are modified by provisions of tax treaties to which Poland is a party.

The regulation concerning limited tax liability with respect to CIT is meagre and generates many doubts in practice. The Polish Ministry of Finance, seeking to clarify at least some of these doubts, in response to an inquiry from the Industrial and Commercial Chamber of Foreign Investors in May 2001 published a general explanation concerning the principle of limited tax liability (letter of 24 July 2001 from the director of the Department of Direct Taxes, Ref. No. PB4/AK-8214-1045-277/01). In this explanation it was stated that there is Polish-source income when "the source of the income is permanently connected with the territory of Poland." The ministry went on to say, however, that Polish-source income does not include "income of non-residents from sources located in the territory of Poland from the sale of 'rights to sources of income' (e.g. the sale of shares, bonds or other securities issued by Polish entities, or debts of Polish entities), because such sale constitutes a source of income separate from the sold source, which is not permanently connected with the territory of Poland."

The Ministry of Finance therefore assumed that as a rule, capital gains of a foreign investor from the sale of shares, bonds or other securities of a Polish issuer are not Polish-source income and are not subject to income tax in Poland.

Meanwhile, the ministry indicated as an exception to this rule the case where the sale of shares, bonds or other securities is made on the Polish exchange. Then, according to the ministry, "the exchange and trading conducted on the exchange constitute an independent source of income located in Poland," and thus capital gains from transactions on the Polish exchange should, as a rule, be subject to income tax in Poland.

This document from the Ministry of Finance significantly affected tax practice in Poland. It is cited by tax authorities when they issue tax interpretations and by the administrative courts in rulings issued in tax cases. It is also cited in practically all commentaries to Polish CIT regulations. This is curious, because the letter from 2001 is laconic, contains hardly any legal justification for the position presented, and is not a document that is in any way binding on tax authorities or taxpayers. More specifically, it does not qualify as a tax interpretation. Despite these various defects, it is generally accepted uncritically as a correct understanding of the principle of limited tax liability.

This position of the Ministry of Finance concerning the tax liability of foreign investors earning capital gains from transactions on the Polish exchange becomes less significant with respect to investors who are tax residents of countries with which Poland has concluded a treaty on avoidance of double taxation (which modifies the application of Polish tax regulations). The rule under such treaties is that the tax obligation is shifted to the investor's country of residence—in other words, in this case, outside of Poland (treaty protection).

But treaty protection will not be available to investors based in jurisdictions with which Poland does not have a tax treaty in force. This applies, for example, to funds investing on the Polish stock market but located in tax havens. Does this mean that such investors must pay income tax in Poland on capital gains earned on the Polish stock exchange? According to view of the Ministry of Finance discussed above, yes.

However, in my opinion, the position of the Ministry of Finance on taxation of capital gains on the Polish exchange is not justified. More specifically, the differentiation in the tax situation in Poland between foreigners investing in shares, bonds and other securities issued by Polish companies outside of regulated trading and those investing through the Polish exchange is inexplicable and without foundation. The exchange is only a platform for conducting transactions (and realising profit from those transactions), but it is still the sale of the securities that is the source of the investor's income. The ministry's position could lead to a situation in which an investor who earns a profit on sale of shares in a listed company in organised trading has different tax obligations than an investor selling the shares of the same listed company but doing so outside of regulated trading—which is entirely possible. It is hard to find any rational justification for this distinction.

I am not aware of any statistics concerning the income tax revenues Poland obtains from tax nonresidents from capital gains on the Polish stock exchange, but it is safe to assume that they are negligible. It is difficult to imagine that the tax authorities would begin actively analysing securities trades to identify sellers who may have tax obligations in Poland for capital gains on the Polish exchange. This has to do not only with technological, personnel or legal limitations (with the claimed weakness of the position of the Minister of Finance and the problems with conducting proceedings against foreign entities) but also the effect such actions would have on the capital markets in Poland. It may be assumed that at least in the short term such measures would cause a reduction in foreign investment on the Polish capital market.

In my opinion, if Polish lawmakers truly sought to achieve effective taxation of the capital gains of foreign investors on the Polish exchange, new legal solutions would need to be introduced in this respect. In particular, it would be necessary to clarify the regulations establishing the rule of limited tax liability, because it cannot be the case that such an obligation is gleaned from a single statement by the Ministry of Finance which raises serious doubts as to its correctness and offers the thinnest legal reasoning. To assure effective collection of such a tax, introduction of a mechanism for withholding at the source (for example by brokerages) would need to be considered, in place of the current rule of self-reporting of income in this respect. Not that tax withholding at the source is an ideal solution—a foreign investor may conduct hundreds or thousands of trades, some generating gains and some losses—but from the point of view of Poland's fiscal interests it would certainly prove more effective.

How foreign investors would react to such changes is another matter, but for now they can rest easy because there are no such changes on the horizon.

Michał Nowacki, legal adviser and tax adviser, is a member of the Tax Practice.

The power industry in Poland: What to expect in 2014?

Weronika Pelc Marek Dolatowski

The planned package of new energy laws is still delayed. But the future shape of the electricity market in Poland strongly depends on industry regulations, which have a direct impact on decisions to carry out new projects as well as operating costs and margins.

The power industry in Poland has an achievable capacity of 35,000 MW and generates about 160,000 GWh of electricity per year. Nearly 90% of the country's electricity is generated from lignite and bituminous coal, but the share of electricity from renewable sources is steadily growing. Electricity prices have remained steady for several years or even fallen slightly at certain periods. The average price of electricity on the competitive market in Poland is now about PLN 196 per MWh. In 2008 it was PLN 155 and in 2009–2012 between PLN 195 and 201.

The market is dominated by four utility groups controlled by the State Treasury: PGE, Enea, Energa and Tauron. Each group includes production, distribution and trading companies. The future shape of the market depends to a large degree on industry regulations impacting operating costs and margins. Lawmakers are encouraging the growth of renewables through a support system while imposing additional costs on generation from fossil fuels, e.g. by charging for greenhouse gas emission rights. But the resulting growth in power prices may be hard to swallow for a country that wants to compete on European and global markets. Energy is a major cost item for Polish industry.

The Polish government is not backing down from its plan to build nuclear power plants, announced a few years ago and now being carried forward, although

more slowly than anticipated. Liberalisation of the power market is progressing, which means that most customers, apart from households, can negotiate electricity prices, and increasingly often do so.

Recent amendment of the Energy Law

Since 2011 the government has been working on a package of new laws regulating the market for electricity, gas and renewable energy sources. Delay in work on the package and proceedings by the European Commission against Poland for failure to implement EU rules forced Polish lawmakers to make a fast-track amendment to the current Energy Law, in the amending act of 26 July 2013, which includes:

- Introduction of the category of "sensitive" electricity customers, which includes individuals receiving a housing welfare supplement. They will receive a lump-sum electricity supplement no greater than 30% of the limit for electricity consumption provided by law.
- Clarification of the rights of end users to terminate contracts for the sale of electricity. The customer may terminate a contract for a definite or indefinite period, but if the contract is for a definite period the customer may be required to pay the costs provided for in the contract. Termination requires a written statement.
- Clarification of the rules for oversight of the legality of electricity use and the ability to cut off electricity, with introduction of a complaint procedure for household customers. If a utility decides to cut off a household's power, the customer may file a complaint with the company, and if the complaint is not upheld the customer may appeal to a permanent consumer arbitration court or the President of the Energy Regulatory Office. Until the case is heard by the arbitration court, the power company is required to continue providing power to the household customer unless the installation presents an immediate threat to life, health or the environment.
- Introduction of the category of "industrial" customers, i.e. businesses from energy-intensive sectors, which have been authorised to handle compliance on their own with the requirement to present certificates of origin for redemption, and also may obtain a reduction in this requirement based on the proportion of energy costs to the overall value of their production (treated as state aid subject to approval by the European Commission).
- Clarification of the rules for unbundling, and introduction of certificates of independence for operators.
- Introduction of certificates for small and micro renewable installations.

Planned Renewable Energy Sources Act

Returning to the energy package, one of its essential elements is to be the Renewable Energy Sources Act, providing a framework for construction and operation of RES facilities. The greatest controversy surrounds the support system, without which generation of electricity from renewables will not be economically feasible. RES installations will not be built or run if the support system is not stable and predictable.

The current system is based on green certificates. In addition to the price for the electricity they sell, RES installations receive certificates which energy trading companies are required by law to purchase. The price of green certificates is not fixed, but depends on the market. In February 2013 the price fell dramatically, to about 40% of what it had been in previous years. Since then the price has steadily risen, but confidence in the current system suffered a blow.

In November 2013, the Minister of Economy announced a new draft of the RES Act, proposing a new support system based on long-term contracts for supply of electricity concluded through an auction system. The auctions would be held separately for small sources (up to 1 MW) and larger sources. In the auctions, there would be a reference price as a maximum. For renewable sources operating at the time the act goes into force, the ceiling would be based on average prices for electricity and green certificates in the past. The reference prices for new installations would be set by the President of the Energy Regulatory Office based on economic analyses by advisory and research institutions. There would be different reference prices for different sources (land-based wind power, sea-based wind power, geothermal, solar, hydro, biomass, biogas, biogas from landfills and biogas from wastewater treatment plants).

Excluded from the auctions would be installations using multi-fuel combustion (apart from dedicated multi-fuel combustion installations), hydroelectric installations with a capacity above 5 MW, and installations with a capacity above 50 MW using agricultural biogas, biomass, biofuels and biogas, except for cogeneration installations with a total thermal capacity of up to 150 MWth.

As a condition for participation in the auction, the project would first have to obtain a positive assessment by the President of the Energy Regulatory Office, with issuance of the relevant certificate. For this purpose, it would be necessary to present documents confirming that the project can be built and to pay a security deposit of PLN 30 per kW of the planned capacity. The documents include planning permission, building permit, grid connection agreement, project completion schedule, and certification from a financial institution of the creditworthiness of the entity to carry out the project. This pre-qualification would not be required for those operating renewable facilities on the effective date of the new act or operators of micro-installations.

Under the proposed RES Act, "obligated sellers" would be required to purchase electricity at the price determined by the auction. These are the trading companies which at the end of August of the preceding year had sold the most electricity to end users. Obligated sellers would be designated by the end of each October by decision of the President of the Energy Regulatory Office. The obligated sellers are expected to be the trading companies from the largest groups—PGE, Tauron, Energa and Enea. Each operator would post information about the obligated seller on its website. Obligated sellers would be required to support renewables not only by purchasing electricity from producers selected by auction, but also by purchasing electricity from micro-installations connected to the grid and from renewable installations that went online before the effective date of the new act.

Obligated sellers would be compensated for having to buy electricity at above-market prices through a clearance company (Operator Rozliczeń Energii Odnawialnej SA), which would make up the difference to obligated sellers with the proceeds of RES fees collected from all customers in the system, via the operators, specifically the transmission system operator. In this way, the costs of support for energy from renewables would be spread among all customers.

Under the proposal, support would be provided for no longer than 15 years following the start of production at an RES installation, through 2035 at latest. RES installations already in operation on the effective date of the new act could continue to use the current support system, subject to certain modifications. Certificates of origin would be issued for up to 15 years from the date of initial production of electricity, through 2035 at the latest.

According to the draft of the RES Act from late January 2014, the new support system would come into effect 12 months after issuance of a positive decision by the European Commission finding that the state aid provided for in the act is compatible with the internal market.

Outlook for the year ahead

What conclusions may be drawn for the year 2014 for the Polish power industry? First, the changes are moving toward liberalisation of the energy market, and stronger protection for end users demonstrates a desire to free electricity prices also for household customers. In terms of Poland's energy mix, it is clear that the government intends to support production of green energy only until Poland achieves the targets set by international conventions. Meanwhile, construction of a nuclear power plant in Poland is still far off, notwithstanding the government's adoption of the Polish Nuclear Power Programme in January 2014. This ensures that the dominant role of coal in the power generation industry in Poland will continue for years to come.

Weronika Pelc, legal adviser, is the partner in charge of the Energy Law Practice.

Marek Dolatowski is a member of the practice.

Why is compliance important in employment law?

Agnieszka Lisiecka Magdalena Świtajska

In employment law, the compliance function enables the employer to minimise the risk of sanctions but also shows that the company is an aware employer, acting transparently and lawfully, which has a positive impact on its image and how it is perceived by employees and business partners.

The compliance function consists of management of the risk of inconsistency between the actions of the business and the applicable legal requirements. In practice, this means a set of measures designed to assure that the relevant regulations, rules and standards are identified at the relevant time and carried out by the organisation, often on the basis of internal regulations implemented for this purpose. Compliance should reduce the risk of sanctions that a business may face due to failure to comply with the law.

As a separate corporate function, compliance is fairly new in Poland, but it is already codified with respect to financial institutions and soon will also be for insurance companies. In practice, particularly with respect to organisations from other sectors, it typically covers such areas as competition law, criminal law, environmental law and tax, as well as employment.

Not hard to violate employment law

Employment law in Poland is characterised by a high degree of legislative intervention in the relationship between employer and employee and great formalism in its institutions. Consequently, nearly every action

connected with employment requires fulfilment of specific requirements. Moreover, the sanctions for the employer's failure to comply with employment regulations can be harsh in financial terms but may also involve criminal or administrative liability. Non-compliance may also threaten the image and reputation of the employer on the employment market and in the eyes of customers and suppliers, who may regard the company as less reliable if it has trouble complying with employment regulations.

It is not difficult at all to run afoul of employment regulations in Poland. For example, in practice employers often fail to calculate overtime for staff employed on a task-based system of working time, and do not maintain records of their working time. They erroneously assume that staff employed on this basis are not entitled to overtime pay. If an employer follows this unlawful procedure in the case of a large number of staff, if even one of them asserts a claim for overtime pay it can, and in practice often does, result in an avalanche of similar claims by other workers. Depending on the scale of the irregularities, even bearing in mind the three-year limitations period for employment-related claims, a sizable organisation might have to pay out millions of zloty for such claims.

Legal compliance from recruitment…

In employment law, compliance begins before an employee is formally hired—at the stage of recruitment and selection of the hiring structure. The employer must comply with Labour Code regulations governing equal treatment of job candidates as well as the processing of personal data of candidates. Violation of non-discrimination regulations mainly exposes the employer to liability in damages, while failure to comply with data protection regulations may lead to administrative or even criminal liability of the person obtaining personal data of candidates in an unlawful manner.

An employer hiring a worker also faces the issue of selecting the proper basis for hiring—whether an employment contract or some other basis such as a freelance contract. This decision should be preceded by an analysis of the legal requirements and risks. If one worker or a group of workers hired, for example, as freelancers seek a determination by the court that they are actually employees, it may have far-reaching consequences for the company. If such a claim is upheld, the employer will be required to make up to the tax office and Social Insurance Institution the difference between the payments made on the basis of the freelance contracts and the amounts payable on the basis of employment contracts, as well as employment benefits owed to the employees. The employer could also be guilty of a criminal violation in such circumstances.

…until after employment ends

Compliance with employment law is necessary throughout the course of employment, with respect to such matters as pay, working time, and occupational health and safety. But it is also important when employment ends. Violation of the requirements for termination of an employment contract (such as properly stating the grounds for termination, which is perhaps the most problematic issue in practice), or failure to settle accounts properly with a departing employee, may result in filing of a claim with the labour court. Regardless of its merits, merely defending against such a claim will require a commitment of time and money by the employer. If the employer violates these requirements in the case of group redundancies, the total amount of the claims or the amount awarded by the labour court may cause serious problems for the employer, particularly if the redundancies were carried out because the employer was in difficult financial condition or if they involved a large number of staff.

Liability for acts of employees

As in other fields of law, the compliance function in employment law should provide not only management of risks connected with unlawful acts by the employer in dealings with the public authorities and employees, but should also assure that the employees themselves comply with the law when performing their duties. The employer is liable to third parties for acts and omissions of employees in performance of their work, including losses they cause.

This is clearly evident in cases involving on-the-job accidents due to failure by a supervisor or other person directing the work of employees to comply, for example, with rules requiring employees to be outfitted with protective equipment when performing specific types of work. In such cases, the employer bears supplementary civil liability to the employee and is required to redress the loss, which may be significant, particularly when, for example, long-term disability payments are involved due to inability to work or increased needs on the part of the injured worker.

While unlawful acts by employees in performance of their duties will not always result in criminal or financial exposure of the employer, they will often have a direct or indirect impact on the employer's reputation. A classic example would be if employees give or receive kickbacks in dealings with customers, suppliers or public authorities in connection with performance of their duties. This may be a punishable offence for the employee rather than the employer, but if it is disclosed it will certainly not enhance the employer's image or reputation.

Education and monitoring

For these reasons, in employment law, the compliance function must also include an effective system for monitoring the acts and omissions of employees. It should provide, first, for the ability to monitor business email, internet and computer use, under rules that are clear to employees, as well as ongoing monitoring of agreements and payments, and in the case of manufacturing and similar operations, periodic occupational health and safety inspections.

But having internal rules and procedures in place, and even appointing compliance officers or separate compliance divisions within the organisation, is not sufficient to achieve effective compliance in the area of employment law. As practice shows, for example in the case of on-the-job accidents, the greatest barrier to achievement of compliance targets is a lack of full awareness on the part of employees of the practical importance of requirements and prohibitions imposed on them, and the consequences.

Written procedures prohibiting employees from paying bribes are no substitute for training that shows employees specific examples of situations to avoid and the real consequences of violating such rules. Similarly, initial and periodic training in occupational health and safety does not obviate the need to make employees aware that above and beyond the formal requirements there is responsibility for the life and health of other people.

The compliance function in employment law thus plays an unusually important role. It not only minimises the risk of sanctions, but also demonstrates that the business is an aware employer, operating transparently and in accordance with the law, which has a positive effect on the employer's image and how it is perceived by staff and business partners, as an employer living up to the highest international standards.

Agnieszka Lisiecka, adwokat*, is the partner in charge of the Employment Law Practice.*

Magdalena Świtajska is a member of the practice.

Consequences of defective representation of the parties to a contract

Dr Jarosław Grykiel Maciej Szewczyk

Even the best-drafted contract will not be effective if it is not signed by the right person. A mistake may not always be apparent at first glance.

Whether an agreement between the parties is effective and constitutes a valid source of their mutual rights and obligations is determined by numerous elements. One example is compliance with the proper form (e.g. a notarial deed for purchase of real estate) or minimal identification of the parties' obligations (e.g. in a sale contract, the obligation to transfer ownership of the item).

Another important but frequently underappreciated element under Polish law is signing of the contract by duly authorised persons. Below we discuss briefly the main risks connected with violating the rules of proper representation of the parties to an agreement.

What to check before signing

At the stage leading up to signing of a contract with a trading partner (or, in an M&A context, in the course of due diligence regarding the contractual obligations of the target), it should first be determined whether the persons signing the agreement are (or were) duly authorised to do so.

If a party to the agreement is a corporate entity or other organisational unit, the following facts, at a minimum, should be checked.

First, who is authorised to represent the party when concluding the specific agreement?

In the case of legal persons (e.g. companies), acting

through their corporate authorities, effective representation depends first on proper existence of the representative authority. This means more specifically the correct composition of the body (it may not be a "rump" body, lacking the minimum number of members), and compliance with the requirements for the proper method of representation. For example, in the case of companies, if the management board has more than one member, and the articles of association or statute do not specify otherwise, representation of the company requires at least two members of the management board acting jointly, or one member together with a commercial proxy.

With respect to certain statutory entities or "imperfect" legal persons referred to in Civil Code Art. 33^1 (organisational units with legal capacity but without legal personality), the manner in which they are represented is determined by the regulations governing their structure and operation. This applies particularly to commercial partnerships, where the right to represent the partnership generally is vested in any of the partners of a registered partnership (if not deprived of the right of representation) or a professional partnership (if it has not appointed a management board), the members of the management board of a professional partnership (under the same rules as a limited-liability company), or any of the general partners of a limited partnership or joint-stock limited partnership (if not deprived of the right of representation by the partnership agreement or a legally final court ruling).

Second, does the person signing the agreement hold the appropriate appointment at the time?

This means that the person has been appointed to serve as a member of the relevant body at the given time. When a member's term of office begins and ends is regulated differently in the case of different types of legal persons.

A key issue here is that the mere fact that the person is listed in the commercial register as a member of a corporate authority does not necessarily mean that he or she truly holds an appointment to that office. Often it happens that a company fails to extend the appointment by reappointing a member of the management board to a new term, but the person still appears in the commercial register as a member of the management board. Significantly, a person's entry in the commercial register as a member of a corporate authority does not carry an (irrebuttable) presumption that the information in the register is correct. Thus the same type of protection of other parties that arises out of the warranty of reliance on the land and mortgage register does not apply in the case of the commercial register.

Third, does conclusion of the agreement require the consent of another corporate authority?

Here it is important to note the various consequences of failure to obtain the required consent. As a rule, a legal act will be invalid if it was made without the consent of an authority of a company required by law (for example, the consent of the shareholders' meeting to sell the enterprise of a limited-liability company, which is required under Commercial Companies Code Art. 228(3)). If the consent is required only by the articles of association or company statute, the act will not be invalid, but the members of the management board who sign the agreement may be liable for acting contrary to the articles of association or company statute.

