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Dear Readers,

It's no secret that predictions work best with hindsight, but this year venturing any forecasts seems particularly fraught with risk. Reality, including legal reality, has sped up greatly and the number of unknowns is mounting. There are so many recent and planned changes in law that they deserve a volume to themselves.

This is one of the reasons we are updating the approach of the *Yearbook* this time around, focusing primarily on issues faced by specific businesses. The great majority of the articles here by our lawyers arose out of concrete matters, from which we have chosen those that best illustrate some broader truth and could be helpful for others. We describe the types of matters in which our clients more and more often seek our advice, as well as issues we have encountered for the first time, opening new fronts in our work for clients.

Once again this year, threats connected with cybercrime take the foreground. Although widely reported on, these threats continue to be ignored, and this in turn is fully exploited by organised criminal groups. Cyberspace is today's Wild West, where criminals seem to have taken free rein. The sheriffs—specialists among the police and prosecutors—are too few to protect our personal and financial interests effectively. Therefore we must take the initiative to help ensure that instruments of legal protection can function online.

The role of lawyers is to protect their clients and the society in which they operate against those acting in bad faith. Drawing attention to threats is thus one of the duties of lawyers. Our task is to explain what is new in legislation and case law and indicate the ramifications for specific legal solutions. The touchstone here is the unchanging values essential for the functioning of the civil society.

For the seventh year, we hope you find useful insight in our annual publication.

Tomasz Wardyński

Internet fraud: Legal protections from a criminal and civil perspective

The internet has overwhelmed our private and professional lives. This applies to international trade, where the great majority of transactions are now conducted via email. But the obvious advantages of speed and informality of commerce are accompanied by dangers that businesses sometimes aren't aware of or don't take seriously.


Paweł Mazur


Janusz Tomczak


Krzysztof Wojdyło

Business email compromise

The email looks innocent, like any of the dozens of others received every day by departments responsible for making payments in our companies. It's all standard, nothing to rouse suspicions. The sender's details, the context in which the message is sent, and the terminology used all check out. It is usually only some time later that it comes to light that the email was sent by criminals. This is the essence of the cybercrime referred to as "business email compromise" (BEC) or "email account compromise" (EAC).

It consists of mimicking real correspondence in order to obtain money under false pretences. The criminals create email addresses beguilingly similar to the real addresses of trading partners. At the top level visible to the recipient, the fictitious email address of the sender may even be identical to the address of the supposed sender. Only a deeper analysis of the address reveals the differences.

The goal of the attack is to delude the recipient into thinking that he is corresponding with someone he knows. This is typically a trading partner or a superior at work (often for example the CEO). According to FBI reports, a radical increase in offences based on BEC/EAC schemes has been noted since 2010. In 2015 the FBI even labelled these cybercrimes as the most urgent problem in cyberspace. In June 2016 the FBI estimated the total value of losses generated so far by these offences at over USD 3 billion. And the FBI statistics only reflect a portion of BEC/EAC incidents.

Cybercriminals masquerading as a person known to the recipient of the email typically request at some point that certain funds be transferred to a bank account given in the email. In the case of emails from a supplier this often comes in the form of a notice of change in the account used by the supplier. In the case of an email supposedly from a superior this might be, for example, a note about the need to make a transfer connected with a top-secret project.

Some of the instances we have encountered in our practice plainly showed that the cyber attack was very carefully prepared. The criminals probably monitored the correspondence between the victims for some time. This enabled them to fit perfectly into the context of the existing correspondence, choose the right moment, and use the same expressions, effectively lulling the injured parties into dropping their guard. The email messages are often lent credibility by providing telephone numbers to supposedly trusted third parties (such as lawyers) who will confirm the transaction data provided in the fake email.

The scale of these crimes varies. In most instances the fraudsters manage to coax the victims into making transfers of several hundred thousand dollars, but there have been instances where many millions changed hands.

The funds transferred using the fake messages usually go to a bank account established by a straw man—an individual or firm who may or may not be aware they are cooperating with criminals. From that moment, the race with time begins.

How to secure stolen funds?

Time is of the essence. If the funds reach the account of the person or firm associated with the criminals, it won't rest there long. Most often the funds are forwarded on, electronically, to countries known for their aversion to international cooperation, and there all trace of the funds is lost or the funds are removed in cash from ATMs.

Blocking of funds immediately after they reach a Polish bank account is possible with a decision issued by the prosecutor. A problem here is the duration of the blockade, which cannot exceed three months before charges are filed against a specific person. But it has happened in our practice that the cooperation between banks has proceeded with such difficulty that the injured firm did not assert its claims until after this period expired. Even if the injured party established before that time the data for the account where the funds were sent, there is still a danger that after 90 days the blockade will lapse and the criminals will exploit this loophole in the law to sweep up the funds for themselves.

A solution could be to obtain interim relief securing the claim in a civil proceeding. As the party authorised to dispose of the funds, the injured party has a claim for their return to the owner of the account where the defrauded funds were found. The legal basis for such a claim could be either tort or unjust enrichment. This is a claim of a financial nature and may be secured among other things by attachment of the claims to the bank account or other claims, including for example the claim the account holder may have against the bank or the prosecutor's office to pay out the money when the blockade period ends. The security is imposed by the court upon application of the plaintiff filed with the statement of claim or before commencement of the proceeding.

The latter possibility is particularly attractive in light of the low court fee and the speed of action by the court which is vital to the case, as the court should decide the application promptly but no later than one week after it is filed. If the court grants the application *ex parte*, without notifying the defendant, the security may be enforced immediately by the bailiff. In effect, the bank or prosecutor will not be entitled, but required, to transfer the secured claim to the bailiff's deposit account, where the funds can safely await the final judgment of the court or decision by the prosecutor to return the funds to the account of the rightful owner.

How to get it back?

The injured parties in cases of this type generally share one motivation: first and foremost, they want to get their money back. They're rarely interested in identifying the perpetrators and the people helping them.

Prosecutors and police also take a pragmatic attitude toward such cases. Aware of the international dimension of these offences, they focus on what is feasible to achieve within their national jurisdiction. The fact that the events making up BEC (electronic correspondence, financial flows) typically occur in jurisdictions that are far apart means that the specific elements of the scam can be treated for example as fraud or money laundering. The legal classification affects the direction and scope of the measures taken by law enforcement authorities.

Because the prosecutor has control over the funds blocked in a bank account pursuant to his decision, the decision on release of the funds and return of the funds to the injured party also rests with the prosecutor.

In practice, the principal challenge in this situation is to collect sufficient evidence to persuade the prosecutor to return the funds to the person who lost them as a result of the fraud. In the formalised criminal procedure, this often makes it necessary to obtain evidence through international legal assistance, which presents numerous difficulties.

But sometimes it happens that the holder of the account takes legal steps for release of the blocked funds. On top of that, sometimes the tax authorities step into action, exercising their right to take measures competing with those of the prosecutor's office and the police. Then it may be necessary to initiate or continue a civil case in which the court will decide on the obligation of the account holder to pay the stolen amount back to the injured party. Such a proceeding can be surprisingly difficult, as the plaintiff must indubitably prove its right to the specific funds in the defendant's account and the correlating duty to release the funds by a firm that may have funds in its account deriving from various—not necessarily illegal—sources.

In short, in seemingly simple cases connected with the return of defrauded funds, it is necessary to deploy a battery of available instruments in various legal regimes and proceedings.

The law trails far behind

The radical growth in the number of cybercrimes based on BEC schemes undoubtedly results also from the negligible effectiveness of the battle against such offences. One of the main reasons is that the legal system is not suited to the task. We outlined above some examples where the regulations don't fit the nature of cybercrimes. But there are many more such examples. Banking secrecy rules quite effectively hinder the search by victims for basic information about the fate of their stolen funds. There is also a lack of effective instruments of international law enabling efficient access to information necessary to prosecute criminals (e.g. the relevant IP numbers and other teleinformatic data). Traditionally, criminal law remains the most poorly harmonised legal regime, which in globalised trade prevents an effective battle with cyber criminals.

Given the difficulties in pursuing justice by traditional methods, victims are beginning to focus on less-obvious solutions. They are starting to pursue damages from the financial institutions that participated in carrying out the transfers, in particular the institutions that maintained the accounts of the straw men used in the scheme. In the near future, the number of such claims against financial institutions is expected to grow. For many injured parties, it may be the only chance to make up their losses.

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From creditor to owner: Taking title to pledged shares in public companies

Łukasz Szegda Artur Bednarski

When a debtor does not pay its debts when they fall due and market intelligence indicates that the debtor is in poor financial condition and may even enter bankruptcy, creditors face a dilemma whether to exercise the security interests they hold or attempt negotiations with the debtor. Enforcement of security requires resolution of a number of issues. The correct solution is a condition for effective satisfaction of the creditor's claims. Apart from satisfaction as such, if the collateral is shares of another company, foreclosing on the collateral may result in the creditor acquiring control of the company whose shares were pledged.

One of our clients had problems with collecting receivables from one of its customers. All indications were that the company had major financial problems. After lengthy negotiations the parties signed an agreement setting forth rules for repayment of the indebtedness. The claims were secured among other things by a registered pledge on shares of one of the debtor's subsidiaries. The subsidiary's shares were dematerialised and listed on the Warsaw Stock Exchange.

It seemed that the crisis had been averted. But despite the agreed restructuring the debtor did not perform its obligations. Finally the client learned that the debtor had filed an application for an arrangement bankruptcy and another creditor had filed an application to place the debtor in a liquidation bankruptcy.

In situations like this, satisfaction of its claim as quickly as possible becomes a priority for the creditor, in order to avoid involvement in a long and costly bankruptcy proceeding. But first the creditor needs to determine what measures it can pursue.

Available options

Our client was still bound by restructuring agreements between the debtor and other creditors. They were supposed to ensure the debtor respite during the restructuring period so that unilateral acts by creditors did not thwart the purpose of achieving maximum repayment of the creditors' claims and avoiding the debtor's bankruptcy. As long as these agreements remained in force, even though they were not being performed by the debtor, the creditor could not take any steps in the nature of execution. So the first question was whether the agreement could be terminated, and if so when.

In such instances the situation when a creditor can terminate the agreement should be precisely defined. Any doubts in this respect may hinder further actions to enforce satisfaction of the creditor's claim. In this case, however, the answer was fairly straightforward, and the conditions for terminating the agreement had actually occurred. But it would still be a long way from termination of the restructuring agreement to satisfaction of the claim. That's where the uphill climb begins.

The agreement on the registered pledge of the shares provided for various means of satisfaction. The basic one was execution pursuant to the Civil Procedure Code. The creditor could also sell the shares at public auction or take title to the shares and apply the value of the shares at which the foreclosure was made against the amount of the secured claim. The creditor also held a power of attorney authorising it to sell the shares. Because bankruptcy petitions had been filed, the selection of the means to follow was dictated by the time necessary to take the particular actions.

Execution according to the Civil Procedure Code is not very fast. The debtor can file a complaint against practically every step taken by the bailiff. Although the regulations indicate that filing a complaint does not stay the proceeding, the circulation of correspondence and files between the court and the bailiff can take weeks. Besides, at the first stage, the debtor really has more control over the sale process.

The brokerage maintaining the securities account where the shares are entered is required to summon the debtor to submit an order to sell the shares so that it is possible to satisfy the creditor within the course of one month. But actions by the debtor can entirely block the sale of shares over this period.

Additionally, in the event of declaration of a liquidating bankruptcy, execution under pledges is impossible because all execution proceedings concerning assets of the bankruptcy estate are stayed, and then when the order declaring the bankruptcy becomes legally final, execution proceedings are discontinued.