Fourth, are the persons signing the agreement acting in compliance with the applicable method of representation?

The method of representation should be indicated in the commercial register and reflect the relevant provisions of the articles of association or company statute, or the default statutory rules.

If the party is represented by an attorney, this has to do with the method of representation of the party when issuing the power of attorney (i.e. checking that the power of attorney was signed by the authorised persons).

Effects of violation of rules of representation of parties

Violation of rules of representation of parties when concluding a contract may exert various consequences in terms of the validity of the legal relationship formed between the parties.

In the extreme case, the sanction is that the act is absolutely invalid. This situation could occur if an agreement is improperly concluded between a company and a member of its management board. In such agreements, the company may not be represented by the interested management board member or other management board members. For the agreement to be valid, the company must be represented by the supervisory board or by a proxy appointed by resolution of the shareholders.

Improper representation of the party will also result in absolute invalidity of the agreement if consent of the shareholders' meeting or the supervisory board to conclude the agreement was not obtained when such consent was required by law (e.g. to sell the enterprise of the company), and the period for obtaining such consent after conclusion of the agreement has passed.

A somewhat milder sanction is "suspended ineffectiveness" of the agreement. If, for example, a person acting for a party does not hold a power of attorney, or is acting beyond the scope of the power of attorney he or she does hold, the act will generally be subject to suspended ineffectiveness. The difference between this and absolute invalidity is that the act by the representative can be ratified by the party after the fact. Such ratification "cures" the originally defective act, which is then treated as if it had been made properly from the very beginning (in compliance with the rules of proper representation).

Finally, in certain situations, improper representation of a party does not affect the validity or effectiveness of the act by the party, but may only give rise to liability in damages to the party that was improperly represented.

This may be the case, for example, when an act is performed by an attorney whose authorisation has expired. If the act by the attorney falls within the scope of his former authorisation and the other side did not know or could not easily have determined that the authorisation had expired, the act is valid. However, the fact that the attorney acted for the party despite expiration of his authorisation may result in the proxy being held liable in damages to the principal.

In certain other instances, there may be only internal consequences within the organisation.

How it looks in practice…

In commercial practice, in Poland businesses rarely go to the trouble of verifying the authority of the person acting for the other side of a transaction. As a rule, particularly in non-professional or semi-professional dealings (e.g. between small enterprises that do not seek day-to-day legal advice and do not have adequate legal knowledge themselves), transactions are often exposed to at least the mildest of the sanctions discussed above. As long as the dealings between the parties go well, more or less as set forth in the contract (or in the way both parties understand their agreement, which often is not the same as stated in the contract), the defects in the conclusion of the agreement have no practical importance. But the situation will change dramatically if a dispute arising out of the agreement develops between the parties.

In order to avoid unpleasant surprises or the need to take remedial measures with respect to defectively concluded agreements, it is worthwhile to assure in advance that the agreement to be signed by a specific person will be valid. At the very least, there are online tools readily available, such as a search engine for companies entered in the National Court Register, which enable a basic check with little difficulty and at no cost whatsoever.

Dr Jarosław Grykiel and Maciej Szewczyk are legal advisers and members of the Mergers & Acquisitions Practice.

New rules for merger review

Andrzej Madała

Plans to amend the regulations on merger review in Poland call for introduction of several major changes and numerous minor changes in determining when it is necessary to notify the Office of Competition and Consumer Protection of an intended concentration, and in the notification procedure.

All indications are that the anticipated changes in the Competition and Consumer Protection Act of 16 February 2007 will finally come to pass. Legislative work has been underway for a long time, and it is expected that the new rules will come into force sometime in 2014 (at the time I was writing this article, the government bill had gone through the first reading in the Sejm and was working its way through the parliamentary committees).

Some of the anticipated changes in the merger control regime should first be pointed out. Most of them derive from the rules adopted in the EU for review of concentrations—particularly in the Merger Regulation (139/2004).

Assuming control and acquiring assets—a new method for calculating basic turnover thresholds

Concentrations are generally subject to notification of the Polish competition authority—the President of the Office of Competition and Consumer Protection—if the combined annual turnover of the participants exceeds EUR 1 billion worldwide or EUR 50 million in Poland. Currently, in checking these thresholds, it is necessary to consider not only the combined revenue of the direct participants in the concentration, but also their entire capital groups (both the buyer and the seller—Art. 16 of the act). This rule will continue to apply to two types of concentrations: merger between two or more independent undertakings (Art. 13(2)(1)) and creation of a joint venture between undertakings (Art. 13(1)(3)).

The changes are to cover the other two types of concentrations, i.e. taking control (directly or indirectly) of an undertaking (Art. 13(2)(2)) and a concentration involving acquisition of part of the assets of another undertaking (Art. 13(2)(4)).

In these two instances, the calculation of turnover would no longer include the seller's capital group. Only the turnover of the buyer's capital group (unchanged) would be considered, as well as the turnover of the acquired undertaking and its subsidiaries. The proposed change responds to calls that have been made for some time not to consider the economic strength of the seller's capital group when determining when there is an obligation to provide notification of a concentration, because it has no economic justification in terms of protecting competition.

The government proposal also includes a number of provisions clarifying the rules for calculating the turnover of undertakings in cases where the participants in a concentration exercise joint control over other undertakings or joint control is exercised over the participants in the concentration. In such situations, the turnover of jointly controlling or jointly controlled undertakings would be allocated (proportionally) to the turnover of the participants in the concentration. A draft has also been prepared of a new regulation on the method of calculating the turnover of undertakings, to replace the regulation of the Council of Ministers of 17 July 2007 which is currently in force.

More *de minimis* concentrations

Not every concentration is subject to review, even if the participants exceed the main statutory thresholds for turnover. An example is small concentrations where the turnover of the acquired undertaking is relatively minor. In such situations, the act excludes the notification requirement.

Under current law, this exclusion covers only concentrations involving acquisition of control if the turnover of the undertaking over which control will be acquired did not exceed the equivalent of EUR 10 million in Poland in either of the two preceding financial years (Art. 14(1)).

An analogous solution applies in concentrations involving acquisition of part of the assets of another undertaking: If the turnover generated by the acquired assets did not exceed the equivalent of EUR 10 million in Poland in either of the previous two years, the concentration is not subject to notification (Art. 13(2)(4), where the *de minimis* threshold is part of the definition of a concentration).

The planned amendment extends the *de minimis* rule to the two other types of concentrations, i.e. creation of a joint undertaking and a merger of undertakings, and thus may exclude them from the notification requirement. Such concentrations would not be subject to notification if the total turnover obtained by the parties to the transaction (including their capital groups) in Poland did not exceed the equivalent of EUR 10 million in either of the two preceding years.

Thanks to this solution, all types of concentrations would generally be treated equally, with a single threshold for *de minimis* treatment or the requirement to make a notification. It should be pointed out, however, that in the case of concentrations involving acquisition of control or assets, the *de minimis* limit of EUR 10 million applies only to the undertaking or assets acquired. In the case of a merger or creation of a joint undertaking, the same threshold would apply to the capital groups of at least two participants in such concentrations.

Reservations concerning concentrations with potentially negative market effects

A new institution included in the proposal is reservations concerning a planned concentration. The President of the Office of Competition and Consumer Protection would be required to formulate reservations in cases where there is a likelihood that the concentration would significantly impede competition on the market. The reservations would require justification, and the undertaking would have 14 days from receipt to address the reservations of the competition authority (with the possibility of obtaining an extension).

The reservations would be presented to the undertaking during the course of the proceeding, so that it could address them prior to issuance of a decision in the case—and possibly modify the planned transaction in order to eliminate the anti-competitive concerns.

This institution would function independently from conditional approval, where, under Art. 19, a decision is issued permitting the concentration under conditions which must be fulfilled. In practice, reservations would be presented at the stage preceding issuance of conditions.

Two-stage notification proceedings

The current regulations provide for single-stage merger review proceedings in the case of all concentrations. Under Art. 96(1), the statutory deadline for issuance of a decision on notification of a planned concentration is 2 months after commencement of the proceeding by the regulator (the date the notification is filed).

This 2-month period may be extended by the definite period needed for example for the undertaking to respond to additional questions from the regulator, add missing items, or supplement the existing information and documents (Art. 96(3)).

A fundamental change will be introduction of two-stage proceedings for notification of planned concentrations. The rule is to be that merger review proceedings are completed within 1 month after commencement of the proceeding. The 1-month period would apply to concentrations that are uncomplicated and do not raise concerns about competition. The President of the Office of Competition and Consumer Protection now estimates that about 80% of decisions on concentrations would be issued during the first stage.

Concentrations that are complicated or likely to have a major impact on the relevant market (i.e. where there is a risk of issuance of conditional approval or prohibition of the concentration), or where the regulator must conduct market research, would undergo a second phase of merger review. The regulator would issue an order extending the period for completion of the proceeding by an additional 4 months (the order would require a justification but could not be appealed). In that case, the proceeding would last a total of 5 months (both stages) from the commencement of the proceeding. However, either of the two stages could be extended under the rules already in force, for example because the regulator requires additional information or clarifications.

The planned changes essentially codify the current practice for merger review by the Office of Competition and Consumer Protection. Proceedings for simple concentrations not presenting negative consequences for the market are typically completed now in about 4–6 weeks, even though the statutory period for resolving them is 2 months and may be extended. On the other hand, complicated cases often take longer than the current statutory period and even the proposed 5-month period. A good example is the conditional decision concerning the merger of Auchan Polska and Real (No. DKK-4/2014), which was issued on 21 January 2014 after a proceeding lasting 10 months.

Notification fees

Under the proposal, the notification fee (the fee for the application to commence concentration proceedings) would double if the case moved to the second stage. In the draft executive regulation to the amended act, the initial fee for consideration of a notification of a concentration would remain unchanged at PLN 5,000, but if the regulator issued an order extending the review period by 4 months, thus moving to the second stage, the applicant would be required to pay an additional fee of PLN 5,000.

New forms for information and documents

The draft executive regulation also introduces two types of notification questionnaires (indexes of information and documents). The difference between these two types of questionnaires is based on the criteria of the relevant markets which would be affected by the concentration horizontally (common markets in which the combined share of the parties exceeds 20%) or vertically (any supplier-customer market where at least one of the parties has a share exceeding 30%). A short-form questionnaire would be used for cases in which the concentration would not have an impact on any markets, and the full questionnaire would be used in all other cases.

Andrzej Madała is a member of the Competition Law Practice.

Repossession of aircraft in Poland

Paweł Mazur Krzysztof Wojdyło

Growing traffic at Polish airports is causing an increase in interest in legal aspects of commercial aviation in Poland. Our practice shows that one of the most pressing issues is the legal options for effectively regaining possession of an aircraft when the airline operating the aircraft has financial difficulties. One question is how Polish law currently governs this matter. Another is whether there are solutions that could improve the legal situation of the aircraft owner.

In the most common business configuration, airplanes are now usually operated by Polish-based airlines pursuant to a leasing agreement. These planes are often entered in the Polish aircraft register, while the leasing company, which also owns the aircraft, is most often based outside of Poland.

The need for the owner of the aircraft to regain possession efficiently may arise in various instances. First, the lessor may decide to repossess the aircraft because of a breach of the leasing agreement by the lessee airline (e.g. for arrears in payment of leasing instalments). Often the need for repossession arises because the airline goes bankrupt. Rapidly regaining possession of the aircraft in these cases is essential to assure the continuing economic vitality of the lessor. When the lessor repossesses the aircraft, it can then lease the aircraft to another lessee. If repossession takes too long, the lessor loses this stream of income.

In any of these cases, depending on the circumstances of the specific case, regaining possession of the aircraft may prove a difficult challenge for the lessor. The lessor will need to deal with a number of international and local legal regulations. Just determining which regulations to apply may be difficult because there may be several legal systems involved at the same time (the law governing the lessor, the law governing the lessee, the law governing the leasing agreement, the law governing the location of the aircraft, and so on). In the case of repossession of aircraft operated by Polish airlines, the lessor must primarily take into consideration the laws in force in Poland.

Polish regulations

It should first be stressed that Poland is not a signatory to the Convention on International Interests in Mobile Equipment signed at Cape Town on 16 November 2001 or the Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment. Consequently, the provisions concerning repossession of aircraft in those documents, including provisions which help expedite the repossession process, will not apply.

Therefore, the regulations set forth in national law will be crucial. Under the basic rule of Polish law, regaining possession by a creditor (when the debtor does not relinquish possession voluntarily) may be conducted only through a special execution procedure conducted with the participation of the execution authority. This rule also applies to repossession of aircraft. It is therefore prohibited to employ measures to regain possession outside of the official procedure provided for execution of claims.

This means that apart from specific instances (one of which we will discuss further below), if the debtor does not consent to release of the aircraft, the creditor's actual taking possession of the aircraft must be preceded by the owner's obtaining an enforcement order, typically in the form of a legally final judgment. It need not be a judgment of a Polish court. It may be a judgment of a foreign court, which then must be recognised in Poland.

The procedures for repossession are modified greatly if the current holder of the aircraft is declared bankrupt. In that case, the provisions of bankruptcy law will primarily control. Depending on the type of bankruptcy (reorganising or liquidating), it may prove that the lessor is unable to regain actual possession of the aircraft for a long time, even though the lessee is not performing under the leasing agreement (particularly in the case of a reorganising bankruptcy). As a rule, any execution being conducted against the lessee is stayed upon declaration of the lessee's bankruptcy.

In practice, the repossession procedure may look somewhat different in the case of a "wet" or ACMI (aircraft, crew, maintenance & insurance) lease. Under wet leasing, the aircraft is delivered to the lessee together with the crew. The fact that the crew of the leased aircraft are employed by the lessor may make it easier for the lessor to regain actual possession of the aircraft in certain situations.

A helpful instrument

As may be seen from the foregoing, under the specific circumstances it may be very difficult to regain possession of an aircraft quickly and effectively. One instrument that can help is voluntary submission to enforcement. Under Polish law, a debtor (e.g. in this case the lessee) may voluntarily submit to enforcement, through a notarial deed, with respect to both monetary claims and non-monetary claims (e.g. for delivery of possession of property). In this case, the notarial deed constitutes an enforcement order, which upon issuance of an enforcement clause may constitute the basis for conducting execution.

This aspect of a voluntary submission to enforcement means that the creditor holding it need not conduct judicial proceedings on the merits before commencing execution against the debtor. A judgment against the debtor is not required in this case in order to commence execution. The only requirement is to obtain an enforcement clause for the voluntary submission to enforcement, but that is issued by the court in a highly simplified procedure, in which the merits of the creditor's claim are not examined at all, but the court only examines the formal aspects related to the voluntary submission to enforcement.

An additional advantage of a voluntary submission to enforcement is that it constitutes a European enforcement order within the meaning of the EU's European Enforcement Order Regulation (805/2004). However, this applies only to a voluntary submission to enforcement with respect to monetary claims. The creditor may thus use a voluntary submission to enforcement by a Polish debtor to execute on its monetary claims against the debtor in other member states of the European Union upon fulfilment of the requirements set forth in the regulation.

The lessor should seek to obtain a voluntary submission to enforcement before delivering the aircraft to the lessee under the leasing agreement. The voluntary submission to enforcement may state that it applies to both the monetary claims and the claim for delivery of possession of the aircraft. It is recommended that the voluntary submission to enforcement also expressly mention the obligation to deliver possession of the documentation associated with the aircraft.

Despite the undeniable advantages of this instrument, it is necessary to be aware of its limitations. This instrument may be used only in a situation where it is permissible to conduct execution against the debtor. Therefore, it could generally not be exercised if the debtor is declared bankrupt. In that case, any execution against the assets of the debtor is governed by special regulations set forth in the bankruptcy law applicable to the debtor.

The voluntary submission to enforcement will therefore be useful primarily when the lessee is in financial difficulty but has not yet entered bankruptcy. In that case, it may prove essential for the creditor to be able to show that it regained possession of the aircraft before the debtor was declared bankrupt. Voluntary submission to enforcement enables the creditor to move to execution without going through the stage of judicial proceedings on the merits, which undoubtedly improves the creditor's chances of achieving this goal.

Paweł Mazur, adwokat*, is the partner in charge of the Aviation Law Practice.*

Krzysztof Wojdyło, adwokat*, is a member of the Payment Services Practice.*

Betting against the market: Short selling and securities lending in Poland

Danuta Pajewska Marcin Pietkiewicz

Short selling and securities lending have much in common and are largely interdependent. An increasing volume of short sales creates demand for securities that can be borrowed to settle short sales, and a developed market in securities lending allows easier access to securities to settle short sales.

The complexity of short selling and securities lending and concerns that such trading could distort the market have led to legislation seeking to increase the transparency of these transactions.

Short selling is often used as part of a complex investment strategy to profit from the fall in prices of securities. In general, it is an undertaking to sell securities that are not recorded in an investor's securities account on the date of sale. An investor that does not possess securities, but anticipates that they will fall in price, borrows or arranges to borrow them (most often from the investor's own brokerage house) and sells them. If they fall in price, the investor—to be able to return them—buys them back at the lower price and makes a profit on the difference in prices (if the price rises, the investor loses). This makes short selling different from usual stock exchange transactions.

Securities lending is a popular method of obtaining securities to settle short positions. It is also an additional method for holders to increase profits from

securities and is popular among financial institutions which hold securities long-term.

Short selling

Existing Polish regime

Polish regulations permit covered short selling. It is only permitted on a regulated market (i.e. the Warsaw Stock Exchange) when an investor and broker agree on delivery of the securities that are required to settle the transaction and the broker is authorised to borrow securities for the investor if the investor fails to deliver the securities on time.

Covered short selling must meet the criteria listed in the WSE Rules. The WSE maintains and publishes daily a list of securities that can be short-sold, and publishes information on concluded short sales.

EU regime

The EU's Short Selling Regulation (236/2012) applies directly in all EU member states. Its purpose is to consolidate the rules for short selling, increase the transparency of short selling, and ensure greater coordination and coherence of short selling within the EU.

The regulation applies to shares listed on EU regulated markets, debt instruments issued by states or state agencies (sovereign debt), and credit default swaps of sovereign debt.

A short sale that comes within the regulation is the sale of shares or debt instruments that do not belong to the seller at the time of sale. A sale falls within the definition of a "short sale" regardless of whether the seller, to settle the transaction, borrowed (or arranged to borrow) securities at the time of sale. The definition does not apply to a sale under repurchase contracts, securities lending contracts, futures contracts, or other derivatives, whereby it is agreed to sell securities at an agreed price on a future date.

A novel requirement is for a holder of a net short position in shares or sovereign debt to report involvement in the short sale, if the sale exceeds or falls below certain statutory thresholds. The basic threshold is 0.2% of issued company share capital, and each subsequent 0.1% above that. The European Securities and Markets Authority publishes thresholds for sovereign debt for each EU member state.

Notification is required by no later than by 3:30 pm on the business (trading) day following attaining a given position. For short positions involving shares traded on the WSE, notification is made to the Polish Financial Supervisory Authority (KNF).

Significantly, not only short sales of shares or debt instruments on a specific market must be considered in determining whether to notify of a short position, but also short positions in securities from over-the-counter transactions and derivative transactions (e.g. options and term contracts), which includes synthetic holdings.

Moreover, as with the notification obligations for holdings of publicly traded shares (long positions), specific guidelines apply to the calculation of short positions held by funds that are managed by the same manager or by entities comprising a capital group.

The regulation requires public disclosure of net short positions in shares that exceed 0.5% of issued company share capital, and each subsequent 0.1%.

The disclosure is made through the website of the supervisory body, which for Poland is the KNF. Therefore, notifying the KNF will be the equivalent of public disclosure of a significant net short position, and the information will be made public on the KNF website.

Changes still to come

Poland still needs to make certain changes in its national regulations to comply with the requirements of the EU's Short Selling Regulation. The amendments are expected shortly.

Securities lending

The law in Poland does not specifically regulate the issue of securities lending. No special licences, authorisations or registrations are required to be able to lend securities that are publicly traded, and the parties are free to determine the type of securities that can be lent.

But certain conditions under Polish securities laws have to be met. The parties have to comply with the requirements of Polish law on transfer of the securities, even if the borrowers and lenders are not Polish residents. Securities in public trading in Poland are dematerialised; that is, they are registered at the Central Securities Depository of Poland (KPDW) and do not exist in the form of a document. As a consequence, ownership of securities in public trading is transferred only when the local custodians register the changes in the borrower's and lender's securities accounts.

A local broker would only have to be involved when a borrower sells borrowed securities on the stock exchange, or a lender short-sells securities that are on loan.

It is also possible to sell the securities directly between a seller and a purchaser without the intermediation of a broker. The transaction would, however, have to be communicated to the local custodian and entered in the relevant securities accounts of the borrower and the lender. Securities lending can freely occur outside Poland and can be governed by the law chosen by the parties, but transfer of the securities between the lender's and borrower's accounts will still be subject to Polish law.