Sale at a public auction conducted by a notary or bailiff is also not a certain method for obtaining satisfaction. The most serious drawback is the lack of relevant executive regulations concerning financial instruments. The existing regulation expressly excludes application of the regulation to financial instruments. And notaries and bailiffs are not eager to conduct such sales.

Selling the shares pursuant to the power of attorney might appear to be an attractive and quick method. The pledgee acting under the power of attorney concludes a contract with the buyer and settles the price against the secured claim. But in the case of shares admitted to trading on the regulated market, any sale must reflect the provisions of the Public Offerings Act. In the case of significant stakes of shares, acquisition of the shares occurs though a tender offer to subscribe for sale or exchange of shares. The party declaring the tender must provide security for the tender and notify the Polish Financial Supervision Authority and the Warsaw Stock Exchange, and the entire tender offer is conducted via an investment firm. This procedure takes several weeks at least.

The final option was to take over ownership of the shares on the basis of the registered pledge agreement. Pursuant to the agreement and the law, the pledgee may notify the pledgor that it is taking title to the pledged property, and in consequence of foreclosure of title the secured claim is reduced by the value at which the foreclosure was made. In the case of shares admitted to trading on the regulated market, the valuation problems typically present when taking title to shares in limited-liability companies do not occur. The law provides that title to the shares is assumed at the share price from the end of the day in which the assumption of title occurs. Moreover, if title to shares is assumed within the pledge enforcement process, the creditor is not required to announce a tender offer pursuant to the Public Offerings Act.

After reviewing the options, the creditor was inclined to take title to the shares, but here an additional problem arose.

Notifications and deadlines

The Registered Pledge Act requires the pledgee to notify the pledgor in advance of the intention of taking over title to shares. The notice should indicate that the creditor intends to seek satisfaction out of its collateral and specify the method in which it will pursue satisfaction. Within seven days after the notice, the pledgor can either pay off the pledgee or file a suit seeking a declaration that the claim is not due and payable or does not exist.

But the creditor was racing against the clock, because taking title to the shares would be impermissible if the shares were attached by another creditor in the course of execution by the bailiff, which in the debtor's situation was highly likely to occur.

The consequences of failure to comply with the period which should pass between the notice and taking title to the shares are not addressed in the Registered Pledge Act. Under the dominant view, this period was provided to enable the pledgor to pay the outstanding claim or seek relief from the court, but the law does not specify that the assumption of title will be invalid if the period is not complied with. According to proponents of this view, violation of this period may at most give rise to a claim for redress of loss suffered by the pledgor because the pledgee failed to comply with the statutory or contractual requirements.

Assuming that despite violation of this period the assumption of title remains effective, the legal situation of the creditor taking over the collateral becomes more favourable. For the debtor to obtain damages it would have to show that as a result of the violation it suffered a loss, that is, a detriment (such as loss of the shares) that would not have occurred if the creditor had complied with the agreement. In most instances the debtor would have to demonstrate that if the collateral were taken in compliance with the agreement, the debtor would have paid the creditor first or the value at which the collateral was taken would have been higher.

The creditor faced the dilemma whether to strictly comply with the agreement and wait seven days, which would threaten declaration of the debtor's bankruptcy before the shares were taken over, or seizure of the shares by another creditor, or to risk violating the seven-day period, which potentially might lead to a claim for damages. After obtaining a legal analysis, the creditor determined that the risk of violating this period did not outweigh the risk of taking over the shares and further delaying satisfaction of its claim. It thus submitted a notice of assumption of title to the shares to the debtor and the brokerage.

Response from the debtor—and the brokerage

The creditor didn't have to wait long for the debtor's response. Not only did the debtor dispute the creditor's actions, but it also applied to the court for interim relief, seeking to enjoin the creditor from disposing of the shares, withdrawing the shares from trading on the WSE, or exercising rights under the shares. The debtor claimed that taking title to the shares without advance notice was invalid.

Surprisingly, the brokerage also refused to execute immediately the order to transfer the shares to the client's securities account. The brokerage demanded proof that there was a due and payable claim and that the required period had passed, and also demanded that the creditor cover the commission for transferring the shares from the debtor's account to the creditor's account (even though the debtor was required to pay this fee under the agreement with the brokerage).

From creditor to owner

The court denied the debtor's application for interim relief, taking a position similar to that which had earlier convinced the creditor to proceed. The court underlined that the act did not provide for the invalidity of the assumption of title to the shares, and pointed out that in any event the debtor was late with its payment for longer than the period it expected the creditor to wait. The debtor's appeal did not change the situation.

After long negotiations and fulfilment of additional requirements, the client was successful in having the brokerage effectively transfer the shares from the debtor's account to the creditor's account. The creditor became the owner of shares representing a significant stake in a public company.

The foregoing example shows that taking over title to pledged shares can be an effective method of satisfying a claim, and also of acquiring control over a company (particularly as exercise of the pledgee's rights does not require announcement of a tender offer). However, such actions must be carefully planned and smoothly carried out, and are not free of risks.

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Don't sign a blank document

In business a document is not always ready to be signed when the person is ready to sign it. Then the person sometimes leaves a signed blank piece of paper with a trusted confidante who will subsequently fill in the content of the document. But this practice can have costly consequences.

Dr Marcin Lemkowski

The plane takes off, the train leaves the station

The Romans said *"Festina lente"*—or to paraphrase, "Haste makes waste." That's how it was in this case. A client negotiating a lease had a plane to catch. The discussion dragged out, but all indications were that an agreement would be reached. So the client signed two blank sheets of paper and left them with a trusted co-worker to continue the negotiations. He was then supposed to use the signed pages to create the final agreed version of the lease.

But the lease agreement was never concluded, and the client forgot he had signed the blank sheets.

A promissory note arrives

A few years after these events, the client was served with an order from a Polish court to pay EUR 3.2 million. The order said it was issued pursuant to a promissory note. The client blanched in astonishment. He had never signed any such promissory note! But the signature looked like his own. Puzzlingly, the note was made in two languages—including Polish, which the client did not speak.

The client filed an objection to the order for payment, alleging that he had not signed the promissory note.

Handwriting expert

In cases of this type the Polish courts almost always appoint an expert to compare the handwriting. That was the case here as well. The court decided to appoint, as the judge put it, "the most distinguished expert"—a university professor with vast experience in examinations of this type.

After reviewing the case file, the professor issued an opinion stating that with great probability the signature did come from the client, but he also could not rule out that the signature was forged by the method of free imitation, where the forger learns the person's signature, practises how it is formed and then commits it to paper. The professor explained that the signature on the promissory note was only initials, an abbreviated signature, while a complete and highly reliable examination requires a full signature of a dozen or so characters.

Memory jogged

Before the opinion was issued, the client was reviewing documents related to the matter and came across a fax in his archive from the former co-worker in which the colleague said that he had the two pieces of paper signed *in blanco* during the lease negotiations but would hold on to them for possible use in the future. After stumbling across this fax, the client requested that the papers be returned. But the papers were not found or returned, and the client never received an explanation of what had happened to them.

From that moment the client became certain that someone had later printed the text of the promissory note onto one of these signed sheets of paper.

The professor replies

A court-appointed expert will generally also field questions from the parties in court. Even when counsel prepare long for the hearing, sometimes the most interesting questions only pop up during the oral examination. It was in response to questions from the client's attorneys that the professor explained that at that time the origin of the paper on which the promissory note was printed could not be identified, nor the printer that was used. The age of the document could be determined, but only if it was no older than two years, as the ink gradually dries over that time. After that, it could only be stated that the document is older than two years. But the most interesting question was how long fingerprints would remain on the paper. A long time as it turned out—up to 20 years!

Dactyloscopy

This opened up a new thread in the case. A dactyloscopic analysis was requested to determine whose fingerprints were found on the promissory note. Obviously, the immediate suspicion fell on the client's former colleague, who in fact was soon scheduled to testify as a witness. At that time, in the middle of the hearing, the witness was requested to consent to taking his fingerprints. He agreed, and the court called officers to escort the man from the courtroom to the police station, where his fingerprints were taken and recorded on a dactyloscopic card.

A secretary's touch

The client recalled that at the meeting concerning the lease there was also a secretary present, and she might have handed him the sheets of paper which he subsequently signed *in blanco*. Finding her fingerprints on the promissory note would back up the allegation that the promissory note was made on those sheets of paper, because under the circumstances neither the secretary nor the former co-worker would have an occasion to touch the document later. So the client requested that the secretary submit to a fingerprint examination, but she refused—as a person has a right to do in a civil proceeding. Soon afterwards the co-worker withdrew his consent to take his fingerprints.

Judgment and appeal

The court refused to admit evidence in the form of a report by a fingerprint expert, finding that the evidence was unnecessary to the case and moreover the persons whose fingerprints might be found on the promissory note had not consented to such an examination or had withdrawn their consent. Then the court issued a judgment upholding the order for payment issued under the promissory note, in the amount of EUR 3.2 million plus interest.

The client did not accept this judgment and filed an appeal, which was granted. The appellate court pointed out primarily that the circumstances of the cooperation between the plaintiff and the client did not suggest that a promissory note had ever been signed in that amount. Moreover, the document was bilingual, and the story of how it came to be as presented in the parties' testimony did not come across as credible. The case was remanded for reconsideration.

Examining fingerprints

Upon rehearing, the court first denied the application to admit an expert opinion on the fingerprints. The client protested this decision, arguing that once a person consents to have his fingerprints taken, subsequent withdrawal of consent is no barrier to admitting such evidence, because the issue should be considered in terms of protection of the person's privacy, which was already infringed when the fingerprints were taken, and thus withdrawal of consent after the fact was ineffective. Upon reconsideration the court admitted a dactyloscopic opinion. But the examination did not confirm that the promissory note contained the fingerprints of the former co-worker. There were prints, but coming from other people, as well as a few that were too indistinct to be attributed to the suspect.

Although this evidence did not determine who forged the promissory note, it nonetheless sufficed for the court to deny the claim against the client. The court found that the promissory note had been made on the sheets of paper signed *in blanco* which the client had long ago left with his former co-worker. The court held that it was irrelevant in this case who had committed the forgery. The plaintiff appealed from this judgment but the appeal was denied.

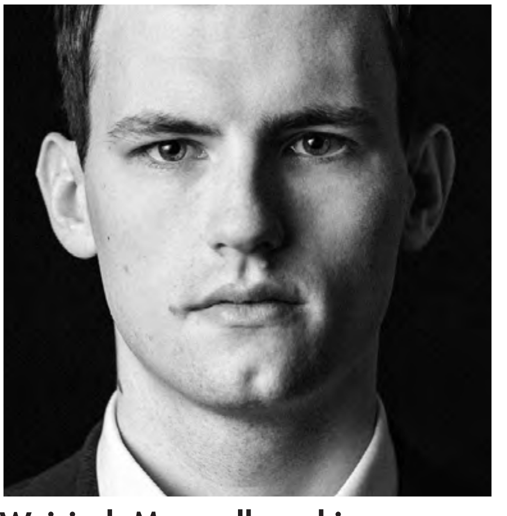
All's well that ends well

The case ended successfully for the client. The attempt to exploit the *in blanco* signatures provided in confidence failed, even though the client was caught in a serious bind after the first judgment.

The lesson? Anytime you consider issuing a signature *in blanco*, think long and hard whether it's really worth doing. A letter for you might just arrive in the post with a document you don't recognise and can't remember ever signing.