Furthermore, Poland generally does not restrict ownership of Polish securities. Similarly, securities lending and settlements outside of Poland will not fall under the Foreign Exchange Law; a Polish resident involved in the transaction could only be required to comply with FX reporting. The only requirement still in force is that non-Polish residents must use authorised banks in Poland to transfer funds abroad and make settlements in foreign currencies in Poland.

Finally, the parties will need to comply with Polish rules on disclosure of long positions in shares of listed companies. A securities lending transaction will be reportable when the title to shares is transferred to the borrower, and then back to the lender. Reporting can also arise even when there is no transfer to the borrower (synthetic lending), if the lender granted the borrower a proxy to vote the shares that are being lent.

Under the existing regulations and those yet to come, the Polish market in short sales offers conditions to investors that are comparable to conditions on other European markets. A separate issue is the prospect for growth of the Polish market. The impetus here comes from the steady increase in the number of companies listed on the WSE whose shares have high liquidity, and from the increasing maturity of the securities lending market.

Danuta Pajewska, legal adviser, is the partner in charge of the Capital Markets and Financial Institutions practices.

Marcin Pietkiewicz, legal adviser, is a member of the practices.

W&I insurance can secure M&A transaction claims

Michał Steinhagen

When acquiring a company or enterprise, risks are limited by carefully examining the target and including representations and warranties in the agreement. But what if it turns out later that the seller's statements were incorrect?

The buyer may seek damages, but in practice satisfying such claims can be difficult and time-consuming. Therefore, to provide security to the buyer, the agreement sometimes provides for the buyer to hold back a portion of the price or pay it into escrow. But sellers are not happy to accept this approach and prefer to receive the entire purchase price at closing. Then it is worth considering insurance to cover the seller's representations and warranties in the agreement.

Warranties and indemnities insurance, or W&I as it is known, shifts to a third party (the insurer) the risk connected with inaccuracy of the seller's representations and warranties. In an M&A transaction, W&I coverage may protect either the buyer or the seller.

When the insured is the seller, W&I coverage protects it against liability to the buyer for breach of representations and warranties. The insurer will pay the loss directly to the buyer or reimburse the seller for damages it has paid. This coverage may be particularly useful if the seller wishes to:

- Free up funds which it would have to earmark as a provision to secure claims under the agreement
- Offer more attractive terms and obtain a higher price
- Limit the negotiations concerning representations and warranties.

When the buyer is the insured, W&I coverage protects it from loss due to inaccurate representations and warranties by the seller. The buyer may obtain compensation directly from the insurer without pursuing the seller. W&I coverage may be helpful when:

- The seller is hesitant to make certain representations and warranties or to back them up financially
- The scope of the seller's liability under the representations and warranties is insufficient for the buyer
- The buyer hopes to make its offer more attractive by requiring less security than other bidders.

For example, if a private equity fund is a potential buyer in a tender for the sale of a company or enterprise, it can gain a competitive advantage over other bidders by taking out W&I insurance. Then it can offer a higher purchase price while accepting a lower level of liability on the seller's part for potential breach of representations and warranties. Depending on the situation, instead of seeking security equal to 25% of the value of the transaction, the buyer may be satisfied with security at 1% of the sale price. The seller would be more inclined to accept a bid from a buyer that demands lower contractual penalties, agrees to pay the entire purchase price at closing, or does not require money to be placed in escrow. The buyer will be in a better position to offer such terms if it is assured that a third party (the insurer) will cover the loss if there is a breach of the seller's representations and warranties.

At the other end, when the same private equity fund decides to sell the company on, it will be interested in exiting the investment as cleanly as possible. Not wanting to freeze a portion of the price or other funds to secure potential claims by the buyer, it may instead propose W&I coverage to the buyer. The cost of the insurance will typically be lower than the cost of other forms of security, and meanwhile the fund can treat the investment as completely closed out.

Often when an investor buys a company, the previous owners will stay on in a management role. If the representations and warranties included in the sale agreement prove untrue, enforcing claims against the sellers who are currently members of the management board could upset the functioning of the entire company. In that situation, it could be a solution for the buyer to hold W&I insurance enabling it to seek compensation from the insurance company rather than pursuing the sellers personally for damages.

W&I coverage can also be a good solution for a foreign investor seeking to limit the risks associated with the specific jurisdiction. Even though most transactions are preceded by due diligence, foreign investors are sometimes worried about unforeseen legal problems, particularly with respect to administrative liability, unclear title to real estate, or environmental contamination.

In practice, W&I insurance is most often taken out by the buyer. Depending on the arrangements between the parties, the seller may purchase a W&I policy in which the buyer is the named insured. The policy could also be taken out by the target company itself.

W&I is a bespoke form of coverage, prepared individually to suit the needs of the specific transaction. The detailed conditions of the insurance, the scope and amount of coverage, the premiums and the term are all negotiable. But an insurer will not necessarily agree to cover every transaction. Typically coverage will be available only in transactions worth over EUR 1 million. Coverage also depends on the risk assessment by the insurer, and thus the policy will not be issued until after the insurance company has conducted an independent review.

The insurance may cover all of the seller's representations and warranties, or only a portion of them. In practice, the insurance is often limited to selected issues, such as tax, litigation, or environmental liability.

W&I coverage may prove very useful if tax problems have arisen in the target company. Considering that tax regulations often generate serious doubts and their interpretation by the tax authorities can be surprising, an ongoing tax dispute or tax audit may be a ticking time-bomb for the acquirer of the company. At the same time, sellers are reluctant to provide security against claims by the buyer when a tax issue is resolved differently than expected. This could even block the transaction, because each party is afraid to assume the risk of liability arising out of the determination of the tax issues. In such case, W&I coverage could be a good solution. And depending on the circumstances of the case, the insurer may issue W&I coverage even if a tax dispute is already pending.

W&I insurance may be concluded at any stage of the negotiation of a transaction or after closing. In practice, the best results are obtained by preparing the insurance at the preliminary stage of the transaction. It should be borne in mind that the insurer must have time to examine the transaction in terms of the representations and warranties that will be covered. If the transaction is preceded by due diligence conducted by a reputable law firm, the insurer will typically be satisfied to review the due diligence report and the issues raised there. This reduces the time necessary to prepare the conditions of the insurance.

The term of the insurance typically coincides with the period of liability specified in the sale agreement. In practice it is no longer than 10 years.

Because W&I insurance is tailored individually for each transaction, it can mirror the conditions for liability set forth in the sale agreement. This is convenient, because it allows the parties to avoid additional disputes in interpretation which could arise from the use of different terminology, a differing scope of liability, or the law of a different jurisdiction.

The amount of the coverage, i.e. the fixed limit of the insurer's liability, may be agreed by the parties. Typically it is in the range of 20–50% of the value of the transaction. There is a one-time premium, currently ranging from 0.75% to 2% of the amount of the coverage.

W&I insurance is particularly common in Western Europe and the United States. In recent years, an increasing number of deals involving companies from Central & Eastern Europe have been covered by this type of insurance. Coverage is most often provided by foreign insurance companies. As W&I coverage grows in popularity, it is expected that the average premium level will decline.

Michał Steinhagen, adwokat*, heads the Insurance Law Practice.*

Dishonest manoeuvres by debtors can be defeated

Adam Studziński Jan Markiewicz

Economic pressure increasingly tempts debtors under a threat of insolvency to resort to illegal means of avoiding performing their obligations. In order to leave creditors high and dry, they use methods that are essentially simple, although cloaked in complex legal structures. Creditors can take action to defeat these efforts.

There are numerous commonly known methods to evade paying debts. The internet is full of offers by certain "consulting" firms who bluntly offer to assist debtors in evading their creditors. The method chosen by the debtor depends on the debtor's plans for the future. Below we describe two structures used by debtors who want to continue doing business in Poland more or less openly. These are entrepreneurs whose original business has become overburdened with debt and want to start afresh without giving up their existing property and market recognition.

Behind the screen

One of the methods is to create screen companies. In Poland, a business that cannot pay its debts is supposed to declare bankruptcy, cease operations, and turn over its assets to its creditors. But instead of declaring bankruptcy, a dishonest debtor may create a new company, with the help of family members or other confidants, which will serve as a screen for continuing the same business as before.

Soon the debtor begins systematically transferring its true business to the new entity. The new company uses the same network of customers, cooperat-

ing personnel and knowhow as the old one. Meanwhile, the dishonest debtor pays only selected key creditors with whom it hopes to maintain good relations, or those to whom the most important assets of the indebted business have been pledged as collateral. Payment of these selected creditors is made in connection with assumption of these claims by the screen company from the indebted entity.

Then the screen company buys from the indebted entity the most important fixed assets which are essential to the debtor's operations—but not the whole enterprise, because then the buyer would become liable for the existing debts of the enterprise. Payment of the price is made by setoff against the claims of selected creditors paid by the screen company. In this way execution of claims against the original entity is intentionally foiled, because the original entity no longer has any valuable assets. Meanwhile, the dishonest debtor continues its previous business, sometimes even at the same location and often under a similar name (particularly when the nominal owner of the screen company is someone from the debtor's family).

Another scheme for operating behind a screen involves establishment of a foreign company (typically in an "offshore" jurisdiction) in the name of a straw owner, which then takes over administration of all or a significant portion of the debtor's existing enterprise on the basis of a long but fixed-term agreement of tenancy or lease. Such agreements are generally binding even after disposal of the tangibles and intangibles covered by the tenancy or lease. The rent in such cases is typically deferred or subject to setoff against fictitious improvements, renovations or investments. The creditors must then execute against assets whose value is drastically reduced by the encumbrance of the tenancy or lease agreements, as a potential buyer would not be interested in acquiring assets which it could not use for many years.

Dilution

Another method involves dilution of the assets. The assets of the indebted enterprise are transferred to several new companies, typically by in-kind contribution. In return, the debtor obtains shares in a conglomerate of new companies, and these then undergo further devaluation, e.g. by "watering" the shares (through an increase in the capital of the companies, with the increased capital taken up by yet another entity controlled by the debtor), followed by a redemption of shares. The creditors are left unsatisfied because there is nothing of value remaining in the indebted enterprise. Meanwhile, the conglomerate of new companies, managed by an entity under the control of the debtor, remain in a continuous, more or less formalised commercial relationship, jointly pursuing the business goals of the former enterprise. After some time, when the debtor believes that for whatever reason there is no longer a danger of measures being asserted by creditors, the debtor may then try to merge the operations back into one entity.

How creditors can protect themselves

Unfortunately, the Polish legal system is learning only slowly and with difficulty how to counteract such practices. The complex and often international structures created in order to strip assets are often new to Polish courts and law enforcement authorities. A practice has not yet developed in the case law of looking beyond the narrow framework of legal personality to capture the true economic intent of chains of transactions designed to injure creditors. The law and practice in Poland are far from adoption of the methods that have been developed in the English or American legal system, where the court may apply such doctrines as "piercing the corporate veil," "mere continuance" or *ultra vires* to ignore the legal independence of specific companies if it is abused to conduct unlawful transactions. Courts in the common law tradition are also free to order injunctive remedies against dishonest debtors, to freeze their assets throughout the world through international freezing injunctions, or, through anti-suit injunctions, to prohibit them from commencing judicial proceedings with the purpose of frustrating enforcement of debts by creditors.

In Poland, creditors are equipped with traditional legal and procedural institutions. But this does not mean they are powerless. Coordinated group initiative often enables creditors to effectively combat even the craftiest constructions created by debtors.

There are a number of investigative and legal tools for avoiding the effects of asset-stripping. As we know from detective fiction, there is no such thing as the perfect crime. We should also remember that every dishonest act leaves some trace or evidence of its unlawful purpose. Fictitious contracts, collusive transactions, draining of funds and creation of artificial entities are not that hard to recognise. Protective measures should begin with locating and securing the evidence demonstrating the true nature and purpose of the acts of a dishonest debtor. To this end, creditors may resort to:

- Asset investigation, through economic intelligence at home and abroad
- Forensic accounting and forensic IT to gather and examine evidence
- Analysis by experts in finance, business, and asset valuation
- Review of economic events from the point of view of tax law and regulatory restrictions under public law, including administrative proceedings to identify the true course of economic events.

Once it has been determined what actions the dishonest debtor has taken, the creditors can take the appropriate legal recourse. Creditors have at their disposal:

- Civil-law instruments, such as claims to invalidate an agreement to the detriment of creditors, fraudulent transfer actions to hold an agreement to be ineffective, and securing and executing on claims when there is a threat of removal of assets
- Criminal-law instruments—initiating, conducting and monitoring criminal proceedings involving commercial offences, and pursuing and enforcing redress of injury in criminal cases
- Insolvency instruments—initiating and conducting bankruptcy proceedings or seeking a ban on serving as a board member or conducting business activity.

The principal legal instruments and the auxiliary instruments should be applied in conjunction with one another. It is also important to coordinate investigative and legal measures, and time is nearly always a crucial factor.

Criminal law measures

A highly effective method of enforcing obligations which not everyone is aware of can be the criminal law. In a criminal case in which a debtor is charged with criminal injury to a creditor, the creditor can and should request that the perpetrator be sentenced to the criminal sanction of redressing the injury. If the court convicts the debtor (or an accessory) of an offence which caused a loss, the court should also order the defendant to redress the loss—and increasingly often the courts do so.

The duty to redress the loss caused by a criminal offence may be imposed jointly and severally on all of the defendants, and then any one of them may be required to pay the full amount of damages ordered in the criminal judgment. A criminal judgment constitutes a writ of execution, like a judgment issued in a civil case. After obtaining an enforcement clause, it may be executed on by the injured party through an execution proceeding conducted by the bailiff. The limitations period under the civil law does not apply to claims for redress of loss caused by a criminal offence.

Finally, it should be pointed out that the criminal court may make acknowledgement or performance of the duty to redress a loss caused by a criminal offence a condition for suspension of a prison sentence (Penal Code Art. 72 §2). This may be of great importance in practice. Not many debtors are so determined not to pay their debts that they are willing to sacrifice their personal freedom to this end. If the debtor refuses to carry out the sanction—i.e. is capable of redressing the loss in whole or in part but fails to do so—the court may revoke the suspension of the sentence of imprisonment imposed on the perpetrator.

Adam Studziński, adwokat*, heads the Difficult Receivables Recovery Practice.*

Jan Markiewicz is a member of the practice.

Assessment of real estate risks in cross-border M&A transactions

Izabela Zielińska-Barłożek Anna Dąbrowska

Following a long stagnation, it looks as if the real estate market is slowly finding its feet. As signals suggesting an end of the economic crisis cautiously flow from different parts of the world, property lawyers are observing an increase in activity. These trends, as well as the pitfalls that may be encountered in real estate transactions in different jurisdictions, were the subject of a workshop in Boston this past October during the IBA Annual Conference.

The workshop provided a platform for exchanging views on this timely topic in a panel discussion between lawyers from such countries as Argentina, the Czech Republic, Germany, Latvia, Poland, Russia, Sweden and the United States.

A different perspective and invaluable insight on the trends observed on the US market were provided by a representative of one of the most renowned firms of real estate brokers. The summary of the situation in the US confirms the global trends and shows the highest increase in investment volume since 2009. The preliminary figures showed almost USD 118 billion in the first half of 2013, compared to slightly over USD 107 billion in the first half of 2012 (and USD 58.5 billion for all of 2009). The increase in activity was picked up by more and more investors from outside the US. Foreign investment was strongest in Manhattan, Los Angeles, and Washington, DC, but also strong in Seattle. The top players originated from

Canada, Singapore, South Korea, Germany and Switzerland. Capital from abroad has the option of entering the scene independently or through various types of joint ventures, with each approach having its pros and cons. Some of the weaknesses of direct buys include difficulties in penetrating the market, high costs of management from abroad, and tax issues. On the other hand, joint ventures are faced with the ever-present difficulty of finding a like-minded partner with a similar outlook on the cooperation. Further negative factors which foreign investors must face include transparency issues and unfamiliarity with local real estate best practices and the tax and legal system. Cooperation with local law firms provides potential buyers with such added value as comprehensive advice on tax and legal structures and thorough identification of possible dangers, and they can deliver feedback on local partners and appropriate dispute resolution mechanisms.

The business overview was a starting point for issues presented by the lawyers on the panel. It was stressed that all real estate transactions may carry some risk for the parties. As all lawyers are well aware, reality often surpasses even the most vivid imagination and it is impossible to foresee all that may be revealed. A tragic-comic example of the unpredictability of circumstances is that of the Walkie-Talkie Building in London, which was dubbed the "Fryscraper" during the summer of 2013 after a car was melted by the sun's rays reflected off its mirrored façade. This is a perfect example of how open-minded lawyers need to be when investigating the target of a potential transaction—being buried in title deeds isn't enough. Although no one would expect a lawyer to point out potential physical defects like those in the London case, it should be remembered that clients expect their advisers to keep the big picture in mind and anticipate what might go wrong and what kind of liability could result from defects or risks that are discovered. This case also serves as an interesting example of the range of liability that needs to be considered in relation to real estate transactions. The significance of thorough due diligence was stressed by the panellist from Russia, who elaborated on the issue by providing examples of far-reaching negative consequences of defects found in real estate documentation.

Not all risks or consequences are as hair-raising as the Fryscraper, but they all must be handled with equal care.

Due diligence is only one of the steps necessary to safeguard an investor against issues that may arise when acquiring real estate. Another essential element is proper structuring of the transaction documents and creating a set of provisions that will help deal with unexpected situations. It was noted by the panellist from the US that in corporate M&A transactions the real estate assets used in the target's business are often treated differently than they would be in a pure real estate acquisition. Generally, depending on whether the subject of the transfer is shares in a company holding real property, land and fixtures being sold directly, or these assets being sold as the target's business (or part of its business), there may be a different approach to due diligence, drafting of representations and warranties, conditions for transfer of title, and so on. Understandably, transactions including a business (rather than only real estate) are usually more complex and may require more elaborate contract provisions.

However, in a questionnaire distributed during the workshop the participants' answers on this issue were divided almost equally, with 54% claiming that the type of transaction does not affect the approach to the transaction. Polish lawyers would take the view that if the property were acquired directly (whether as a standalone asset or as an enterprise or part of an enterprise), the buyer is protected by the warranty of reliance on the information disclosed in the land and mortgage register (a principle recognised by many jurisdictions). But this would not apply to share deals in which real estate is acquired indirectly.

The issue of the seller's liability is crucial, regardless of whether the transaction involves real estate or not. Apart from conducting an in-depth examination of the target, in many jurisdictions the need to secure the buyer's interests leads to lengthy and detailed representations and warranties of the seller and provisions specifying the seller's liability if the representations and warranties turn out to be untrue, imprecise or misleading. A Swedish perspective on this revealed that there, a buyer will not be entitled to any remedies for a defect if it is shown that the buyer could have identified the defect prior to the acquisition by making a professional inspection. In other words, the buyer needs to undertake an extensive examination of the property, short of taking it physically apart. The seller is required to inform the buyer of any circumstances that might be relevant. However, the buyer has no other choice than to review whatever information is made available and to make any inspections offered. In practice, the parties are generally free to agree that the seller also takes responsibility for matters which the buyer could have identified upon inspection. In order to be effective, such agreement and waiver of the duty to inspect must be precisely worded. But in the end the issue is not so clear, and it is up to the court to determine whether such agreement and waiver are enforceable. Any reference to hidden defects and the seller's liability for them must also be worded with great care, as Swedish law does permit waiver of this liability.

Under Polish law, the seller is liable for inherent defects—legal or physical—of the property sold. The seller can be released from liability under the implied warranty, but only in situations in which the buyer knew of the defect at the time of delivery. It is also possible to modify the liability under the implied warranty for defects, but exclusion or limitation of liability is ineffective if the seller intentionally concealed a defect from the buyer.

In a straw poll, 92% of the lawyers at the workshop confirmed that in their jurisdictions, in general, a buyer can rely on the representations and warranties provided in a contract, i.e. it is not necessary for the buyer to inspect real estate in order to have the right to make any claims against the seller in the future.

Another element of transactional practice which also applies to real estate deals is the issue of interim events. Depending on the complexity of the transaction, closing usually takes place some time after signing of the initial agreement, to allow the parties to fulfil their contractual obligations to each other and obligations to third parties. Interim periods are even more frequent in real estate deals where registration issues or a requirement to obtain approval of public authorities or waiver of rights of first refusal of public authorities often plays a significant role in transfer of title.

Finally, as the workshop reviewed cross-border issues in real estate transactions, one of the topics was cooperation between counsel from different countries and the impact this can sometimes have on a deal. The reason this topic came up is that with real estate in particular, there is a strong element of local law that cannot be avoided and might not necessarily reflect international standards. To communicate the resulting risks and the potential impact on the transaction can be challenging. In some cases it is not easy for lead counsel to understand that certain internationally accepted principles do not apply under local law and they must rely on local advisers. Every lawyer working on a cross-border real estate transaction needs to know where his or her professional limitations lie and when it is impossible to proceed effectively without the assistance of local counsel to deal with specific issues under the given legal system.

Fewer than 10% of the participants admitted that they had encountered significant difficulties dealing with legal advisers from other countries.

The conclusions from the IBA workshop were cautiously optimistic. Although the real estate market is reviving from its previous stupor and it looks like there will be more and more to do in that area, it is also crucial to realise how unexpected real estate issues can be. Thorough examination of the target and precise drafting of the documentation are essential.

Izabela Zielińska-Barłożek, legal adviser, is the partner in charge of the Mergers & Acquisitions Practice.

Anna Dąbrowska, legal adviser and partner, is a member of the practice.

Environmental liability resulting from subsea technology in offshore oil and gas production

Dominik Wałkowski

Advances in offshore technology and climate change causing the polar ice cap to melt are encouraging prospecting and drilling for oil and gas in new, non-traditional areas. There is particularly dynamic growth in this activity at sea, under tougher and tougher conditions.

The attractiveness of mineral deposits in Arctic regions is encouraging major companies to explore risky ventures, raising concerns about the environment as well as international security. The status of these regions under international law and in geopolitical terms is not entirely clear. In 1849, California had a Gold Rush. Today's increase in mining for oil and gas in polar regions is being called a "Cold Rush."

State-of-the-art technology enables mining to be conducted safely in difficult regions and at great depth. Nonetheless, accidents are common, and often caused by human error. And with ventures of this type, it is not sufficient just to take measures to prevent serious accidents. It is also necessary to have instruments in place so that if there is a spill, it can be contained and immediate cleanup can begin. This aspect is often overlooked, but stopping a spill early on is crucial for limiting the dimensions of ecological harm and preventing a broader catastrophe.

Not just the *Macondo*

Accidents related to drilling at sea are all too common, as confirmed by the statistics maintained by the UK's Department of Energy & Climate Change.

The explosion on the *Piper Alpha* platform in the North Sea in 1988 had terrible consequences—167 men died. Following that tragedy, a number of measures were introduced to increase the safety of offshore drilling. But environmental harm was an afterthought. The number of victims and the disastrous effect on the industry took priority.

Environmental harm was discussed after the accident on the *Ekofisk Bravo* platform in the North Sea in 1977, which resulted in the largest spill in the region, and after the catastrophic consequences of the spill at the *Ixtoc I* rig in the Gulf of Mexico in 1979.

More recently, in August 2009, there was a spill at the *Montara* platform (in the Timor Sea off the northwest coast of Australia). A few months later came the catastrophe at the *Deepwater Horizon (Macondo)* platform in the Gulf of Mexico, which attracted massive media attention, and in 2011 the spill at the *Gannet Alpha* platform in the North Sea.

The law at sea

The seas are particularly sensitive regions in political and legal terms. Offshore mining is a unique activity and still quite new. It is difficult to embrace it within the classic concepts of the law of the sea, which developed through custom over the centuries.

The principal regulation in this area is the United Nations Convention on the Law of the Sea. Under the convention, the sovereignty of a coastal state extends beyond its land territory and internal waters to an adjacent belt of sea, known as its "territorial sea." This belt, 12 nautical miles (about 22 km) wide, falls within the territory of the coastal state. Beyond and adjacent to the territorial sea is an "exclusive economic zone," or EEZ. It is not part of the territory of the coastal state, but is subject to a special legal regime under the convention. In its EEZ, a coastal state has sovereign rights for the purpose of exploring and exploiting, conserving and managing natural resources. It also has the exclusive right to construct and to authorise and regulate the construction, operation and use of installations and structures in its EEZ for these purposes.

The continental shelf is a different notion. In simple terms, it includes the seabed and the subsoil of submarine areas extending beyond a coastal state's territorial sea which are the submerged prolongation of its land mass, to the outer edge of the continental margin. A coastal state exercises sovereign rights over the continental shelf for the purpose of exploring it and exploiting its natural resources, but this does not affect the legal status of the waters covering the continental shelf.

Thus, states have full sovereignty with respect to commercial activity only within the narrow range of their territorial seas. A coastal state does have extensive rights in its EEZ and continental shelf, but given the nature of oil spills, which respect no boundaries, liability for environmental harm from oil spills is an issue that needs to be resolved by international law.

International protection of the marine environment

The marine environment is protected through numerous legal instruments, primarily regional, including, around Europe, the OSPAR Convention (for the Protection of the Marine Environment of the North-East Atlantic), the Barcelona Convention (for the Protection of the Mediterranean Sea Against Pollution) and the Helsinki Convention (on the Protection of the Marine Environment of the Baltic Sea Area).

But these conventions do not directly address liability for environmental harm. In this respect there is the Offshore Pollution Liability Agreement, a voluntary understanding among operators of offshore facilities. Originally OPOL applied exclusively to the UK, but later it was extended to cover Denmark, the Faroe Islands, France, Germany, Greenland, Ireland, the Isle of Man, the Netherlands and Norway, but excluding offshore installations in the Baltic and the Mediterranean. This regime is fairly limited, however.

Under international law, a basis of liability for oil spills is the International Convention on Civil Liability for Oil Pollution Damage, but it is addressed to spills from ships, which for the most part prevents it from applying to offshore drilling activity. Nonetheless, attempts to classify certain offshore installations and mobile platforms as "ships" have generated a number of legal controversies.

The Convention on Civil Liability for Oil Pollution Damage Resulting from Exploration for and Exploitation of Seabed Mineral Resources of 1 May 1977 would have applied more directly to offshore drilling, but it never came into force.

The liability regime is thus far from adequate, particularly because there is no comprehensive regulation in this area comparable to the Oil Pollution Act which was signed into law in the United States in 1990.

EU initiative

Given the lack of initiative under international law, the European Union decided to adopt its own solutions. The result is Directive 2013/30/EC on safety of offshore oil and gas operations of 12 June 2013, which places particular emphasis on environmental protection.

The directive establishes minimum requirements for prevention of serious accidents resulting from offshore oil and gas operations.

One of the key elements of the directive is the introduction of full liability for environmental harm. The member states must ensure that the licensee is financially liable for the prevention and remediation of environmental damage caused by offshore oil and gas operations carried out by, or on behalf of, the licensee or the operator.

In order to ensure the effectiveness of this approach, the Environmental Liability Directive (2004/35/EC) was also amended, so that it now covers damage to areas outside of the territory of the member states where exploration and exploitation of resources are conducted. This means that the current environmental liability regime will be expanded to cover all sea areas as far out as a member state has or exercises jurisdictional rights. Thus, in practice, the Environmental Liability Directive will cover damage in an area that also includes the EEZ of every coastal member state.

The member states have until July 2015 to enact legislation transposing the new directive into their national legal systems. The new directive may prove to be more effective than any of the other legal instruments discussed above, because it will not be limited by the ambiguities arising from some of the other partially overlapping liability regimes.

For companies conducting offshore oil and gas exploration and mining, the new Offshore Directive will make it necessary to conduct a new risk assessment for these operations, as the Environmental Liability Directive now extends beyond the traditional understanding of damage to directly address harm to protected species and habitats.

It is just too bad that there does not appear to be any immediate hope that such solutions will be adopted with respect to Arctic regions. The best the European lawmakers could do was to state in the directive, "Member States who are members of the Arctic Council are encouraged to actively promote the highest standards with regard to environmental safety in this vulnerable and unique ecosystem."

Dominik Wałkowski, adwokat*, is a member of the Environmental Law Practice.*

Purchasing rental property: Selected legal aspects

Stefan Jacyno

Rental property is entwined with multiple legal relationships. Some existing contracts concluded by the previous owner pass to the buyer of the property, while others must be concluded anew. And there are certain obligations which cannot be escaped.

There is more to a leased property than just the lease and related security such as a security deposit, guarantee or voluntary submission to enforcement. There are also credit agreements, mortgages, easements, insurance, contracts for supply of power, heat and water and removal of wastewater and garbage, telecommunications services, and agreements for building management, security, cleaning, technical maintenance, advertising and so on.

The transfer of ownership of real estate is a bilateral agreement between the previous owner and the new owner. The conveyance affects other persons automatically, by operation of law, only with respect to *in rem* rights and lease relationships. All other contracts require legal actions of some kind, such as assignment of rights and obligations (upon consent of the creditor) or termination of the existing contracts and conclusion of new ones.

In rem property rights

All *in rem* property rights entered in the land and mortgage register pass along with ownership of the real estate. The buyer must accept that, for example, transmission lines for utilities leading to other properties will continue to pass through the owner's property if a utility easement has been established, but by the same token the new owner can enjoy the benefit of a road easement, for example, previously established by a neighbour.

The property may be acquired encumbered by mortgages. In practice, however, the buyer always pays off the seller's debt out of the purchase price, the existing creditor consents to deletion of its mortgage, and in its place the buyer enters the mortgage in favour of its own bank. Mortgage encumbrances cause more of a practical than legal need to conclude agreements concerning the mortgage, and primarily concerning the agreements secured by the mortgage.

Utilities

With respect to supply of utilities, removal of wastewater, and telecommunications services, the owner of each functional property has agreements in place with the relevant suppliers. They are governed by laws such as the Energy Law, the Act on Collective

Supply of Water and Collective Removal of Wastewater, and the Telecommunications Law. All of these regulations require the supplier to conclude such agreements upon request of the new owner of the real estate. But nothing happens automatically. Each party must comply with the relevant formalities to avoid interruptions in service or payments.

Insurance

Rights under insurance policies may be assigned to the buyer if permitted by the policy or the insurer consents to the assignment. Otherwise, the insurance ends when the property is sold.

Building services

The acquirer of the real estate may wish to continue existing agreements for building management, cleaning, maintenance of green areas, security and so on. Then it is necessary to reach a three-party agreement in which the rights and obligations under the agreement are transferred to the new owner, while releasing the former owner at the consent of the service provider. Or the buyer may prefer to hire a different service provider, and has the right to demand that the existing service provider leave the property.

The liability of the previous owner is another matter. If the agreement was concluded for a definite period or contains provisions on termination with advance notice, and the matter is not resolved with the supplier, the previous owner may face claims for damages by the "evicted" supplier.

It should also be determined whether the agreement with the property manager is a package deal, under which the manager arranged for all services in its own name, or was only authorised to conclude agreements with suppliers on behalf of the owner. In the former case, maintaining the status quo will require only the three-party agreement referred to above. Otherwise, it will be necessary to conclude new agreements with all of the different service providers.

Leases

The essence of transactions on the commercial real estate market is for the buyer to obtain a stream of rental income from the property. Art. 678 of the Civil Code provides that the acquirer of real estate that is leased enters into the lease relationship. The acquirer becomes the landlord by operation of law, and therefore may demand that the tenant pay its rent to the new owner. All that is required is a notice to the tenant of the change in owners.

This is an exception to the rule that an agreement is binding only on the parties that concluded it. This is the difference between personal (contractual) obligations and *in rem* obligations, which are binding on whoever is the owner of the property at any given time. Because entering into the lease relationship is an exception to the rule, it may not be interpreted expansively. The Civil Code refers to entering into the lease "relationship," not the lease "agreement." The agreement concluded between the tenant and the previous owner may have been called a "lease agreement," but the only provisions of that agreement that will be binding on the new owner are those that shape the lease relationship. None of the other provisions will be binding on the buyer without an express statement to the tenant that the new landlord wishes to assume them.

The document which includes the lease agreement may govern numerous other matters unrelated to the lease relationship or only indirectly related to it. These provisions are not binding on the buyer. An example would be lease extension provisions. If they are in the nature of a preliminary agreement which is unilaterally binding, then this is not an element that shapes the lease relationship, but only concerns a future lease agreement. The tenant will not have a claim against the new owner to conclude another lease agreement, because the new owner did not undertake this obligation to the tenant. To assure that such undertaking continues, the new owner must submit a statement to that effect. The same may apply to a clause in the lease under which the lease term may be extended under the same conditions pursuant to a unilateral notice by the tenant. Such a clause is in the nature of an offer to amend the lease agreement. But if at the time the notice of extension of the lease term is submitted the owner is different from the one who made the offer, it may be concluded that the new owner is not bound by the offer which was made by the prior owner and not yet accepted at the time of the sale.

Unless expressly released, the previous owner remains responsible to the tenant for all obligations that are not elements of the lease relationship. Similarly, the obligations of the tenant which are included in the lease agreement but are not an element of the lease relationship may not be enforceable by the new owner. These issues require particular attention before deciding on the purchase.

The new owner has the right to terminate a lease agreement concluded for a definite term, but the tenant will be protected against termination if it holds an agreement with a certified date. Any tenant may at any time obtain a certified date by presenting the lease agreement to a notary. This action does not require notice to the other party, and thus the new owner can never know for sure whether the termination will be effective. One instrument often used to secure the landlord's claims for rent is to obtain a voluntary submission to enforcement, i.e. an undertaking in a notarial deed that can be executed directly from the notarial deed. It cannot be ruled out that in the event of a dispute, the court might find that making a voluntary submission to enforcement of obligations under the lease agreement referred to in the notarial deed also fulfils the requirements for obtaining a certified date with respect to the lease agreement—thus protecting the tenant from termination of a lease for a definite term.

Security for rent and other payments

Rent and other payments due under a lease agreement are secured by a statutory lien on movables brought into the leased premises by the tenant (Civil Code Art. 670), and they may also be secured by a bank guarantee, a third-party guarantee, a security deposit, or a voluntary submission to enforcement. It is clear that the statutory lien under Civil Code Art. 670 does not need to be assigned to the new owner. The same is true of a voluntary submission to enforcement. Art. 788 §1 of the Civil Procedure Code enables the new owner to obtain an enforcement clause for the voluntary submission to enforcement upon presenting an official document showing that the claim has passed to the new owner. This will not be difficult, because real estate is acquired through a notarial deed, which is treated as an official document.

A third-party guarantee of the tenant's obligations may also be enforced by the new owner. It is accepted that a contractual assignment of a claim results in assignment of a third-party guarantee of the claim, and thus passage of the claim by operation of law also has this effect. But this conclusion does not automatically apply to a bank guarantee or insurance guarantee. Art. 82 of the Banking Law provides that the claim under a bank guarantee may be transferred only together with the secured claim. This does not mean that the claim cannot be assigned without also assigning the security of the bank guarantee.

Unlike a third-party guarantee, a bank guarantee is not treated as an accessory obligation. Therefore, entering into the lease relationship and assumption of a claim for payment of rent and fees does not automatically cause assignment of the rights under a bank guarantee. This requires additional legal actions. Depending on the wording of the bank guarantee, this could be either an assignment by the previous owner or a new bank guarantee issued at the instruction of the tenant.

Here we have only signalled the great array of issues that may arise upon sale of rental property. These issues are complicated further when the acquisition is structured as sale and leaseback or finance leasing. Then the entry into the lease relationship by the buyer (the financing party) causes certain difficulties, making it necessary to conclude a number of additional agreements requiring the cooperation of the tenants.

Examination of reprivatisation claims

Finally, the need to examine reprivatisation claims must be mentioned. Such review is justified only in the case—rare nowadays—in which the property is being sold by a state enterprise or cooperative. If the ownership or perpetual usufruct of the property has been transferred in the past and at the time of transfer no claims were disclosed in the land and mortgage register or known to the buyer, the acquisition occurred in good faith. Then the buyer is protected by the warranty of public reliance on the land and mortgage register. Even if reprivatisation claims were made and were fully justified, they will not present a threat to the buyer. The claims of the former owners will be satisfied by the state in the form of damages.

In order to maintain good faith, it is sufficient to examine the land and mortgage register. The buyer is not required to search through ministerial or municipal archives. Notwithstanding these rules, investors often request detailed research, and Polish lawyers enthralled by practices from Anglo-Saxon legal systems carry out unnecessary tasks, increasing the time and effort required to handle the transaction.

Stefan Jacyno, adwokat*, is the partner in charge of the Real Estate & Construction Practice and the Reprivatisation Practice.*

Current challenges in trademark disputes

Dr Monika Żuraw-Kurasiewicz

Trademark litigation is increasingly common in Poland. There is not such a long history and wealth of case law in this area in Poland as in some other European countries, and the number of cases reaching the courts, particularly the civil courts, is relatively small, but they are no longer the novelty they were just a few years ago.

Trademark law is notable for its flexibility of interpretation. Grounds for infringement such as risk of confusion, dilution of the distinguishing power of a mark,

or unjustly benefitting from the renown of a mark require elucidation. Even the similarity between trademarks and goods is difficult to determine objectively. This is why it is mostly left up to the courts to determine the boundary of protection, i.e. the line where the exclusivity of the holder of a mark ends and the freedom of third parties to use somewhat similar marks begins. The courts determine whether a specific use is infringing. The legal interpretation of such concepts as risk of confusion, renown of a trademark, or the similarity between two brands, is most often drawn from the court's intuitive understanding.

Trademark law is developing rapidly. It is unnecessary to amend the regulations in order for the holder's rights to be modified significantly. Certain trends may be observed in the case law—either toward a broad designation of the area of protection of a trademark or toward a narrowing of the scope of protection, to the benefit of third parties and freedom of competition generally. The case law in Poland and at the EU level now appears clearly to be following the latter path. This means that it will be harder for holders of trademarks to receive protection, as the similarity between brands, risk of confusion and infringement of renown are less likely to be found.

Two tracks for proceedings

Trademark cases are resolved in Poland by administrative courts and civil courts. Administrative disputes involve trademark registration, typically seeking to cancel the registration of a trademark because it conflicts with earlier rights. Civil courts resolve disputes seeking protection of trademarks when a third party uses a trademark which the plaintiff alleges infringes its exclusive rights. The dual system of protection adopted in the Polish legal system does not encourage consistency in the case law and often makes it harder for the holder to enforce its rights. Proceedings must be conducted on two tracks, which duplicates the cost because the disputes are separate. Cancellation of a registration is not the same as a prohibition against using the mark, and conversely, winning a civil dispute does not affect the validity of the registration of the mark.

The courts accent the independence of these legal regimes. They often stress that a dispute over registration of a trademark may come out differently than a dispute over use of a conflicting mark, because the barriers to registration of a mark are analysed from a different perspective than infringement of a mark by use of a conflicting mark. In an administrative proceeding, the mark is evaluated in the form in which it was filed, while a civil dispute evaluates the manner in which it is used, together with many other circumstances surrounding the use.

It was only recently held that the mere fact that a mark is registered does not necessarily mean that when it is used in trade it will not infringe another mark (*Okpol,* Supreme Court of Poland judgment of 23 October 2008, Case No. V CSK 109/08). Rarely do the civil courts see any reason to wait for the result of administrative proceedings before issuing a judgment. In practice, however, they do follow the guidelines from the rulings by the administrative courts, and therefore the result of one dispute may influence another dispute decided shortly afterward. A continuing complaint about both types of proceedings is their duration and the possibility that the same matter may come before the administrative authority or court of first instance multiple times. Decisions and judgments at the first instance are often set aside on appeal due to procedural errors, not necessarily because of erroneous findings on the merits.

Narrowing scope of protection

There is a perceptible trend in the Polish case law toward narrowing the scope of trademark protection. Not long ago the Polish courts found that the user of the Velux trademark infringed the Okpol trademark when only the graphics of the marks were similar (Case No. V CSK 109/08). In a case involving the Mastercook trademark for seasonings, there was held to be a risk of confusion with the Vegeta mark when there was only a general similarity in the packaging, including the colour scheme, but the specific elements, including the verbal mark, were different (Supreme Administrative Court judgment of 12 October 2010, Case No. II GSK 849/09). In more recent cases, the courts have looked sceptically at claims of similarity between marks and goods, often finding that the similarity is too minor to cause a risk of confusion.

Verbal designations continue to play a dominant role. Even strikingly similar graphics need not result in a finding of infringement when the verbal element is somewhat different. On the other hand, graphic elements may be regarded as excluding the similarity of combined marks even when the verbal elements are quite similar.

It is also harder to obtain protection for renowned trademarks. The rules applied by the Polish courts correlate to the latest rulings from EU courts in which the same degree of similarity between the marks is required as in the evaluation of the risk of confusion. This means that if there is no risk of confusion, typically it will be held that there is no infringement of a renowned mark. The first stage of the review is to assess the similarity, under the same criteria as for risk of confusion. Under the earlier interpretation, it was sufficient for infringement of a renowned mark if the disputed mark only caused an association with the earlier renowned mark, involving a much lower degree of similarity than in the case of a risk of confusion. The latest case law significantly narrows the protection afforded renowned marks. Nonetheless, in order to find an infringement it is still not required to prove that the act of the third party using the disputed mark caused any actual negative consequences for the renowned trademark, such as diminution of its distinguishing power or renown. Arguments showing that there is a probability of causing such injury remain sufficient.