Dr Marcin Lemkowski, adwokat*, partner, Dispute Resolution & Arbitration practice*

Wholesale tax fraud requires retail examination



Dariusz Wasylkowski Wojciech Marszałkowski

A tax inspection at a company often serves as a prelude to fiscal penal proceedings, and increasingly often also criminal proceedings against members of the management board. Fulfilment of the elements of commission of a fiscal offence must be examined scrupulously with respect to each board member separately. Board members acting within their defined field of competence often have no grounds for suspecting irregularities in the company's tax settlements.

The facts we present below are hypothetical, but under the commercial realities in Poland in recent years, similar events have occurred numerous times.

A surprising coincidence

A limited-liability company is in the business of trading in coffee beans. It buys beans from big wholesalers or importers and resells them to suppliers of restaurants and workplaces. The coffee market is fragmented, with many entities operating on the market on varying scales.

The management board of the company is made up of three people. The first member is responsible for sourcing suppliers and for sales and marketing, including presenting the company's products at trade fairs. The second member is the finance director. The third member of the management board is responsible for operating activity, logistics and other current matters.

In 2014, during a periodic trade fair, the company's stand was approached by a businessman who introduced himself as a distributor of coffee supplying convention centres and food service locations in northern Poland. After reviewing the company's product line, he said that he would like to buy three tonnes of coffee—a mix of Arabica and Robusta beans roasted by the producer Grado Espresso—at a price of PLN 60 net per kilogramme. He also pointed out that it would be a trial order, to test the supplier's reliability. The company did not have this product in its range, but the board member at the trade fair accepted a business card from the customer he had just met. Two weeks later, the company received a call from another unknown trader, offering to supply Grado Espresso for PLN 57 net per kilogramme. The company bought a three-tonne sample of the coffee from the supplier and sold it on to the buyer met at the trade fair.

The cooperation with the new partners expanded quickly. As the volume of orders increased, the company began to use the services of a shipper recommended by the new supplier to deliver the beans directly from the company's supplier to its buyer.

A visit from the tax audit office

In 2016 the company had a knock on the door from the tax audit office. During the audit it was found that the company and its trading partners had participated in a criminal chain of transactions. The company was ordered to pay VAT for specific periods in 2014 set at several million zlotys, resulting from denial of the company's right to deduct the input VAT on the invoices issued by the supplier of the goods and the logistics firm because of the non-existence of the transaction—the absence of actual trading.

In the justification for the decision, the tax authority stated that because of the non-existence of the transaction there was no obligation to examine whether the company acted in good faith, i.e. whether it had selected its trading partners with due care. Nonetheless, the tax authority found that the company had entered into cooperation with previously unknown entities and the members of the management board were aware that the cooperation had expanded at an unusually quick pace. The tax authority also pointed to the inadequate verification of the identity of the supplier, and regarded it as negligent for the company to use an unknown shipping firm. The evidence included decisions issued by the authorities against the company's counterparties and persons cooperating with them, indicating a closed circle of suppliers. The decision concluded that the company had agreed to participate in a criminal scheme.

Liability of management board members

Should the findings of the tax audit authority have a decisive influence when weighing the liability of the management board members in a fiscal penal proceeding?

Fiscal penal proceedings are conducted concurrently or following audit proceedings, inspired by information that finds its way into the files of the fiscal penal case. Thus the tax audit authorities bear a high responsibility for the accuracy of their factual findings and application of substantive law. The prosecutor should not accept automatically and uncritically the findings and legal assessment made during the audit proceeding.

Scope of examination by tax audit office

During audit proceedings, the authorities have a duty to take all necessary measures to thoroughly clarify the state of facts and resolve the matter. The substantive scope of the matter limits the set of circumstances that should be examined by the tax audit authority.

In VAT carousel fraud cases, the decisions by the authorities most often indicate that the invoices issued by a non-existent entity or confirming activities that were never performed do not constitute a basis for deduction or refund of input VAT. According to the practice, if the authorities find that a real transaction occurred, the subject of the examination will be whether on objective grounds it can be found that the taxpayer knew or should have known that the transaction which was the legal basis for deducting VAT was tied to a criminal offence committed by the issuer of the invoice or other entity operating at an earlier phase of trading.

Scope of examination in this case study

Under the facts presented in this case study, each of the members of the management board was in possession of part of the knowledge of the cooperation with the trading partners. The role of the first member ended when the cooperation was established; the role of the finance director was limited to oversight of cash flows and the correctness of the documentation; and the role of the board member handling logistics included issues of the increase in sales volume and cooperation with the shipping firm.

The tax audit authority alleged that the transactions did not occur and the company had no right to deduct the VAT, thus releasing itself from the burden of examining whether the taxpayer acted in good faith. Nonetheless, the audit authority expressed an opinion on the knowledge of the management board members, stating that all of them were aware of the criminal procedure.

In reaching this conclusion, the audit authority combined the knowledge of specific board members with the findings made during other audit proceedings and attributed all of this knowledge to the members of the management board as a group. The authority thus exceeded the substantive scope of its consideration of the case by evaluating the company's intention with respect to participation in a carousel fraud.

Prosecutor's role

The prosecutor bears a heavy task. Here the facts of the case seemed on the surface to have been clarified during the audit proceeding, but in reality many of the findings remained disputable.

The prosecutor is required to reach factual determinations with respect to each individual separately, because someone who is jointly involved in commission of a punishable act is criminally liable within the limits of his own intent or negligence. This dispersed examination is one of the requirements differentiating audit proceedings from fiscal penal proceedings. In the case of audit proceedings, the conclusions of the audit authority (whether or they not they may be regarded as too far-reaching) should concern the taxpayer, i.e. the company. But in the case of fiscal penal proceedings, the party is a member of the management board.

The role of counsel

In addition to measures pursued in connection with the merits of the case, the task of the party's attorney in audit proceedings is to insist that the audit authority accurately identify the actions of specific persons and to contest inaccurate findings by the authority, even if on the surface they seem irrelevant to the determination of the case—because such findings can influence the subsequent fiscal penal proceedings.