Factual considerations

The evaluation of infringement of rights to trademarks is a normative evaluation. Whether there is infringement is determined by legal criteria developed in the case law, and not by the factual circumstances. For there to be a risk of confusion, it is not necessary that customers actually choose the wrong product. But recently there appears to be a tendency to evaluate infringement within the context of actual market conditions, such as distribution channels, prices, and differences in quality between similarly marked goods. For example, in one case the regional court held that despite the similarity in marks, there was no risk of confusion because the defendant's goods were sold only in its own chain of stores, while the plaintiff's goods of the same type were not offered by that chain. But the court of appeal correctly held that the use of different sales channels does not eliminate the risk of confusion (see justification to Supreme Court of Poland order of 7 December 2012, Case No. II CZ 152/12). In another judgment, one of the facts found to exclude a risk of confusion was that the products of the plaintiff and the defendant were sold in different sections of the same stores (Warsaw Court of Appeal judgment of 27 August 2013, Case No. I ACa 67/13).

High evidentiary hurdles

Recently there has been an observable heightening of requirements with respect to the evidence presented by the parties in trademark disputes. In both administrative and civil cases, the burden of proving that relief should be granted rests on the holder of the mark. There are numerous facts that must be proved in a dispute. Because the evaluation of whether there is an infringement or a barrier to registration is normative, it generally used to be sufficient to present the circumstances of the dispute, particularly with respect to the use of the disputed mark. But recently there have been more and more judgments issued in which the courts have held that the party seeking protection failed to prove its claims.

Even demonstrating that goods are counterfeit may be a problem. Previously it was enough to submit a justified statement by the holder that the goods bearing the disputed mark were not produced by the holder. Now the courts sometimes seek to confirm this through court-appointed experts. When issuing their opinions, the experts in turn must use information provided by the plaintiff. Appointment of an expert is therefore most often unnecessary, and it drives up the costs of the proceeding. And although this is not a dominant trend, there are examples where the expert is asked to determine whether there is a risk of confusion in the specific case, even though, as mentioned above, under trademark law the risk of confusion is a legal issue, not a factual issue.

Market research as a form of evidence

Given the heightened evidentiary demands, the parties increasingly conduct market research to help prove their case. Previously, research was usually aimed at demonstrating the degree of familiarity with a trademark among Polish consumers and the renown of the mark. Evaluation of the risk of confusion as such—as a normative evaluation—was left to the court. Now, for purposes of trial, research is conducted on whether actual mistakes could be made by consumers. Such evidence, most often submitted by the plaintiff, is considered by the judge along with all the other evidence in the case.

Carefully conducted market research most often confirms the evaluation of the case made on the basis of theoretical criteria. From this perspective, market research may be regarded as unnecessary and as needlessly increasing the costs of the proceeding. On the other hand, the findings may effectively rebut the defendant's argument that the plaintiff failed to prove its case. The practice of using such market research is relatively new and the rules for evaluating it have not yet developed.

In summary, it may be said that trademark disputes are not easy cases to conduct in Poland. It is necessary to present extensive argumentation and a great deal of evidence. The case law is not uniform, but to an increasing degree it does follow the case law from EU courts. The difficulties should not discourage holders from seeking protection for their trademarks. A victory usually has preventive value and helps eliminate similar infringements, while failure to react to infringement of the trademark or registration of a conflicting mark may threaten a loss of rights to the trademark or a reduction in the scope of protection of the mark.

Dr Monika Żuraw-Kurasiewicz, legal adviser, is a member of the Intellectual Property Practice.

How will the investment funds market look after implementation of the AIFM Directive?

Marcin Pietkiewicz

The principle of the free flow of services on the European investment funds market is spreading to include a growing range of investments. The rules for operation of open investment funds (UCITS) have been harmonised at the EU level, as have, more recently, the rules for alternative funds. 2014 should see implementation in Poland of the Alternative Investment Fund Managers Directive (2011/61/EU), enabling cross-border operation of entities managing a wider range of funds than UCITS.

EU regulations of the investment funds market may be divided into those governing "undertakings for collective investment in transferable securities" (UCITS) and those governing "alternative investment funds" (AIFs).

UCITS are open funds which redeem participation units upon request from the holders, using the assets of the fund, which is possible because the funds invest in liquid financial assets on the basis of diversification of risk. The EU market for UCITS-type funds has been unified through a series of directives, the most recent iteration of which is UCITS IV (2009/65/EC). UCITS IV was implemented in Poland through a March 2013 amendment to the Investment Funds Act.

AIFs include a range of funds that do not meet the criteria to qualify as UCITS but raise capital from investors with the intention of investing it in line with a specific investment policy in order to generate returns for the investors. The process began in 2013 of unifying the regulations of the member states governing the operation of alternative funds, which take various legal and organisational forms which previously had not been the subject of uniform regulation in the EU. Previously, there was a lack of uniformity on the possibility of offering participation in such investment vehicles in member states other than the one where the fund was based. The deadline for implementing the AIFM Directive was 22 July 2013. Poland is one of a group of member states that failed to implement the directive on time.

Investment funds under Polish law

Polish law distinguishes among three basic types of investment funds: open investment funds (FIO), specialised open investment funds (SFIO), and closed investment funds (FIZ). Under EU law, the first category, open investment funds, qualify as UCITS-type funds. The anticipated implementation of the AIFM Directive in Poland will bring establishment, management and marketing of closed investment funds under the AIFM rules.

In September 2013 the guidelines were published for an Alternative Investment Funds Management Act in Poland. Although the details of the proposal may change before the act becomes law, the guidelines show the approach Polish lawmakers intend to take in implementing the AIFM Directive.

After implementation of the AIFM Directive, what will be an AIF?

The AIFM Directive defines alternative funds in terms of their activity, which is to "raise capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors." As in the case of UCITS, the issue of the legal form of AIFs is left up to the member states to determine.

While there was no doubt during implementation of UCITS IV that Polish open funds would qualify as UCITS, it is unclear now which Polish funds will be regarded as AIFs. Closed investment funds will be treated as AIFs, but there is a question whether specialised open investment funds will be treated the same way. Based on the guidelines for the AIFM Act, SFIOs will probably be counted as AIFs because of their similarity to FIZs in terms of the possibility of introducing limitations in their charter concerning the persons eligible to purchase participation units in the fund, as well as restrictions on redeeming participation units.

New opportunities for sale of foreign AIFs in Poland

Currently, activity involving collective investment of funds raised from investors through offers to participate in such ventures may be conducted in Poland either by investment funds established pursuant to the Investment Funds Act or by foreign open-end funds notified to the Polish Financial Supervision Authority under the rules of UCITS IV. Other foreign investment funds are not allowed to offer shares or units to investors in Poland—except for situations where the products are regarded as securities and are offered under an approved prospectus, or where they are sold solely at the initiative of an investor from Poland and not in connection with any offering by the fund directed to investors in Poland.

The AIFM Directive will bring major changes in this area. AIFMs which are licensed to operate in their home member state will be able to offer units or shares of the funds they manage upon notification of the Financial Supervision Authority (via the regulator in their home member state), under AIFM Directive Art. 32. The notification procedure will enable foreign AIFMs to offer units or shares to professional investors (such as banks and investment funds). The use of this procedure should be regarded as permissible now for foreign funds recognised as AIFs in their home member states, based on the principle of direct effect of directives as set forth in a long line of case law from the European Court of Justice. A condition is to carry out the notification procedure based on Art. 32 in the home jurisdiction.

The AIFM Directive provides that a member state may permit units or shares of AIFs from other member states to be marketed to retail investors in that member state. Based on the guidelines for the proposed AIFM Act, it appears that Polish lawmakers will take a conservative approach to this issue and not expand the possibility of offering units or shares in alternative funds to retail investors under the same rules as they could be offered to professional investors.

TFI compliance with AIFM rules

As it is proposed that Polish investment fund companies (TFIs) could be regarded as alternative investment fund managers, existing TFIs which manage funds that will be treated as AIFs (for example, closed investment funds) will be required to adjust their operations to comply with the new requirements, and will be required to apply for a licence to operate as an AIFM. The directive requires entities such as TFIs to bring their operations into compliance by 22 July 2014. Because of the delay in implementation of the AIFM Directive in Poland, the drafters of the proposal for the AIFM Act decided not to use the deadline of 22 July 2014 but instead to give TFIs a grace period of one year from actual implementation of the directive. During this time, TFIs would have to apply to the Financial Supervision Authority for a licence to operate as an AIFM.

The requirement for existing TFIs to apply for a new type of licence may raise certain practical concerns on the investment market. In an extreme case, a TFI which did not obtain a licence to operate as an AIFM would have to cease managing funds regarded as AIFs. An alternative for a TFI which for whatever reason did not obtain an AIFM licence would be to continue operating on the basis of the existing licence, but it would not be able to exploit certain opportunities provided by the AIFM Directive (such as the ability to notify its intention to sell units in other EU member states).

Moreover, under the AIFM Directive, managers of AIFs with small portfolios (less than EUR 100 million) should be exempt from most of the requirements of the directive. Such managers should be able to operate on the basis of an entry in the register of managers, without having to obtain a licence. But based on the proposal for the AIFM Act, Polish TFIs will not be allowed to enjoy this exemption, regardless of the size of their portfolios.

The approaching implementation of the AIFM Directive will bring with it a number of challenges and may introduce major changes in the structure and functioning of the non-public market for collective investments in Poland. The first sign of this is breaking the monopoly of Polish closed funds, which had restricted the offering of foreign non-UCITS funds in Poland. Now managers from other member states can offer AIFs to professional investors in Poland. The other changes are soon to come.

Marcin Pietkiewicz, legal adviser, is a member of the Capital Markets and Financial Institutions practices.

Liability in damages of public authorities

Krzysztof Wiktor Leszek Zatyka

The financial liability of a public authority for injury caused by its functioning has evolved over the past several decades. These changes are headed in the direction of expanded liability of the State Treasury and territorial governmental units—and thus at least theoretically an improvement in the legal position of injured parties.

The State Treasury and territorial governmental units are the largest legal entities in Poland. They are present in nearly every sphere of life and the activity of individuals and companies. On one hand, they exercise administrative authority, but on the other hand they sometimes act as parties to ordinary civil transactions. In this article we will address the liability of these entities connected with their exercise of public authority.

The State Treasury performs authoritative functions through legislative power (enacting laws), executive power (including issuance of administrative decisions), and judicial power. Territorial governmental units exercise public authority primarily through executive power, and to a lesser extent legislative power (acts of local law).

A violation of the rights of a private person could occur in any of these branches of power, resulting in a financial injury to the private person.

Business entities are perhaps particularly susceptible to the consequences of defective actions by public authorities. They come into contact with representatives of public authority at every step—for example, when carrying out construction projects (obtaining planning permission and building permits from local

government authorities), when importing goods (customs officials), and during tax audits (tax authorities).

An application to the public authorities for issuance of a decision, permit, licence or approval is usually preceded by long preparations; expenditures are made by the private party, and sometimes credit agreements are concluded or other financial obligations are undertaken.

An unlawful administrative decision may effectively block a transaction or project that has been in preparation for some time, and cause a loss of financial liquidity for the enterprise or even force it into bankruptcy or liquidation. There are well-known instances in Poland where major firms—leaders in their fields—have gone bankrupt when erroneous decisions by tax, customs or prosecutorial authorities put them out of business. Questionable decisions by the public authorities in such cases often generated negative reports about the companies in the media, and their reputation among suppliers and customers suffered as a result.

There have also been cases where administrative proceedings have dragged out for an inordinately long period, during which time changes occurred (in the condition of the enterprise, in the market, or in the applicable legal regulations) which rendered the project no longer feasible for financial or practical reasons.

Laying the groundwork

Businesses do not always realise that redress may be available for injuries caused by wrongful acts of public authority. If they had this awareness, they could take steps to secure their future claims for damages.

One such measure is to obtain a finding that the ruling or decision was not in compliance with the law. Such a finding—in the form of either an administrative decision or a judicial ruling—will establish the precedent that will serve as the basis for obtaining damages. In order to secure the claim, it is also important to prepare and maintain the relevant documentation, expert reports and other information on a current basis, because this may be difficult or impossible to obtain later, at the stage of asserting the claim for damages.

The failure to take steps early on to lay the groundwork for the claim may prevent or seriously hinder efforts to obtain damages in the future, even when it is clear that there was an injury.

Scope of liability of public entities

The scope of liability of public entities is set forth in the Civil Code and (with respect to injuries arising prior to 1 September 2004) the Administrative Procedure Code. This scope has changed over the past few decades, and has come to include a wider range of acts of public authority.

The direction taken by these changes is influenced by the increasing democratisation of the country, but also by the line of precedent that has developed through rulings by the Supreme Court of Poland and the Constitutional Tribunal, particularly in connection with reprivatisation.

Public entities are liable for an injury caused by an act or omission in the exercise of public authority which is inconsistent with the law. "Inconsistent with the law" in this sense is understood to mean contrary to specific regulations of law, and thus is equivalent to the term "unlawful."

A public authority is liable for the full amount of the injury, that is, in the form of actual injury as well as lost benefits.

"Actual injury" is understood to mean a diminution in assets or increase in liabilities, and thus out-of-pocket costs, expenditures and losses which the injured party incurred in connection with actions taken toward implementation of the planned project. Injury in the form of lost benefits results from the failure to realise the planned project. The injured party may expect compensation for injury in the form of the lost profit which it could have counted on if the project were carried out.

The most frequent cause of injury connected with acts of public authority is issuance of a defective final administrative decision or defective legally final judicial ruling. Redress of such injury may be sought once the decision or ruling has been held in the relevant proceeding to be inconsistent with the law.

For example, a developer may suffer an injury if it has incurred expenditures on construction of a residential development based on a building permit it has been issued, but subsequently it is held in an administrative proceeding that the decision issuing the building permit was invalid. Then the investor may seek reimbursement of the costs it has incurred as well as the lost benefits from failure to sell the units within the planned time.

A developer will also suffer an injury if the administrative authority does not issue planning permission or a building permit within the time provided by law (due to delay), or fails to issue it at all despite the existence of the legal grounds to issue it. In this case as well, the investor could seek redress in the form of the costs incurred and lost benefits—after obtaining a finding in the relevant proceeding that failure to issue the ruling or decision was inconsistent with the law.

The rarest and most difficult example is where the injury occurs due to issuance of a normative act (regulations of law). Then redress may be sought only after it has been held in a proceeding before the Constitutional Tribunal that the act is inconsistent with the Polish Constitution, a ratified treaty or a statute. There are also very few instances of seeking redress of an injury caused by failure to issue a normative act when there is a legal requirement to issue it. The unlawfulness of non-issuance of a normative act is confirmed by the court hearing the case seeking redress of the injury.

The injured party must always demonstrate a causal connection between the injury and the wrongful act or omission by the public authority. The public authority will be liable when, if not for the wrongful act of the public entity, the injured party would have carried out the project and gained the anticipated income.

It should also be borne in mind that a public authority is liable only for the ordinary consequences of the act or omission which gave rise to the injury. The amount of the injury may be limited if the injured party itself caused or aggravated the injury.

In the judicial proceeding, the injured party must also prove the amount of the injury, and must prove the unlawfulness of the act or omission of the public authority by showing the specific regulations of law that were violated.

There is no way to count the number of instances in which an erroneous act of a public authority prevented a project from being carried out or caused the investor to become insolvent or enter bankruptcy. But the growing number of court cases seeking redress of injuries caused by the functioning of public authorities demonstrates that the problem is widespread.

Educational upside

The instructional aspect of enforcement of rights through the courts should also be mentioned in this context. The more businesses demand redress of injuries caused by wrongful acts of public authority, the more carefully public officials will comply with the law and the applicable procedures. The Act on Financial Liability of Public Officials for Gross Violation of Law of 20 January 2011 should be helpful in this respect. Under that act, a public official is liable for an injury caused by the official in the exercise of public authority. As a condition for such liability, it must be found through a judgment or administrative decision that the law was violated, the act of the public official was wrongful, and a public entity had to pay damages to the injured party accordingly.

A side effect of claims for damages against public authorities may be the development of more predictable and user-friendly conditions for doing business in Poland. Such claims are, after all, a legal form of pressure on public institutions (and directly on public officials) to comply with the laws ultimately enacted by the state itself.

The courts look more favourably now than they once did on those who seek damages from public authorities. Just a few years ago, such cases were largely condemned to failure. Now the state courts understand better that public authorities may cause financial losses to private entities through their acts or omissions. In a free-market economy, this can have a negative impact on the commercial interests of the state.

Krzysztof Wiktor, legal adviser and partner, co-heads the Reprivatisation Practice.

Leszek Zatyka, legal adviser, is a member of the practice.

So much ventured, nothing gained: Bidding as a consortium in a tender

Mirella Lechna

A contractor may bid in a public tender if it meets all the prequalification requirements. But one company alone may not have the required experience or staff—particularly on major, multi-phase development projects, e.g. using a public-private partnership model, where the contracting authority sets appropriately high conditions for participation in the tender.

Then it is necessary for the contractor to team up with one or more bidders which together make up for one another's shortcomings. A foreign contractor may also wish to cooperate with a local partner because of the benefit it will gain from the local partner's knowledge of the legal and business environment of the market where the project is to be carried out.

Contractors may cooperate in any form. Since Poland's Public Procurement Law was amended in 2009, the conditions for participation in a tender may be fulfilled not only by use of the contractor's own resources, but it may also rely on resources "borrowed" from another contractor.

When deciding on the bidding structure, the contractor generally has the following options to consider: to join the tender as a sole bidder and seek reinforcement in the form of subcontractors at the execution stage, or if the bidder does not meet the conditions for participation in the proceeding by itself, to rely in the offer on potential subcontractors who will be available to the contractor at the implementation phase. Or a consortium may be a formed—a creature made up of several firms which does not have a separate legal personality but is treated under the public procurement regime as a single contractor. Then the experience and potential of all the members of the consortium are added together, which raises the qualifications of such a contractor in the assessment of its capacity to perform the contract.

Experience shows that the bidder's selection of a partner for the tender is often made somewhat spontaneously. The determination of the members of the group that will submit a joint offer is dictated by the desire to achieve the best possible result at the stage of prequalification for the tender. The deciding factors are the portfolio and renown of the candidate and the desire to gain experience as a contractor on a huge project. These two aspects make firms eager to form consortia to join tenders.

But what are the consequences? From the moment they submit a joint application or offer, the consortium partners are bound to cooperate with each other, often for a long time. Their individual business decisions must reflect not only their own interests, but also the interests of their partners, and in many cases this requires great effort to work out a consensus. The Public Procurement Law generally does not permit a change in contractors. Once a consortium is formed, the composition of the consortium will remain unchanged until performance of the contract is completed.

When a consortium is created

No agreement must be concluded for bidders seeking a public contract to form a consortium. The consortium comes into being by filing a joint request to participate in the proceeding or by filing a joint bid. The contracting authority may request that a consortium agreement be presented only after selection of the bid and prior to conclusion of the public contract. Moreover, it should be stressed that the law does not specify any requirements for the content of a consortium agreement. It thus may be worded very generally, merely describing the basic rules for the parties' cooperation. Sometimes business partners just decide to join a tender proceeding, and without agreeing on any other terms, sign the application or bid and wait to see how events unfold.

This is a particularly dangerous situation when the consortium is taking part in a two-stage proceeding. This procedure encourages bidders to agree on only rough, preliminary terms at the stage of filing requests to participate in the proceeding, while leaving agreement on the detailed terms of the cooperation to the later stage, after the consortium is shortlisted or even after selection of the consortium's bid. This approach may seem rational from a business perspective (minimising cost and effort at a stage when it is not certain that the consortium members will win the contract), but from a legal point of view it generates many risks.

In preparing for joint performance of a contract, there are several aspects which may stand in the way of achieving unanimity. Up until the signing of the public contract, failure to maintain unanimity within the consortium will destroy the chances of winning the contract.

Joint and several liability

As all of the members of the consortium jointly seeking a public contract are regarded by the contracting authority as a single contractor, they are jointly and severally liable to the contracting authority for performance of the contract. This means that any of them may be held liable if the contract is not properly performed, and could be required on this basis to pay the contracting authority a contractual penalty or damages. The contracting authority may demand performance of the entire contract by any partner or partners of the consortium it chooses, regardless of the internal arrangements among the members of the consortium concerning the division of tasks and responsibilities.

Even though a recent amendment (from 2012) to the regulations governing cooperation in the form of a public-private partnership eliminated the joint and several liability of consortium members, the attachment to this approach on the part of contracting authorities means that in practice it should realistically be assumed that joint and several liability will be provided for in the project through the terms of the PPP agreement.

As a consequence, smaller partners, or those that are to perform only a small part of the contract, seek assurances from the other members of the consortium that they will not have to commit greater resources to performance of the contract than necessary to perform the tasks assigned to them. From a commercial point of view, such a partner may not play a major role in performance of the contract, or could even be replaced by a subcontractor. Nonetheless, until the entire contract is performed, such a consortium member will remain jointly and severally liable to the contracting authority, and therefore it will demand some security for its interests from the other consortium members. In extreme cases, this could even take the form of seeking a bank guarantee equal to the overall value of the contract. Such security, especially if granted for a long period, will significantly increase the cost of performance of the contract. But if the consortium members cannot agree on security, one or more members may withdraw from the consortium, and consequently the consortium will not be able to continue further in the tender proceeding.

Authorisation

The regulations do not set forth the requirements for the scope of authority which the consortium members must vest in their representative who is the consortium leader. In most instances, several separate powers of attorney are issued as the tender process progresses: a power of attorney for filing of the request to participate, for participation in dialogue or negotiations, for filing of the bid, and, finally, for conclusion of the contract. Under this approach, passage to each successive stage depends on the consortium members reaching another unanimous decision on issuance of the next power of attorney. This in turn encourages the individual consortium members to condition signing of the successive power of attorney on achievement of favourable results in the negotiations concerning other arrangements which must be agreed on among the consortium members.

Changes in ownership of a consortium member

The interests of the consortium may be threatened if there is a change in the ownership structure of a consortium member prior to signing of the public contract. Although such a change would not appear on the surface to affect the tender proceeding, it could effectively prevent the consortium from winning the contract. This is because the situation may arise in which as a result of a change in owners, a consortium partner is objectively incapable of acting, if its existing statutory authorities have been recalled and new authorities have not been appointed. If this is the case as of the date set by the contracting authority for signing of the public contract, and as a result one of the consortium members fails to sign the contract, the contracting authority will find that the consortium has refused to conclude the contract. It will then retain the bid bond paid by the consortium and award the contract to another bidder.

A partner's bankruptcy

The financial reliability of the consortium members is also an important factor for their cooperation. If a bidder is declared bankrupt, it must be excluded from the tender proceeding. This is not changed by the fact that such bidder is seeking a contract as just one member of a consortium. Therefore, if one member of the consortium is declared bankrupt after the consortium has joined the tender but before the contract is signed, the entire consortium will be at risk of being excluded.

For these reasons, a decision to participate jointly in a tender should be taken carefully, and from the very beginning any fundamental differences should be eliminated by concluding a consortium agreement precisely governing the cooperation at every stage of the tender. Over the course of time, any differences may only grow wider, generating conflicts and leading to the breakup of the consortium. The consortium members must avoid situations in which after months of negotiations with the contracting authority and preparations for filing a joint offer, the consortium fails to reach unanimity. Sometimes the only solution is for the individual contractor to take a timely decision to participate in the tender on its own.

Mirella Lechna, legal adviser, is the partner in charge of the Infrastructure, Transport and Public Procurement practices.

Interim manager: An employee or not?

Dr Szymon Kubiak

An interim manager is most often a person with very high qualifications, serving as an outside expert for special tasks, who comes onboard for a strictly defined purpose, such as putting the firm back on its feet when problems grow beyond the control of management. An interim manager temporarily manages the enterprise, a division, or a specific project.

The need to bring in an interim manager arises most often when an organisation (the employer) is carrying out a transformation, for example to handle a crisis, or when the company must make changes but does not have the right people on staff to implement them. Or it may be a simple need to improve the financial results or to restructure employment, or to create something new from the ground up. Projects implemented by interim managers generally last from 3 months to a year.

Interim managers are undoubtedly an elite profession. The profession is the most popular in Germany, where there are about 10,000 interim managers. On the developed market of the UK there are about 5,000–7,000 of them, and in Poland perhaps 200–300 truly experienced people in this field, which began to gain popularity here only quite recently.

The most important things an interim manager offers are experience and characteristics like skill at managing projects and people, independence, analytical skills, assertiveness, the ability to quickly build strong authority and an image as an expert, mobility, entrepreneurship and a goal-oriented attitude. Interestingly, a people-centred approach may actually get in the way of achieving the interim manager's goals in certain projects, such as employment restructuring.

Basis for hiring

The ways in which an interim manager may be hired fall within the broad category of flexible forms of employment. From the point of view of a lawyer practising employment law, the nature and characteristics of the legal relationship between an interim manager and the company where he is performing his tasks deserve some thought. Whether it would be more appropriate to hire the interim manager on an employment or non-employment basis is not so obvious. In my view, however, the most appropriate form of hiring is not an employment contract but a civil-law agreement. There are several reasons that emerge when we analyse the key characteristics of the work or services performed by an interim manager.

- **Personal performance.** This is closely connected with the high individual qualifications which are the main reason for selecting and hiring the specific person. In my view, the interim manager's ability to work through a substitute or assistant seems dubious at best. But this follows more from the crucial importance of his individual characteristics than from the "personal" nature of the work, which is a characteristic of an employment relationship.

- **Pay.** As a rule, the compensation of an interim manager is strictly tied to the requirement to achieve a specific result. A modest fixed monthly component (which is not always present, and sometimes the compensation is paid less frequently than once a month as would be required under the Labour Code) is often much less significant than the bonus he will receive for results, for example calculated as a percentage of the increase in enterprise value upon project completion. Consequently, the compensation of interim managers is on average some 50–100% higher than that of managers hired as permanent employees. The contract with the interim manager usually sets a strictly defined goal (e.g. increasing sales or margins to a certain level within a certain time). Customarily the interim manager reserves the right in the contract to have a final say on the instruments to be used to achieve the agreed result. Therefore it should be recognised that an interim manager directly bears the economic risk associated with the tasks he performs, which is impermissible in an employment relationship.
- **Definite term.** By definition, cooperation with an interim manager is established for a fixed period determined in advance, during which time the interim manager is to perform strictly defined tasks. The interim manager may devote his downtime between jobs to seeking the next project or, for example, pursuing personal interests. This is a feature that is shared with an employment contract for a definite period or a contract to perform specific work.
- **Subordination.** In the case of interim managers, we may say that they are subordinated not so much in the sense of the classic, strict employment subordination (which is an essential characteristic of an employment relationship), but rather of "autonomous subordination," which is permitted, according to rulings by the Supreme Court of Poland, particularly when a member of the management board is hired on the basis of an employment contract. Although the range of decision-making discretion left to an interim manager is usually broad, this generally does not imply that he is assuming total management of the enterprise with no supervision whatsoever. It may thus be recognised that the autonomy of an interim manager, extending beyond the subordination found in an employment relationship, is an inherent feature of the work performed by an interim manager.
- **Working time.** Under the current regulations of the Labour Code, there is no system of working time ideally suited to the rigorous requirements of the work of an interim manager, who often works far longer hours than normally allowed by the code. This may seem surprising in light of the exceptions in the code for employees managing the workplace on behalf of the employer, but even these employees may not work constantly, for limitless hours, in violation of the mandatory periods of rest required by the Labour Code. It is not unheard of for an interim manager to work nearly 24/7 in extreme cases.

It cannot be ruled out that an interim manager could be hired on the basis of a properly structured employment contract, but using a civil-law agreement would be more appropriate in my view. The decisive factors are the greater flexibility and freedom of the parties when drawing up a civil-law agreement, which usually better suits the nature of the work performed by an interim manager than an employment relationship. But this solution is not entirely risk-free, as may be seen from an analysis of the case law, particularly concerning reclassification of civil-law managerial contracts concluded with management board members.

The demands of today's dynamic, knowledge-based economy lead to the use of a broad array of legal arrangements for the performance of work or services by interim managers. These include other forms, such as hiring the interim manager as a temporary employee and lending him to the enterprise, various forms of outsourcing, and self-employment.

Advantages of interim managers

In summary, there is certainly no cause to fear this method for supporting management which is innovative in Poland. As demonstrated by the experience of numerous companies, in most cases scepticism has quickly given way to enthusiasm when they see the results.

How can interim managers be so effective? Managers who have been employed at the company "forever" always owe their position to some extent to their survival skills, and they are closely wed to the employer-employee relationship. Trapped in the corporate mindset, they simply may not notice issues that are vital to the success of the organisation.

In order to overcome any mistrust, when hiring an interim manager, the employer may also secure its own interests, for example through a confidentiality agreement or a non-competition agreement. Given the brief duration of the projects implemented by interim managers, the question arises whether it would still make sense for the interim manager to commit to a project under such restrictions, and what liability the interim manager might face for breaching such an agreement. But that is a topic for another article.

Dr Szymon Kubiak, legal adviser, is a partner in the Employment Law Practice.

Antitrust risks in franchise agreements

Sabina Famirska

Franchising is one of the most popular forms of distribution in Poland. According to figures from the Polish Franchise Organisation, there were about 930 franchise chains operating in Poland in 2013 and more than 54,000 franchise locations. But the decision by the Office of Competition and Consumer Protection of 25 June 2013 in the *Sphinx* case raises the issue of whether the strong commercial ties between franchisor and franchisees present such a great threat to competition that they call into doubt the purpose of the venture.

Under Polish law, franchise agreements fall within the group of miscellaneous contracts. Franchise agreements as such are not defined in the Civil Code or elsewhere in current law. However, competition regulations do define a "franchise distribution system." The Regulation of the Council of Ministers of 30 March 2011 on Exclusion of Certain Types of Vertical Agreements from the Prohibition of Agreements Limiting Competition defines this as a system of distribution in which the distributor directly or indirectly undertakes to resell goods purchased from the supplier covered by a vertical agreement, using intellectual property rights or knowhow provided by the supplier for consideration.

Under EU law, there are highly developed guidelines governing franchise distribution, but the European Commission's approach to franchising has changed over the past few decades. In the 1980s the Commission strongly signalled the distinct nature of this form of distribution by issuing a separate act governing it—Commission Regulation (EEC) No 4087/88 on the application of Article 85(3) of the Treaty to categories of franchise agreements. The regulation was devoted exclusively to this form of commercial cooperation, but it expired at the end of 1999 and was not renewed. Over time, it was recognised that franchising could be treated like any other form of distribution and does not require a separate regulation. Now the specifics of franchising are addressed in the Commission's Guidelines on Vertical Restraints (2010) and in the case law.

What is permissible for the franchisor

Notwithstanding this historical evolution, it is undoubted that franchising is a form of distribution presenting clearly distinctive features. One characteristic feature is the close cooperation between the creator of the network (the franchisor) and the members of the network (the franchisees), and the uniform method of distribution of goods or services throughout the network. The franchisor provides the franchisees certain rights, but at the same time imposes on them an obligation to operate in compliance with the franchisor's concept and business model. As a rule, the franchise agreement includes a requirement to use a uniform name and logo and to assure that the location has a consistent look, while the franchisor supplies the franchisee with knowhow (although the Polish definition of "franchise distribution system" does not necessarily require that knowhow be provided—intellectual property rights are an alternative), as well as ongoing commercial and technical assistance over the duration of the agreement.

It is accepted in the Guidelines on Vertical Restraints that the sharing of intellectual property rights and knowhow justifies the use of a number of contractual clauses limiting the franchisee's freedom to a certain extent. These restraints are designed to protect the joint venture and to ensure close cooperation between the members of the network.

Therefore, provisions are permissible requiring the franchisee not to engage in any similar business (generally permitting the use of a non-competition clause in the franchise agreement), or imposing on the franchisee an obligation not to disclose to third parties the knowhow provided by the franchisor if it is not in the public domain. The franchisee may also be required to communicate to the franchisor any experience gained in operating the franchise and to grant the franchisor and other franchisees a nonexclusive licence to use the knowhow resulting from the franchisee's experience. The franchisee may be prohibited from using the knowhow licensed by the franchisor for purposes other than the operation of the franchise. The Commission also permits imposing obligations on the franchisee:

- To inform the franchisor of infringements of licensed intellectual property rights
- To take legal action against infringers or to assist the franchisor in any legal actions against infringers
- Not to assign the rights and obligations under the franchise agreement without the franchisor's consent.

However, the Commission has indicated that the franchise agreement may not contain restraints on competition with the same subject matter as vertical agreements which do not fall under the Block Exemption Regulation—for example, setting minimum resale prices.

Consequently, the most serious, "hardcore" restrictions, particularly setting minimum or fixed resale prices, will generally be evaluated the same as under other distribution agreements. Any contractual provisions concerning the retail prices of goods will generate significant antitrust risks. For consumers accustomed to uniform prices of goods sold across the same franchise chain this may be difficult to accept.

The question also arises whether different rules should be applied to chains in which the distribution of goods occurs partially within a franchise network and partially through the supplier's own network (as is the case, for example, with McDonald's restaurants). So far the answer is no. Chains of this type must anticipate that attempts to set retail prices may draw a strong response from the competition authority.

The view from Warsaw

In the *Sphinx* decision, the President of the Office of Competition and Consumer Protection took a positive view of franchise distribution systems, but also stated that this view "in no way releases the undertakings from the prohibition against setting fixed or minimum resale prices, which are absolutely prohibited." However, the regulator did not rule out the theoretical possibility that certain ancillary restraints in distribution agreements could be accepted if the clauses are objectively and directly related to and necessary for establishing and operating the franchise and achieving the purposes of the franchise.

Although the *Sphinx* decision did not address the issue, it should also be assumed that certain contractual provisions could enjoy an individual exemption from the general prohibition on anti-competitive agreements, under the procedure set forth in Art. 8 of the Competition and Consumer Protection Act of 16 February 2007. To obtain such an exemption, it is necessary to demonstrate the positive effects of the limitation, particularly of a pro-consumer nature. This option is of very limited relevance in practice, as the approval of necessary restrictions or recognition of an individual exemption is rarely applied, and the bar is set very high for any undertaking seeking to rely on this legal possibility.

It was stated in the *Sphinx* decision that as in the case of ordinary distribution, it would be permissible in franchise networks to recommend non-binding resale prices or to set maximum prices, so long as they were not *de facto* minimum or fixed prices. It appears that current law enables reliance on the use of maximum prices in franchisor-franchisee relations, which allows for closer control of resale prices charged by franchisees while generating only a limited antitrust risk under this precedent. This would nonetheless require a case-by-case analysis, particularly in terms of the market share of the franchisor and franchisees.

It should also be pointed out that so far franchising has not attracted very much attention from the Polish competition authority, and few administrative decisions have been issued concerning this form of distribution. The decisions that have been issued concern price arrangements with respect to setting retail prices within a franchise network, and in all of the decisions it was consistently assumed that any type of attempt by the franchisor to influence resale prices is against the law. But these decisions did not present an extensive analysis of the nature of franchise agreements. They were treated more or less like ordinary vertical agreements between the manufacturer or supplier and the distributor of the goods. The question therefore arises whether in the context of competition law there is some reason to distinguish franchising from other forms of distribution, or that would be a pointless exercise. The answer should be that franchising is distinct. Franchising is a unique form of distribution, different from other types of vertical agreements, which can be clearly identified by reference to Polish and EU law. In practice as well, franchising can hardly be regarded as an ordinary form of commercial cooperation. Clearly the range of permissible behaviour within a franchise network is broader than in the case of other forms of distribution. This involves not only the restraints referred to above which have been accepted by the European Commission, but also other areas of cooperation such as imposing obligations on franchisees in connection with carrying out joint marketing campaigns, or requiring franchisees to provide the franchisor information on their sales volume and turnover.

Sabina Famirska, legal adviser, is a member of the Competition Law Practice.

VAT consequences of transfer of infrastructure free of charge to the local commune

Przemysław Szymczyk

The taxation of transfer of a road or other infrastructure without consideration depends on who is the owner of the land on which the infrastructure is built—the investor or the commune.

Investors carrying out construction projects often conduct a lot of additional work, apart from building the main structure, connected with installation of the related technical infrastructure, such as transportation links and water and sewer networks. After completion of the project, this infrastructure is typically transferred to the commune without payment, either under an agreement or as required by law. For example, under Art. 16 of the Public Roads Act, construction or alteration of a road as a result of a non-road project is the responsibility of the investor for

the project, and the specific conditions for construction or alteration of the road (including transfer of the road) are set forth in an agreement between the operator of the road (most often the commune) and the investor.

In practice, there are some doubts surrounding the tax treatment of these transactions. From the perspective of VAT, the fundamental question is whether a donation of infrastructure should be classified as supply of goods or provision of services.

Under Art. 7(2) of the VAT Act, any transfer without consideration by a VAT payer of goods belonging to the taxpayer's enterprise (whether or not the goods are produced for purposes connected with the enterprise) is subject to tax if the taxpayer had a right to deduct all or part of the input VAT on such goods from its output VAT (only having such right is relevant, not whether the right was actually exercised). In other words, when there is a free transfer of infrastructure, a possible connection between the structures or equipment transferred and the economic activity of the investor is irrelevant, because in any case—so long as there was a right to deduct input VAT—the transaction will be treated as equivalent to supply of goods for consideration and will be subject to VAT.

Thus if the investor transfers to the commune an access road, a water and sewer connection, or other equipment constructed on its land, it will be regarded as a supply of goods (i.e. the land together with the improvements), which should be taxed. But because the commune, pursuant to the agreement, is acquiring the infrastructure for free, the actual cost of the tax is borne by the investor, which will be required upon making the donation to issue an internal invoice and assess VAT (23%). The basis for calculating the VAT in such case will be the cost of building the infrastructure, determined as of the date it is transferred free of charge.

The situation is different in the case of provision of services without consideration. This is subject to taxation only when it is not connected with the taxpayer's economic activity (VAT Act Art. 8(2)). In the vast majority of cases there is a clear connection between the infrastructure that is being transferred and the main project, and VAT will not be charged.

Under the position taken by the tax authorities, if a project (e.g. construction of a road) is carried out on land that is owned by the commune, then the transfer of the project to the commune does not meet the definition of supply of goods (under VAT Act Art. 7(1)). This is due to the principle of *superficies solo cedit* (set forth in Civil Code Art. 48 and 191), under which buildings and other fixtures permanently attached to the land are regarded as an integral part of the land, and therefore belong to the owner of the land. There is no doubt that infrastructure (particularly roads) built by an investor on commune land is permanently connected to the land, and thus belongs to the commune. Therefore it cannot constitute a separately owned item, which means that the investor that built the infrastructure never became the owner of the infrastructure and could not dispose of it by making a supply of goods. It follows from this that transferring to the commune free of charge infrastructure built on land belonging to the commune is classified as provision of services, because under VAT Act Art. 8(1), any transaction which is not supply of goods must be regarded as provision of services (e.g. Warsaw Tax Chamber ruling of 24 November 2011, No. IPPP2/443-1046/11-2/MM). In that case, all that the investor is transferring to the commune is its investment (i.e. provision of services), and not the right to dispose of a good as the owner (i.e. supply of goods).

The result is similar in the case of free transfer of fixtures such as water and sewer connections. Under Civil Code Art. 49 §1, equipment for conveying liquids, steam, gas or electricity and similar equipment does not constitute an integral part of the land if it is part of a utility enterprise. A person who has incurred the cost of construction of such equipment and is the owner of the equipment may demand that the utility which has connected the equipment to its network acquire the ownership of the equipment for an appropriate fee, unless the parties have agreed otherwise. The utility may also demand the transfer of ownership of such equipment.

This means that such equipment ceases to be an integral part of the land when it is connected to the network belonging to the utility. Therefore, when the investor transfers for free the connections it has built, it is not acting as the owner of the connections because at that time they are already part of the network belonging to the local utility (e.g. owned by the commune). Therefore, in this situation there is no supply of goods, but provision of services, and it is only the investment in the fixtures that is being transferred, not the economic dominion over the equipment.

Thus if the investor wishes to avoid incurring the additional burden of paying VAT, it should consider building the infrastructure on ground which it does not own (e.g. belonging to the commune). In addition, it will also have to demonstrate a connection between the transferred fixtures and its own economic activity, which in most instances should not present a problem.

And in that case, the investor will still have a full right to deduct the input VAT paid when acquiring the goods and services necessary to build the donated infrastructure. Under VAT Act Art. 86(1), the taxpayer may make such deduction insofar as the goods and services are used to perform taxable activities, and thus insofar as there is a connection between their purchase and the investor's business. Because building and transferring the infrastructure most often is an essential element of the main project (for example, by enabling access to a shopping centre built by the investor, an access road increases the number of potential customers), there is a direct causal connection between the expenditures incurred to build the infrastructure (and therefore the input VAT) and the taxable activities performed by the investor. This provides full grounds for the investor to deduct the input VAT when incurring expenditures to build the infrastructure.

The ability to deduct input VAT is also a reflection of one of the fundamental structural principles of VAT: the principle of neutrality. The essence of this principle is that the activity of a VAT payer should not be burdened with non-deductible VAT charged on the acquisition or production of goods and services used by the taxpayer for pursuing taxable activity.

This means there is no legal barrier to deducting VAT on goods and services acquired for the purpose of building infrastructure to be transferred free of charge as a service that is not subject to VAT. This position has also been taken in the case law and interpretations issued by tax authorities (e.g. judgment of Province Administrative Court in Warsaw of 13 February 2007, Case No. III SA/Wa 3630/06, and individual tax interpretation issued by the director of the Poznań Tax Chamber dated 11 March 2010, No. ILPP1/443-1563/09-4/AI).

If, however, during a period of 5 years (or 10 years in the case of real estate) there is a change in the degree to which the infrastructure is used for purposes of economic activity—particularly when the infrastructure begins to be used to perform activities that are not subject to VAT or are exempt from VAT—the investor will be required to make an adjustment to the input VAT deducted on creation of the infrastructure.

In summary, under current law, any transfer of infrastructure free of charge is subject to VAT. The only exception is for infrastructure built on land belonging to someone else—particularly the local commune—but on the condition that the transfer of the fixtures is connected to the economic activity conducted by the investor. In that situation, there is not a supply of goods, and therefore no transfer of the right to dispose of the fixtures as their owner, because the commune, as the owner of the land, is also the owner of all integral parts of the land, including the infrastructure built on the land.