During the fiscal penal proceedings, defence counsel should first identify the shortcomings of the decision issued by the tax authorities, particularly those that were irrelevant for determination of the tax proceeding (as the relevant circumstances are reviewed by the administrative courts) but were not removed during the audit proceeding.

Conclusion

An active approach by counsel at the stage of the audit proceeding is essential because it is harder to combat findings by the authorities during a fiscal penal proceeding. In practice, the findings by the audit authorities enjoy an unwritten presumption of truth, and consequently defence counsel is forced to prove the management board member's innocence.

An honest business has a range of arguments at its disposal during the proceedings, including procedural measures as well as demonstrating that the counterparty in question had made all the legally required registrations, and showing that the transaction was conducted in compliance with market practice and the prices were not suspiciously out of line with market standards.

But the key to safety of the company and the management board members is prevention, involving a review of the company's portfolio and elimination of suspicious suppliers, designing procedures for verification of new trading partners appropriate to the given sector of the economy, and sometimes also filing of amended tax returns as necessary.

These tactics are essential, because exploitation of honest businesses by fraudsters is a widespread practice. Consequently, it is often honest businesses that suffer the worst consequences from the actions of tax auditors and law enforcement authorities. When it is impossible to act against the fraudsters, the authorities may shift their focus—and the negative financial and criminal consequences—to entities that are ready to hand and have available assets.

Dariusz Wasylkowski, adwokat*, tax adviser, partner heading the Tax practice*

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Acquisition of an enterprise: The buyer's liability for the seller's obligations

Bartosz Kuraś Izabela Zielińska-Barłożek

In M&A practice, a fundamental question is whether the transaction involves assets or shares. If the transaction involves assets, they may constitute an enterprise or an organised part of an enterprise. This is particularly relevant for the acquirer (buyer), because by law, the sale of an enterprise has certain consequences in terms of the buyer's liability for the seller's obligations.

The liability of an acquirer of an enterprise for the debts of the seller is a solution adopted in the Polish legal system which foreign businesspeople often find surprising, particularly if they come from common-law jurisdictions. Consequently, the parties often attempt—not necessarily successfully—to frame the transaction in such a way that it would not be deemed to involve the sale of an enterprise.

Below we describe what can be regarded as an enterprise and provide a few examples involving the rule of the liability of the acquirer of an enterprise and possible exclusion or limitation of the rule.

Enterprise—meaning what?

When the subject of the transaction is assets, rather than shares in a company, it should be examined whether the assets constitute an enterprise, as such a classification entails certain consequences for the buyer. One of them is liability for the history of the enterprise, i.e. the obligations connected with the enterprise prior to the acquisition.

Under the statutory definition, an enterprise is an organised set of tangible and intangible elements intended for conducting economic activity. The law indicates examples of the elements that may be included in an enterprise, specifically: the name of the enterprise; ownership of real estate and movables, including equipment, materials, goods and products; other rights to real estate and movables—*in rem* rights or rights arising out of contracts of lease or tenancy; receivables; rights to securities and cash; concessions, licences and permits; industrial property rights; economic copyright; and books and records connected with business operations. A typical element of an enterprise—regarded as one of the most important—is clientele, as well as goodwill, a notion drawn into the Polish legal system from the common law, generally epitomised by a certain reputation and network of connections of the enterprise.

An enterprise is thus a certain organised complex of assets intended for operation of economic activity. It may comprise various elements. For the purposes of each transaction, an evaluation should be conducted of the elements that are to be the subject of the transaction. First and foremost it should be evaluated, separately on the legal side and the tax side, whether the given assets which are the subject of the transaction are functionally and organisationally combined as a whole to constitute an enterprise. This is vital, as an enterprise is a special subject of legal and economic dealings. As demonstrated by the practice and the case law, what is decisive is the existence of an element of organisational and functional connection between the various elements of the enterprise enabling it to be treated as a certain whole.

For example, an organisationally and functionally distinct division of a firm handling accounting and financial operations has been held to be an enterprise (or an organised part of an enterprise, which is generally also governed by the rules applicable to an entire enterprise). In another case, a division of a company handling sales of a certain product line was held to be an enterprise.

Conversely, there is the example of a company that ceased operations and then, after an extended dormant period, offered assets for sale in the form of real estate and machinery. These assets, despite having a certain connection, had not been used for years and did not constitute an enterprise. It was only when these assets were supplemented after the transaction (with investment in a production line and renovation of the production hall so that the buyer could begin operating there) and became appropriately connected functionally and organisationally (with the relevant management, client base and employees) that an enterprise was created.

Acquirer's liability for obligations of enterprise

The appropriate classification is essential, as the acquirer of an enterprise (e.g. the company purchasing it) is jointly and severally liable with the seller (e.g. the company selling its enterprise) for the seller's obligations connected with operation of the enterprise. This makes the buyer of the enterprise directly liable to the seller's creditors. Following the sale of an enterprise, a creditor of the seller (e.g. a supplier of materials, or a bank financing the seller's operations) may generally demand satisfaction from the buyer (e.g. payment for supplied materials or repayment of the loan).

This liability does not arise if the subject of the transaction does not constitute an enterprise.

Nor does this liability arise if at the time of the acquisition the acquirer did not know of the obligations despite making due inquiry. In other words, before acquiring an enterprise the acquirer should examine it carefully. The review should be conducted with due professional care, with the involvement of specialists in various fields to clarify issues of a legal, organisational or financial nature.

The detailed scope of the examination obviously depends on the type and scale of the enterprise. The typical examination conducted by buyers thus includes legal and tax due diligence. If the enterprise includes real estate, the buyer often also decides to conduct a technical or environmental examination. In certain situations it may also be necessary to conduct, for example, an examination of IT systems. Maintaining the due standard of care required in professional dealings at the stage of examination of the subject of the transaction (i.e. the enterprise) is necessary so that the buyer later can rely on an exclusion of liability for unknown debts of the seller.

The acquirer's liability is also limited to the value of the enterprise in its state as of the time of acquisition and the prices in force at the time the creditor is satisfied. Such liability cannot be limited or excluded without the creditor's consent.

Attempts to limit or exclude liability

The buyer's liability for the seller's debts connected with the enterprise cannot be excluded vis-à-vis the creditors by agreement between the seller and the buyer. This rule thus applies in relations between the seller and the buyer of the enterprise, on one hand, and the creditors of the enterprise on the other, regardless of what the seller and the buyer may have agreed between themselves. In practice, the seller and the buyer will usually agree on rules for the seller to bear liability if the seller's creditors assert claims against the buyer related to the period prior to the sale of the enterprise. But this agreement is effective only internally, between the buyer and the seller.

In practice, various attempts are often made to exclude the buyer's liability. With respect to the seller's principal creditors, particularly banks and other lenders, the common practice is to obtain these creditors' consent to exclusion of the buyer's liability. Typically such consent is combined with at least a partial repayment of the seller's existing obligations, often applied directly from the purchase price the buyer pays for the enterprise. This is undoubtedly the safest method of limiting the buyer's liability for the seller's obligations, present at some stage in most transactions involving sale of an enterprise.

Other methods encountered in practice involve phasing of the transaction. In one case the seller decided to phase the sale of specific elements of the enterprise. The totality of the interrelated assets—including real estate, machinery, rights under contracts with customers and suppliers, and intellectual property rights—undoubtedly constituted an enterprise. However, the elements making up the enterprise were transferred under separate agreements at different times. Additionally, the buyer made the direct acquisition of the assets via two different wholly owned subsidiaries. Thus in economic terms, the buyer acquired all elements of the enterprise indirectly, over a certain time frame, but formally the elements were divided between two buyers.

Selling specific elements of an enterprise under various contracts does not eliminate the risk of the buyer's liability for the seller's debts. Indeed, it is frequently the case that the sale of an enterprise occurs on the basis of more than one contract, particularly when the enterprise includes real estate.

The situation is more complicated when the sale of specific elements is spread out over time and the sale is formally made to different entities (but belonging to the same corporate group). Here the specific case must be examined. In the example given above, the transaction was structured to give the acquirer as many arguments as possible for claiming that it had acquired assets that did not constitute an enterprise. But from the overall documentation and circumstances of the case it was clear that the subject of the transaction was the enterprise, and the transaction was structured with the intention of avoiding the buyer's potential liability to the seller's creditors.

Protection of creditors' rights

Extending to the buyer liability for the seller's obligations connected with the operation of an enterprise means that the buyer accedes to the seller's debts. The purpose of this rule is clear: to protect the rights of creditors. Sale of the enterprise generally does not release the seller from liability for the history of the enterprise. Alongside the seller, the creditor can look as well to a new debtor—the buyer and current owner of the enterprise.

The rules for the buyer's liability when acquiring an enterprise should be reflected in the transaction documents, as the rules enable the creditors to pursue their rights, in court if necessary, against the holder of the assets—the acquirer of the enterprise.

Bartosz Kuraś, legal adviser, M&A and Corporate practice

Izabela Zielińska-Barłożek, legal adviser, partner heading the M&A practice

Can a company be stolen? The case of Mr A

Weronika Pelc

If you're the shareholder of a profitable company run by managers enjoying your boundless trust, remember that sometimes matters can take an unexpected turn, and without your knowledge or consent your profitable business can find its way into other people's hands.

Mr A was an entrepreneur operating a commercial business in numerous countries around the world via a network of companies. As there was just one of him, but many companies in various jurisdictions, governed by different legal requirements and varying business practices, Mr A cooperated with local minority shareholders who knew the local languages, laws and customs.

If the local partner proved responsible and trustworthy, Mr A agreed for the person to join the management board or granted him far-reaching authorisation. He also relied on the person's knowledge of local law and opinion as to the formal structure for the business. Mr A assumed that a management board member permanently residing in the country of operations would not risk taking any actions contrary to law, and that it would be in that person's interest to conduct all business aboveboard.

Mr A often visited his companies and reviewed their accounting figures, but he relied on the manager's books because the local financial reports were not always understandable to him, as he didn't know the language and the accounting rules differed.

Shortly after one of Mr A's visits to his Polish company, his trusted confidante, Mr X, who was also a minority shareholder with 10% of the shares in the company and a member of the management board, stopped taking his phone calls or responding to his emails. The office staff couldn't say where their local boss was. Concerned, Mr A again travelled to Poland and showed up at the office of his company. There he greeted the staff and asked for a cup of coffee and information about recent transactions.

Imagine his surprise when the employees he had known for years served him coffee but said they couldn't report to him at all on the status of the company's affairs because they hadn't worked for the company for a month. Moreover, the office was no longer the office of Mr A's company, because the lease had been terminated. Now the office was the headquarters of company XYZ belonging to Ms Y. The staff didn't know where the documentation of Mr A's company was located and couldn't indicate the whereabouts of Mr X.

Mr A then dropped by the bank where the company kept its accounts, but the bank refused to provide him with any information because he was not indicated as a person authorised to use the account and his signature was not found on the signature card. The only person authorised to access the account was Mr X and the accountant, who was now employed at company XYZ.

Mr A wanted to head straight to the police and report the theft of his company, but he was held back by his lack of knowledge of Polish. He contacted a lawyer he knew whose services he had used from time to time in disputed matters. The lawyer couldn't enlighten him as to the condition of his company because the current legal affairs of Mr A's company were conducted by Mr X along with his trusted accountant. He did explain that it would be pointless to go to the police or the prosecutor's office without gathering more information and evidence. Employees can change jobs, after all, and companies can change offices. As a member of the board authorised to represent the company individually, Mr X could legally and effectively terminate the lease. Besides, Polish law did not provide for any such offence as stealing a company. The lawyer printed out the current transcript from the National Court Register for Mr A's company. According to the transcript, a couple of weeks before an independent commercial proxy had been entered in the register—a person unknown to Mr A with a foreign-sounding name.