If this approach is not available because the land is owned by the investor, selling the equipment for a token price should be considered, as this may enable the investor to significantly reduce the tax basis and thus the amount of VAT to be paid.

Przemysław Szymczyk is a member of the Real Estate & Construction Practice.

Cola boycott in Polish schools?

Joanna Krakowiak

A proposal is being debated in the Polish Parliament to amend the Food Safety and Nutrition Act to eliminate foods regarded as unhealthy from school shops and to prohibit all forms of promotion of such foods at educational and childcare institutions. Does this mean hard times ahead for manufacturers of products that are adored by children but despised by nutrition experts?

A sweet and sour problem

The World Health Organisation has been warning for years about the bulging percentage of overweight children. It is not a problem just in America, but also in Europe, including Poland. Although researchers are alarmed to see children grow fatter and fatter, parents often ignore the issue, assuming that children can shed a few extra pounds as they mature. Scientists respond that when overweight is ignored, the problem may become worse (the dubious record-holder is a Chinese three-year-old who weighs 60 kg) and lead to serious diet-related illnesses such as diabetes and hypertension. Excessive consumption of food, which in unlimited quantities can become a health hazard, is exacerbated by reckless advertising. Down the road, the legal blame for ruining children's health through an improper diet may be placed on food companies, who may face lawsuits if they do not change the way they promote their products.

Stigmatising certain food products?

Under the proposed changes to the Food Safety and Nutrition Act, on the site of preschools, primary schools, middle schools and other educational and childcare facilities, it would be prohibited to sell certain categories of foods which have been deemed by lawmakers to be unhealthy, or which could be unhealthy for children if consumed in excessive quantities. Examples include sweets containing more than 10 g of sugar per 100 g of product, fast-food or instant dishes with over 300 mg of sodium per 100 g of product, carbonated and non-carbonated beverages with added sugar and artificial colouring, as well as energy drinks and isotonic drinks.

It would also be prohibited to advertise such products, and, significantly, serve them, in school and preschool cafeterias.

If the prohibited products were found to be advertised, sold or served at such locations, the director of the institution would have the right to terminate the contract with the entity which violated the prohibition (e.g. the tenant of a school shop or a catering company) without advance notice. Sanitary inspection authorities would also be authorised to impose a fine on an entity violating this prohibition in an amount of up to 30 times the average monthly wage in the year preceding the imposition of the fine.

The information essential to determining whether a product could be sold at a school or preschool is not always found on the label. In that case, it would be necessary to inquire of the manufacturer whether the product meets the requirements for food to be offered at schools and preschools. If in doubt, it would be necessary to conduct a detailed examination of the product in the laboratory, for example to determine the levels of sodium or sugar or the presence of trans fats. But in practice it is unlikely that school directors would have the knowhow or the means to carefully examine every product offered at a school shop.

Ban on sales a two-edged sword

Prohibitions against selling certain types of foods at schools are in force in several countries, such as Canada, France, Latvia and the UK. France, like New York State, has introduced more far-reaching restrictions by banning advertising of certain foods targeted at children.

In Poland, as demonstrated by the examples of prohibitions against the sale of alcohol, drugs and tobacco, one of the effects of introducing the ban may be an increased demand for the prohibited products. The risk of this reaction among children is important, because the prohibited products in this case would continue to be available at shops away from school grounds and could still be intensively promoted in the media.

What's next in food advertising directed to children?

Currently the image of a child may appear on labels or in advertising of foods basically without restrictions, and regardless of whether or not the food is suitable for children. In this respect, the regulations are so liberal that except for a few specific instances, such as messages exerting excessive pressure on parents or constituting emotional blackmail, in most cases children's participation in food advertising is not questioned.

Consequently, children appear in advertisements for foods intended only for adults, such as coffee. This liberal practice generates profits for producers from increased sales, but in the long run it may cause losses.

When a child participates in an advertisement, it typically suggests that the product is appropriate for children. Moreover, if the advertising message is not formulated carefully, it may be taken by a child, or a parent deciding on the child's diet, as encouragement to consume the product in practically unlimited quantities. In such a situation, can manufacturers of foods—especially foods which may be harmful to the health of a child if consumed in excessive quantities—be certain they will not be sued in the future by the child's parents, or by the grown child, for damages resulting from, for example, obesity or a diet-related disease? While from a legal point of view it would be difficult to prove to the court that a health problem occurred as a result of excessive consumption of an advertised product, regardless of the ultimate judgment the loss to the producer's image from reporting on the case by the media would be huge and difficult to repair.

Key role of food manufacturers

Neither a total ban on sale, advertisement and consumption of certain products in schools, nor the common use of children's images in advertising of products not intended for children, is beneficial for producers or consumers.

Food manufacturers that want to target advertising of their products to children or use their images in advertising should review the ad proposal from at least the following angles:

- Does the advertising exploit the gullibility of children?
- Does the advertising directly exhort children to buy the product, or encourage children to pressure their parents or others into buying the product?
- Does the advertising abuse children's trust in their parents or teachers?

As shown in *A Junk-Free Childhood: The 2012 report of the StanMark project on standards for marketing food and beverages to children in Europe*, leading food manufacturers develop detailed rules for promoting their products to children—not only in school shops, but also online, on social media, through product placements in films, and through sponsorship of sport events.

Considering the global trend toward restriction of marketing of foods targeted to children, it should be recognised that maintaining corporate policies covering this aspect of operations and scrupulously reviewing advertising campaigns involving or directed to children are fundamental requirements for any responsible food manufacturer.

Joanna Krakowiak, legal adviser, is a member of the Life Science Practice.

Transfer of personal data in the era of globalisation

Agnieszka Szydlik Sylwia Paszek

As the world economy becomes more closely interconnected and more data must be transferred among companies in multinational groups, the practical importance of regulations governing transfer of personal data to third countries is growing.

This trend is intensified by the widespread outsourcing of various business functions, including outsourcing to third countries. The launch of cloud computing has made the transfer of data to third countries a commonplace among businesses. But along with it comes the need to assure that personal data—of employees, customers and suppliers—are transferred to third countries in compliance with the law.

Adequate level of protection

Under Polish law, for data protection purposes "third countries" are those not belonging to the European Economic Area (made up of the member states of the European Union—for now excluding Croatia—plus Iceland, Liechtenstein and Norway).

Leaving aside the transfer of data at the consent of the data subject—which is not practical to obtain in most instances—personal data may be transferred to a third country if the third country "ensures an adequate level of protection of personal data in its terri-

tory" (Art. 47(1) of the Personal Data Protection Act of 29 August 1997).

A third country is deemed to ensure an adequate level of protection when the European Commission has issued a decision confirming that it ensures protection of personal data comparable to the level provided under the Data Protection Directive (95/46/EC). Such decisions have been issued with respect to such countries as Andorra, Argentina, Canada, the Faroe Islands, the Isle of Man, New Zealand and Switzerland. US entities that have been issued a Safe Harbor Certificate from the United States Department of Commerce have a similar status. In either case, transfer of data does not require an additional review of the level of protection or a permit from Poland's data protection authority, the Inspector General for Personal Data Protection (GIODO).

Examination of level of protection

In other situations, transfer requires a positive review of the level of protection in the destination country. It is not necessary that the data protection in the third country be the same as in Poland. What is crucial is that the fundamental principles of data protection are analogous. Among these principles are the rule that data be processed only for a designated purpose and within a designated scope, and the principles for use of measures assuring the security of data at the level specified by EU regulations, as well as the real possibility for data subjects to exercise their rights, such as the right to correct their data and to demand removal of their data.

An adequate level of protection in the destination country is ensured when the destination country—and not just the company receiving the data—ensures an adequate level of protection in its territory. Thus it is assumed that the company alone will not be in a position to ensure an adequate level of protection in the destination country. Consequently, a data controller seeking to transfer personal data to a third country may not transfer the data just because it has concluded an agreement with the company receiving the data in which the recipient promises to ensure a given level of protection. The level of protection is identified and evaluated on the basis of the overall set of conditions for transfer and processing of the data—in the relations between the entities but also within the context of the legal system of the destination country. Recently, European data protection authorities have questioned registration in the Safe Harbor system as a sufficient basis for transfer of data. It was pointed out that the Safe Harbor system is based on a declaration by the company on assurance of an adequate level of protection, but the US government does not verify the fulfilment of these declarations.

Verification by GIODO

Verification of whether an adequate level of protection is ensured for a planned transfer of personal data is conducted by GIODO through a proceeding for issuance of a permit to the data controller to transfer the data to a specific recipient in a specific third country. When considering an application, GIODO examines the overall circumstances accompanying the intended transfer: the nature of the data, the purpose and duration of the planned processing operations, the regulations in force in the given third country, the security measures and professional rules applied in the third country, the use of various forms of protective measures, as well as the contractual provisions.

The data processing agreement between the data controller and the recipient of the data is thus one of the elements subject to review, together with other elements.

Inclusion in the contract of "model clauses" developed by the European Commission (Commission Decision of 5 February 2010 on standard contractual clauses for the transfer of personal data to processors established in third countries) will certainly have a bearing on the evaluation by GIODO. However, use of a model clause does not automatically mean that the review will be successful and does not mean that GIODO must permit the transfer of data to the third country.

Binding corporate rules

The case is similar with respect to use of "binding corporate rules" for personal data protection. The concept of binding corporate rules was developed by European data protection authorities in the advisory committee known as the "Article 29 Working Party." A series of documents drafted by the Article 29 Working Party concerning binding corporate rules contain information about the criteria that such rules should comply with as well as the procedure for approval of the rules by national data protection regulators.

Working Papers WP 74, WP 107, WP 108, WP 153, WP 154 and WP 155 address binding corporate rules for data controllers, while Working Papers WP 195 and WP 204 concern rules for data processors.

Binding corporate rules are internal rules for protection of privacy and data security adopted within a group of affiliated companies operating in different jurisdictions. Their purpose is to guarantee that processing and transfer of data between these companies is carried out in compliance with the requirements set forth in EU data protection regulations.

Originally, binding corporate rules were used as the basis for exchange of data between data controllers. Such exchanges are often made by multinational groups, in which processing of customer data may require that the data be transmitted to companies in the group operating in countries that do not ensure an adequate level of data protection.

The next step was to try to meet the needs of entities that process personal data under contract from data controllers, for example in business process outsourcing.

Similarly, in the case of providers of cloud computing services backed by binding corporate rules, it may be assumed that the services will be performed in compliance with adequate levels of data protection. Thus the customer for the cloud services is protected against an allegation of violation of Art. 31 of the Personal Data Protection Act, which requires that the data controller be able to monitor the processing of data by the data processor.

The procedure for adoption of binding corporate rules requires that they be approved by data protection authorities. Basically, the lead entity in the group should file a request for approval of the rules with the data protection authority for the location of the lead entity. This authority, referred to as the "lead authority," will examine the correctness of the rules and invite the data protection authorities in other EU member states where the companies in the group are located to join the proceeding for approval of the rules adopted by the group.

Unfortunately, under current law, there is no basis for Poland to join in any legally binding manner a proceeding before another data protection authority for mutual recognition of binding corporate rules. Under current law, GIODO is only authorised to approve an application in which the Polish member of the group seeks approval for transfer of data based on binding corporate rules. When the rules have already been approved by another data protection authority in the EU, approval in Poland is almost certain to follow, but there is the inconvenience of having to submit all the documents in Polish.

Meanwhile, a proposal for an EU-wide regulation, known as the General Data Protection Regulation, superseding the Data Protection Directive implemented through the member states, has been working its way through the legislative process since release of the proposal in January 2012. If adopted, the regulation would enable automatic recognition of binding corporate rules approved in another EU member state. This would simplify things greatly in Poland—a major market for outsourcing services.

Agnieszka Szydlik, adwokat*, and Sylwia Paszek, legal adviser, are members of the Personal Data Protection Practice.*

Extraction and trading of gas in Poland

Weronika Pelc Radosław Wasiak

There's a lot happening on the gas market in Poland. Legislative work is underway with the aim of increasing state control over extraction operations, while the market for trading in gas is more quickly becoming liberalised.

Poland consumes more natural gas than it produces. According to data from Poland's energy regulator, the President of the Energy Regulatory Office, less than a third of some 15 billion m^3 of gas used every year in Poland comes from domestic sources. The vast majority of customers—nearly 95% of the gas market—are served by the same supplier, Polskie Górnictwo Naftowe i Gazownictwo S.A. It supplies customers primarily with gas extracted domestically or purchased from a company in the Gazprom group under long-term contracts.

Proposed changes to the rules for gas exploration and extraction

Legislative work has been going on for a long time to change the current regulatory system for exploration and extraction of hydrocarbon deposits with enactment of a new law on fossil fuels. In these proposals, the attempt to increase state control over mining activity may be of particular concern to investors.

The original legislative plans called for establishment of an entirely new entity known as the National Operator of Energy Mines (NOKE), supervising the regulated activity in this area and collecting a portion of the profit from such activity. NOKE, in the form of a company wholly owned by the State Treasury, would have been required to participate in every concession for extraction of hydrocarbons from deposits, through involvement in both the costs and the profits of such operations. Under criticism from the hydrocarbons extraction industry, the Ministry of the Environment finally gave up this idea. But this does

not mean that there will not be increased oversight of regulated activity. According to the current plans, such increased supervision would be carried out instead by geological and environmental inspection authorities. The competencies of these authorities in the area of oversight of extraction operations would be expanded. Moreover, the State Treasury's participation in profits from extraction would be assured through separate tax acts introducing special taxes on the quantity of minerals extracted and on the profits earned on concession operations.

New concession procedure

Under the proposals, awarding of hydrocarbons concessions would require conducting a tender proceeding, commenced by the concessioning authority at its own initiative or at the request of the interested parties. The concessioning authority would independently agree the conditions for the future concession with the relevant entities and obtain a decision on the environmental conditions for the future project. Then the concessioning authority would publish an announcement on commencement of the tender, in which it specifies the technical and financial conditions for award of the concession.

The tender procedure would be divided into four stages. First an entity interested in commencing extraction operations would apply for qualification to determine whether the entity is under the corporate control of a third country (not a member state of the EU, EFTA or NATO) or a citizen or entity from a third country. If such control were found, it would be necessary to determine whether it could pose a threat to state security. The qualification procedure would be conducted with the involvement of financial regulators and intelligence and counter-intelligence services.

Bidders that successfully complete the qualification round would be invited to submit offers. A new option would be the possibility of submission of a joint offer by more than one entity. Now a concession may be granted only to a single business entity. In the case of a joint application for a concession, it would be necessary to designate one entity which would serve as the operator throughout the process and be required to perform the rights and obligations arising out of the concession vis-à-vis the public administrative authorities. Additionally, the members of the consortium would agree between themselves on a percentage split of the costs of the work.

Factors to be considered when evaluating the offers would include the bidders' experience in extraction operations, their technical and financial capability, the proposed technologies, the schedule for the work, and the amount of the fee for mining usufruct. The selection of the most favourable offer would be made by a specially appointed tender commission, which would then report its selection to the concessioning authority.

On the basis of the tender, the concessioning authority would award the concession to the entity which submitted the most favourable offer. The concession would provide the exclusive right to conduct extraction operations in the designated area for a definite period of 10 to 30 years.

New rules for conducting concession operations

Under the proposals, the rules for conducting regulated activity would also change. Operations would be divided into an exploration phase and an extraction phase. The exploration phase would last up to 5 years and could be extended once for up to 2 years. This is intended to motivate concession holders to conduct their explorations quickly and begin extraction. Delay or failure to conduct the work would be grounds for withdrawing the concession. Passage to the extraction phase would require an investment decision issued on the basis of the results of the exploration work. The extraction phase would then last until the end of the concession period. It could be extended, however, for up to 5 years at a time, until the deposits have been exhausted.

These changes in the rules for concessions for extraction operations could affect the position of current operators. As a rule, concessions issued prior to the effective date of the amendments would remain in force until the end of the period for which they were issued. Holders of a concession for exploration and identification of hydrocarbons would be able to convert the existing concession into a concession for exploration and extraction of hydrocarbons from deposits, on condition of positive completion of the qualification procedure. Operators that decide not to convert their concessions would maintain their current right of priority to exploit identified deposits on the basis of a concession for extraction, but exercise of this right would depend on the results of the qualification procedure.

Liberalisation of the gas market

The liberalisation of the gas market in Poland picked up speed in 2013. Following entry into force of the amendments to the Energy Law on 11 September 2013, energy companies involved in trading in gas are now required to sell gas on the commodities exchange. The exchange obligation in 2013 was 30% of the gas introduced into the transmission system. From 1 January 2014, it is 40%, and from the beginning of 2015 it will be 55%. Thanks to this regulation, an exchange market for trading in gas is slowly emerging. It was possible to trade gas through the Polish Power Exchange (Towarowa Giełda Energii S.A.) from the end of 2012, but the number of trades and the trading volume were minimal.

Final customers have gained the ability to terminate contracts for supply of gas for an indefinite period, upon written statement, without incurring additional costs. Final customers may also terminate contracts for a definite period, upon payment of costs and penalties provided for in the contract. Operators must allow gas customers to change sellers no later than 21 days after notifying the operator that they have concluded a contract with a new gas seller. These changes should enable trading companies other than PGNiG S.A. to operate effectively on the market.

The requirement for the President of the Energy Regulatory Office to approve tariffs for natural gas for all customer groups, including on the wholesale market, was regarded as one of the main barriers to development of a competitive gas market. In February 2013 the regulator found that the segment of wholesale trading in natural gas may be regarded as a competitive market, and continuing to maintain the existing rules for approval of tariffs would limit the growth of the liquidity of the market. He therefore released energy companies from the obligation to submit wholesale tariffs for approval. Previously, individual decisions on relief from the obligation to obtain approval of tariffs had been issued to businesses holding a concession, at their application. The regulator also released energy companies holding concessions for foreign trading of gaseous fuels or natural gas from the obligation to submit tariffs for approval with respect to liquefied natural gas. In the autumn of 2013, the regulator announced that he would lift the requirement to submit tariffs for approval with respect to sales of natural gas to final customers which had used 25 million m^3 or more in the preceding calendar year. This should happen at the beginning of 2014. Then the obligation to submit tariffs for approval will apply only to tariffs for sale of gas to customers not meeting the quantitative threshold for gas consumption, and to household customers.

The changes described above should strengthen the role of the state in the hydrocarbons extraction industry while creating a more competitive gas market, providing customers the ability to choose gas suppliers and negotiate prices.

The market still anticipates adoption of a new Gas Law which would comprehensively regulate the functioning of the gas market and resolve some existing issues, for example concerning storage of gas.

Weronika Pelc, legal adviser, is the partner in charge of the Energy Law Practice.

Radosław Wasiak, adwokat*, is a member of the practice.*

Bid bond and performance bond: Securing the proper document from a foreign bank

Anna Prigan

Contracting authorities require security for bids in high-value public procurement projects. In practice, this means that in most public procurement procedures, foreign bidders must provide a bid bond with their offer and a performance bond before signing the contract. The Polish Public Procurement Law provides several methods for submitting a bid bond or performance bond, but the most common methods in practice are cash, a bank guarantee, or an insurance guarantee. Foreign bidders most often provide a bank guarantee.

The Public Procurement Law does not specify the wording required for a bank guarantee submitted as a bid bond or performance bond. However, the requirements for such guarantees are usually set forth in the tender documentation. The contract notice or terms of reference may indicate the features of the guarantee which are essential for the contracting authority. The tender documentation often includes as an appendix a specimen of the guarantee which the bidder should follow.

A bidder obtaining a bank guarantee should basically use the specimen provided by the contracting authority. In practice, however, this may not be easy, because every bank uses its own form of bank guarantee and may not be willing to issue a guarantee using the wording presented to the bank. This may be a particular problem when using a guarantee issued by a foreign bank for presentation in Poland, specifically because of two typical clauses which Polish public authorities require of bank guarantees: that the guarantee be governed by Polish law and that disputes arising out of the guarantee be resolved by the court proper for the registered office of the contracting authority. Occasionally the contracting authority will include an arbitration clause in the form for the bank guarantee, and if so it invariably calls for arbitration before an arbitration panel in Poland and governed by Polish law.

Another typical requirement imposed by contracting authorities is that the bank guarantee be irrevocable, unconditional, and payable at first demand of the contracting authority. These clauses are common in banking practice and are designed to allow the holder of the bank guarantee to draw on the guarantee upon submission of a written demand for payment, without further difficulties. Although these requirements may increase the cost of obtaining the guarantee and deprive the bank of the opportunity to verify the basis for the demand, they are fully justified, because the bank guarantee should give the contracting authority the same certainty of satisfying its claim as it would have in the case of a cash deposit.

An obvious but crucial element which the contractor must pay attention to when obtaining a bank guarantee is to assure that the contracting authority, as the beneficiary of the guarantee, is properly identified in the wording of the guarantee, with no mistakes in its name or address. The same applies to the bank's customer, i.e. the contractor taking out the guarantee. Any errors in identifying these parties may render the guarantee unenforceable, preventing it from serving its purpose, and thus it will be regarded as unacceptable. Other important elements include proper identification of the tender procedure for which the guarantee is submitted. Ideally, the name and reference number of the procedure should be stated just as provided by the contracting authority. These items are found in the tender notice.

And obviously it is vital that the amount of the guarantee comply with the amount required by the contracting authority, and that the period of validity of the guarantee be correctly stated. Banks will not agree to define the period of validity indirectly, but in every case insist that the period of validity be stated through a specific date. However, in the case of a bid bond, the tender documentation states only that the bank guarantee must be valid for a certain number of days, i.e. the same number of days as the bidder's offer remains valid. The period of validity of the offer runs from the date that the bids are opened, and therefore the bidder itself must calculate the term of the guarantee. However, if the deadline for filing bids is extended, the validity of the guarantee should also be extended. In tenders above the EU thresholds, the period of validity of a bid is 90 days. But for practical reasons, the bidder should consider submitting a guarantee immediately for a longer period. This is because, firstly, if the deadline for filing bids is extended, the change usually occurs shortly before the original deadline. Then it is highly likely that the foreign bidder will already have obtained a bank guarantee, but for a period ending earlier, so it would no longer be acceptable to the contracting authority.

While it is best to have the bank guarantee issued just before the deadline, foreign contactors must allow additional time to get the document to Poland. It should be stressed that both a bid bond and a performance bond must be submitted to the contracting authority by the stated deadline in the original. If a copy is submitted, even a notarised copy, the guarantee will not be treated as properly submitted. This is because a copy of the guarantee will not enable the contracting authority to exercise its rights under the guarantee; the bank will always require presentation of the original of the guarantee letter.

While the SWIFT bank guarantee is popular around the world, it is not in written form but is issued electronically in a message from one bank to another. The bank receiving a SWIFT message containing the guarantee may only confirm the contents by issuing certified copies of the bank messages together with a cover letter, but such documents do not formally constitute the original of the guarantee, because in the case of an electronic bank guarantee no written original is ever created. Unfortunately, Polish contracting authorities are not eager to accept SWIFT guarantees and often specify in the notice that the guarantee must be issued in writing. According to the law, contracting authorities do not have this right. The National Appeal Chamber and the President of the Public Procurement Office agree that a guarantee in electronic form is just as valid as a guarantee in written form. In practice, however, contracting authorities do not follow these guidelines, and in that case the contractor's only remedy is to file an appeal disputing the requirement of a written guarantee, or simply obtain a written guarantee letter as requested by the contracting authority. If a contractor in that situation chose the more difficult route of filing an appeal, it would have to incur additional costs, not to mention incurring the displeasure of the contracting authority. But more to the point, the period for filing an appeal is short—10 days from publication of the tender notice—and the contractors may not be aware of the commencement of the procedure soon enough to appeal. Even if they were aware of the procedure they would rarely begin their review of the tender notice by focusing on the bid bond provisions—particularly if they first have to translate the notice from Polish.

In the case of a bid bond bank guarantee, it must remain valid for the entire period of validity of the bid. Thus if it is necessary to extend the validity of the bid (because the tender procedure is extended), the validity of the guarantee must also be extended. Calculating the length of this additional period is not easy if the validity of the bids is suspended or if the validity of the bids has already been extended before. The contracting authority will call on bidders to extend the validity of their bids and submit a bid bond with an extended period of validity only one time. Further extension of the validity of the bid may be made only at the contractor's own initiative, and then the contractor must assure that the validity of the bank guarantee is properly extended, or obtain a new bank guarantee for the following period.

As mentioned, in order for a bid bond or performance bond to be regarded as effectively submitted, the contracting authority must receive the original of the bank guarantee by the designated time. Sometimes the contracting authority requires the original bid bond to be submitted earlier than the deadline for submitting offers. In the case of a performance bond, the original must be delivered to the contracting authority prior to conclusion of the public procurement contract. At the time the contract is concluded, it must already be effectively secured by a performance bond, and there is no option to submit the performance bond later. If the contracting authority does not obtain the original performance bond by the time it has set for signing of the contract, the contracting authority will retain the bid bond on the grounds that the contract could not be concluded for reasons attributable to the bidder. In that case, it is no longer possible to conclude the contract with that bidder, and the contracting authority will be able to conclude a contract with the bidder that submitted the next most advantageous offer in the tender, without the necessity of beginning another proceeding for award of the contract.

Foreign contractors preparing to sign a public contract in Poland are sometimes surprised also by requirements for the form and content of the performance bond which were not expressly stated in the tender documentation or the draft contract. This primarily involves the case where the contracting authority questions the possibility of submitting a guarantee issued by a foreign bank, particularly from outside the EU. If the bidder does not have operations in Poland, it may be much more expensive to obtain a guarantee from a Polish bank.

Anna Prigan, legal adviser, is a member of the Infrastructure, Transport and Public Procurement practices.

Tax aspects of factoring

Kazimierz Romaniec Jakub Michałeczko

The economic slowdown has forced businesses to seek alternative methods for improving their financial liquidity and assuring stable cash flow. A convenient instrument to achieve these aims is factoring, which is becoming increasingly popular under the current market realities.

According to the Polish Factors Association, the turnover of factoring firms in Poland in 2012 was PLN 100 million, an increase of 20% from 2011, and in 2013 their turnover grew by a further 15%.

Factoring is a commercial transaction creating a legal relationship in which the factor (service provider) acquires the seller's trade receivables in exchange for an appropriate consideration, typically defined as a percentage of the face value of the receivable, with a commission for the factor. Acquisition of the receivables takes place under an agreement which is not specifically classified under Polish law but contains elements of various types of contracts, e.g. an agreement on assignment of a receivable or a contract of mandate. Factoring therefore gives the seller a steady flow of cash (even when payment by the seller's customers for goods or services is doubtful) as well as additional services provided by the factor.

The use of factoring to assure liquidity offers numerous advantages. It helps eliminate payment gridlock. The funds received from the factor enable the seller to better organise its financial policy. By investing the funds obtained from the factor, the seller may generate a return even before the payment from the customer falls due. Factoring also enables cost optimisation by shifting the financial burden of administering and monitoring the receivables. This improves the seller's financial indicators because this form of

financing of the seller's enterprise does not function as a charge against the seller's credit capacity. Finally, particularly during a time of economic slowdown, the readier availability of factoring services compared to other forms of financing, such as bank loans, can be invaluable.

Taxation of factoring

But when deciding to use factoring services, the seller must consider the tax issues surrounding factoring. The VAT Act provides a broad range of subjective exemptions from VAT, including with respect to financial intermediation. Services constituting an element of a financial service making up a separate whole, necessary and proper to provide services exempt from VAT, are also exempt. However, the VAT Act states that this exemption does not cover debt collection activities, including factoring, which means that such activities are subject to VAT at the rate of 23%.

There have been numerous controversies surrounding the possibility of charging the tax on civil transactions on the assignment of receivables, which is one of the elements of factoring services. In *Finanzamt Essen-NordOst v GFKL Financial Services AG* (judgment of 27 October 2011, Case C-93/10), the European Court of Justice held that when the subject of the assignment is receivables as to which there are serious doubts whether they will be satisfied, and the factor assumes the risk of non-payment in exchange for a price below the face value of the receivables, the difference between the face value of the assigned receivables and the price for sale of the receivables does not constitute a fee for a service but reflects the actual economic value of the receivables at the time of the assignment. Because in such a case, as the ECJ held, no service subject to VAT is being supplied, in Poland this permits the tax on civil transactions to be charged on the assignment of receivables in this scenario. Consequently, even though the VAT Act expressly provides that factoring services are not exempt from VAT, the assignment of receivables in performance of a factoring agreement may be subject to the tax on civil transactions rather than VAT.

The position of the ECJ is reflected in the case law from Poland's administrative courts. In the judgment of 19 March 2012 (Case No. I FPS 5/11), the Supreme Administrative Court agreed with the views of the ECJ presented above. This began a new line of judgments by administrative courts, and a new practice arose in the tax rulings issued by Polish tax authorities. The departure from the view that every purchase of receivables in a factoring arrangement constitutes supply of factoring services means that it is necessary for the taxpayer to examine in each case whether the transaction is subject to VAT or the civil transaction tax.

VAT obligation and tax basis

In the context of VAT on factoring services, issues connected with the time when the tax obligation arises and the calculation of the tax basis should also be considered.

Under the general rule for VAT, the tax obligation arises upon supply of the goods or the services (i.e., in the case of factoring, acquisition of the receivable). However, if factoring services are settled on the basis of established consecutive payment periods up to one year, the service is regarded as supplied at the end of each period for which the payments are due, up until the time of completion of supply of such services.

The doubts connected with determination of the tax basis concern the consideration paid on the purchase of the receivables. There is no controversy surrounding the view that in the case of a fee expressed in the form of a commission, the basis for taxation is the amount of the commission. But in the case of a fee in the form of a discount, that is, the difference between the face value of the receivable and the price paid for the receivable, the question of what should be the tax basis arises. In a tax ruling, the director of the Warsaw Tax Office held that "the basis for taxation of the activity of purchasing a receivable is the difference between the face value of the receivable and the value the seller received from the buyer, less the tax due." This position appears correct. The discount reflects the true consideration paid to the service provider, and there do not appear to be any persuasive arguments for any other method of calculating the tax basis.

An important VAT issue is how to settle VAT when the provider of services to a Polish entity is a factor which does not have a registered office or permanent establishment in Poland. In that situation, the place of supply of the service is the place where the service recipient which is a VAT payer has its business headquarters, i.e. Poland. Because under the VAT Act, legal persons, organisational units without legal personality and natural persons who are recipients of services supplied by taxpayers without a registered office or permanent establishment in Poland are also VAT payers, supply by a factor of paid services to a Polish entity is regarded as import of services, and the Polish business (the recipient of the factoring services) charges VAT on its own end using the reverse charge mechanism. The service recipient in such case also, as a rule, deducts the same VAT—charging the output VAT and deducting it as input VAT in the same VAT return.

Income tax on factoring

There are also controversies in interpretation with respect to income tax on factoring. The question arises whether after making an assignment of a receivable the seller is required to recognise income as a result of payment of the agreed portion of the receivable by the factor. There are two diverging positions on this issue. On one hand, payment for a receivable by the factor should not constitute revenue for the seller as payment of the revenue owed which was previously booked. On the other hand, it may be stated that in the case of sale of the receivable by the seller, there is a separate source of revenue in the form of the price payable to the seller for sale of the receivable. The latter position is reflected in the case law from the Supreme Administrative Court.

In the latter case, another doubt arises, concerning recognition of tax-deductible costs associated with the revenue recognised on obtaining funds from the factor, in the gross or net amount. It appears that since the seller transfers the receivable to the factor in order to obtain the revenue, the seller diminishes its assets by the face value of the receivable and therefore the entire face value of the receivable, including VAT, should constitute a tax-deductible cost for the factoring service recipient.

Another debatable income tax issue is the time for recognition of revenue on the sale of the receivable. Under the general rule, amounts that are owed to the taxpayer in connection with its business activity are recognised as revenue even though payment has not actually been received yet. But there are specific rules concerning services performed on the basis of periodic settlements. Therefore, if the parties establish settlement periods for performance of factoring services, the last day of the settlement period should be the date when the revenue arises. Sometimes, however, application of this rule is disputed by the tax authorities.

These issues show that use of factoring by businesses to assure liquidity requires careful planning of the steps to be taken, which should be closely tailored to the circumstances in terms of their tax treatment. The tax cost of factoring is important for determining whether the arrangement makes economic sense.

Kazimierz Romaniec, legal adviser, and Jakub Michałeczko are members of the Tax Practice.

The saviour of failed rescues: A new attempt at defining who can be saved from the shoals of insolvency

Michał Barłowski

New insolvency regulations soon to be enacted in Poland are designed to limit the stigma of bankruptcy, treat reorganisation as a normal part of commercial life, and encourage troubled companies to continue as a going concern when their core business remains viable.

It has been 11 years since the Bankruptcy & Recovery Law of 28 February 2003 replaced a set of bankruptcy laws from 1934. We again stand at the threshold of changes that may truly be considered revolutionary, particularly in the area of reorganisation.

A new beginning

In 2014, two new acts are expected to enter into force: the Restructuring Law and the Bankruptcy

Law. The Restructuring Law is to cover four different types of arrangement proceedings, one of which is a modified form of the current bankruptcy with the possibility of concluding an arrangement. The other three are entirely new types of proceedings, but covering the current recovery proceedings.

The new Bankruptcy Law would cover the current liquidating bankruptcy. The intention is that ring-fencing "bankruptcy" would limit to these proceedings the stigma resulting in loss of reputation and attrition of customers and suppliers. Restructuring, freed from this stigma, would be regarded as a normal phase of commercial life—a process businesses go through like any other, such as mergers, acquisitions, or the sale of enterprises or assets, which processes are indeed an aspect of restructuring in the broader sense.

Chapter 11 for Europe

The economic crisis and slowdown in Europe and the rest of the world have changed the attitude of states to the issue of bankruptcy over the past 10 years. In 1996, at the time of publication of Miguel Virgós and Étienne Schmit's *Report on the Convention of Insolvency Proceedings*, which would later serve as a roadmap to the EU's Insolvency Regulation (1346/2000), "pre-insolvency" proceedings hardly existed in Europe and the regulations were aimed at "hard" bankruptcy, where the only option was to liquidate the debtor's assets. More recently, preventive proceedings such as the English scheme of arrangement and the French *procédure de sauvegarde* have become widespread in Europe. The archetype is US Chapter 11, an added benefit of which (unavailable in Europe) is that it can cover a group of companies.

The regulations in Poland and other European countries governing insolvency or the period running up to insolvency are silent on the fact that a company facing insolvency might belong to a capital group. This presents formal difficulties in conducting an effective economic restructuring of a capital group or several troubled companies within a capital group (although there is "soft law" in this area, such as the

European Communication & Cooperation Guidelines for Cross-border Insolvency by Bob Wessels and Miguel Virgós). The very concept of a capital group is vague. There is no developed notion of the interests of a capital group, which is vitally important under corporate governance principles.

The amendments to the Insolvency Regulation proposed by the European Commission in December 2012 would at least partially fill this gap, but the mechanism in the proposed amendments is based on a duty to cooperate among members of the group covered by insolvency proceedings, without hard and fast rules forcing them to act.

The need for coordination of insolvency proceedings within a group is evident from the example of the proceedings currently underway involving the Fagor group, where financial problems of the parent company led to the bankruptcy of other companies from the group. The court in San Sebastián, Spain, held that the "centre of main interests" of the companies from Spain, France and Poland all lay within Spain, but secondary insolvency proceedings could interfere with the quick and harmonised sale of assets in several countries. Experience shows that only a synchronised sale provides a chance of obtaining the best price while also enabling enterprises to continue as a going concern.

Better than a cure

A preventive approach, enabling debtors to decide whether to commence proceedings to head off bankruptcy, makes obvious sense. Prevention is better than a cure.

Leaving aside a "pre-packaged" sale, which may have various consequences over the longer term, for creditors an arrangement seems to violate the principle of enforcement of contracts, and an arrangement represents a kind of novation of the existing obligations. In any restructuring, creditors bear the risk of non-performance of the arrangement. The debtor must not only pay the obligations that arose before the arrangement proceedings were commenced (generally in a reduced amount), and cover the costs of restructuring, but also must earn money going forward to cover current new obligations as they arise.

The belief that performance of the arrangement is feasible must have a strong economic foundation. The debtor's market environment and its reformed internal structure must provide a sufficient margin on the debtor's core business to satisfy current obligations, pay down the instalments under the arrangement, and continue the restructuring. On a highly competitive market, it may not be possible to live up to all these requirements.

Creditors typically agree to an arrangement to cut their losses when the alternative is a liquidating bankruptcy generating even greater losses. This approach is codified in Poland's current Bankruptcy & Recovery Law, where the choice of the bankruptcy procedure is determined by the degree of satisfaction of creditors.

Choices and questions

The new restructuring proceedings in Poland could be commenced by solvent as well as insolvent enterprises. The concept of "insolvency" would be redefined to better suit commercial reality and also to prevent "bankruptcy blackmail," where bankruptcy petitions are filed by creditors to force the debtor to pay off those creditors. This works against other creditors and can expose the debtor's representatives to liability for selective payment of creditors.

Allowing insolvent enterprises to open preventive proceedings would upset the existing legal order. Now, an insolvent debtor should file for bankruptcy as soon as it becomes insolvent.

The new restructuring regulations would take a different tack. Recognising that it cannot be predicted *a priori* which type of proceeding will be more beneficial, a reasonable debtor (taking account of the creditors' interests) could select the restructuring procedure best suited to the specific financial and business circumstances.

This approach opens up new possibilities for concluding an arrangement, e.g. allowing the debtor to solicit support from creditors when the debtor is illiquid but has a healthy enterprise capable of generating returns. This could cut the duration of the arrangement proceedings to a minimum. There is a danger, however, that the new reorganisation procedures would not be suited to the debtor's situation and would be exploited when bankruptcy should be declared.

How would the Polish market respond to repeated restructuring of the same debtor (or members of the capital group)? Should this be permissible, as in other countries? Or should there be severe restrictions, as there are now for recovery proceedings?

Another issue is competitiveness. The plan to put trade creditors on an equal footing with the State Treasury in priority of satisfaction would make it easier to reach an arrangement, and arrangements would be concluded more often. (Now liquidating bankruptcies represent nearly 80% of all proceedings.) In relation to SMEs, would the private investor test be sufficient to filter restructuring procedures so that they do not disrupt competition? In practice would it not mean that a restructured enterprise could offer goods and services at lower prices than competitors that have not gone through restructuring and must continue to work toward paying off old debts?

Learning from our neighbours

It is clear that the proposed new regulations would open up new possibilities in Poland. First, as in most EU member states, once the proceedings were opened they would be effective against all creditors. Now, out-of-court negotiations with various groups of creditors can be difficult to organise, provide too much leeway to debtors, cost too much and last too long. Introduction of universally binding regulations would offer a real hope of solving at least some of these problems.

But Europe appears slow to embrace preventive proceedings, out of concern for possible abuses and too-rapid changes in law, and questions about the rationale for staying creditors' rights to pursue the debtor, which otherwise could drive an unprofitable enterprise from the market. These questions will return and will be asked in Poland following the initial experiences under the new regulations.

Fortunately, Polish lawmakers managed to identify certain errors from other countries to be avoided. For example, only actual votes by creditors would be considered on approval of an arrangement—rejecting the position that a creditor's silence should be taken to mean consent to the arrangement (as in the French Code de Commerce). Thus only truly interested creditors would have an influence on what happens with the restructured enterprise. The new regulations should also put an end to backseat control of the enterprise, without bearing any consequences, when insolvency proceedings should be opened.

It can only be hoped that when the expected new regulations are themselves amended, as they inevitably will be after they have been in force for a few years, lawmakers will not return to the principle enshrined in the current Bankruptcy & Recovery Law that the first priority is to satisfy creditors to the greatest degree, and only then to try to maintain the current enterprise of the debtor as a going concern. That would undermine the purpose of introducing restructuring proceedings.

Michał Barłowski, legal adviser, is the partner in charge of the Bankruptcy and Restructuring practices.

About Wardyński & Partners

Wardyński & Partners is an independent Polish law firm with over 100 lawyers, many of whom are noted experts in their field of law.

We provide a full range of legal services and help our clients solve their most difficult problems.

We draw upon the finest traditions of the Polish legal profession. Dedication, integrity, trust and transparency are the values that guide us in our work for clients each day.

Thanks in part to our involvement in many international legal and business organisations, we apply global best practice in law firm management, which we believe generates added value for our clients.

We advise our clients in the following areas:

Aviation law
Banking & finance
Bankruptcy
Business crime
Capital markets
Commercial contracts
Competition law
Corporate law
Difficult receivables recovery
Dispute resolution & arbitration
Employment law
Energy law
Environmental law
EU law
Financial institutions
Healthcare
Infrastructure & transport
Insurance
Intellectual property
Life science & regulatory
Mergers & acquisitions
Outsourcing
Payment services
Personal data protection
Private client
Private equity
Public procurement & public-private partnership
Real estate & construction
Reprivatisation
Restructuring
Retail & distribution
Sports law
State aid
Tax
Technology, media & telecommunications

To help foreign clients we have set up Czech, French, German, Korean, Russian and Spanish desks.

Our offices are in Warsaw, Poznań, Wrocław, Kraków and Brussels.

Wardyński & Partners is the publisher of the Litigation Portal **(www.LitigationPortal.com)**, presenting news and analysis of topics related to judicial, arbitration and administrative proceedings, and the Transactions Portal **(www.TransactionsPortal.com)**, devoted to the legal aspects of M&A transactions in Poland. Both portals are published in Polish and English.

The firm is also the publisher of Wardyński+, the first Polish-language app on legal topics for iPad and Android. The app is available free of charge at the App Store and Google Play.

www.wardynski.com.pl