Mr A attempted to obtain information and corporate documents from the accountant, but she could not be reached. With the lawyer's help, Mr A began drawing up a strategy for regaining control over the company and its property. Although he was a shareholder with 90% of the shares and votes, he couldn't change the management board immediately because that required him to call an extraordinary meeting of shareholders to adopt the relevant resolutions. That took two precious weeks. During that time, many people, including trading partners and institutions, refused to provide Mr A any information or access to documents concerning his company, pointing out that Mr A was not authorised to represent the company. Finally Mr A adopted the relevant resolutions, removing Mr X from the management board and appointing himself in his place. The next step was to make a formal request to the accountant and Mr X to provide him the company's documentation, and to visit the bank and the company's key customers and suppliers.

At the bank it turned out that there was little money left in the account, and significant sums had been transferred to companies unknown to Mr A, located in Eastern European countries outside the EU, as payment for trade debts. Moreover, there was no evidence that the companies' long-term customers, known to Mr A, had made any payments to the account.

Mr A's Polish customers were taciturn. They said they had fully settled their accounts with his company, and Mr A should have the proof of that since he was a member of the management board. They didn't want to discuss their further cooperation, only saying that they had new suppliers.

Mr A had to hire a private detective, who determined that Ms Y, the owner of XYZ, had been living with

Mr X before his disappearance. The detective also located the warehouse where the goods of Mr A's company were stored. The warehouse was rented by XYZ. XYZ explained that the goods in the warehouse, as well as the office furnishings, belonged to it, and it had purchased them at a bargain from company W. Ms Y had a valid sale contract. She didn't know how W had acquired the office furnishings or goods of Mr A's company. She refused to answer any questions about her relations with Mr X.

Mr A did not have in his possession any of the accounting records of his company, and thus he could not even legally prove that the goods in XYZ's warehouse had belonged to his company. When he alerted the prosecutor and the police, all they did was check that XYZ held a contract confirming they had legally acquired the items.

Mr A summoned Mr X, as the former management board member, to transfer all the company's documents to him as the new management board member. After an exchange of correspondence over many weeks, in which Mr X explained the situation by claiming he had a sudden, serious illness—for which he even presented a doctor's certificate—a meeting was finally held between Mr X and Mr A, and the company's documents were handed over.

Mr X claimed that he had been cheated by the new commercial proxy. The new proxy, who had been a rank-and-file employee of the company, had presented to him rosy prospects for expanding the business into countries in Eastern Europe, and had even managed to finalise and settle several successful deals. But further transactions depended on him being granted the duties of a commercial proxy. Then, exercising his new rights, he made a number of transactions that were no longer so successful—the buyers didn't pay. The company suffered heavy losses. To stem the losses, Mr X had moved to smaller and cheaper offices and announced salary cuts for the employees. In response, the staff had quit. Mr X also put up the remaining goods for sale because the existing customers had lost interest in cooperating with the company. He refused to discuss Ms Y's company and claimed that he had no connection with her.

Mr A didn't believe what Mr X was saying and filed a notice of suspicion of commission of the offence of acting against the interests of the company by Mr X. Mr X claimed in his defence that he had assumed an economic risk and not every business decision proves to be advantageous. The prosecutor's office discontinued the proceeding due to lack of evidence, but Mr A filed a private criminal complaint.

The case went on for several years. There were lots of difficulties presenting evidence because of a lack of documents and trouble taking witness testimony. Neither the former commercial proxy nor his trading partners showed up at the hearing, and their actual whereabouts were unknown.

Ms Y's business is blossoming. Mr X is no longer in business. You can meet him in the street in the middle of the day picking up his children from preschool. Ms Y is their mother.

Weronika Pelc, legal adviser, partner, Energy Sector practice and M&A practice

Criminal conviction of a Polish company abroad is not science fiction

Aleksandra Stępniewska

Elimination of international barriers opens up investment possibilities, but also expands the range of legal liability—including criminal liability. State borders are no longer an obstacle to enforcement of penalties.

Poland's accession to the European Union and the common market opened up new growth and investment prospects for Polish companies, with a range of new forms available for business expansion.

Selection of a business model (representative office, branch, or subsidiary) is dictated by various considerations and strategic decisions which sometimes depend on the specifics of the market sector in which the enterprise operates, as well as the legal environment. It would be a truism to say that notwithstanding the freedoms guaranteed by the EU, doing business in another member state requires compliance with the law in force there. But it may not be so obvious to point out that this applies as well to criminal law, and business may be subject to a broad range of risks of criminal liability—not only for individuals, but also for a Polish company operating in Poland or a subsidiary established in the target country. Criminal responsibility of companies in other countries may come as a great surprise to Polish businesspeople since in Poland criminal liability attaches primarily to individuals, and liability of corporate entities for criminal offences hardly exists in practice.

In the worst-case scenario a Polish company may be convicted and sentenced for a criminal offence by a foreign court, in a territory where the company has an economic presence, whether through its representatives or through a subsidiary, and within the EU such a sentence will be enforceable in Poland.

Corporate criminal liability

The situation as described above can be linked to the criminal liability regime in force in the given member state and the practice under which it is applied. In certain situations this practice can even lead to "piercing the corporate veil" that is recognised between corporate affiliates and subsidiaries which are legally separate entities.

The fact that a Polish company is a foreign entity may be irrelevant for criminal liability in another country. If an offence was committed in the territory of the given state and the conditions for corporate criminal liability are met, then the justice system in that state will generally have jurisdiction to prosecute, convict and sentence a foreign legal person. This is a natural consequence of the application of a country's criminal law to offences committed in the state's territory, regardless of the nationality of the perpetrator.

An example of a legal system in which a regime of corporate criminal liability functions is France. This is an autonomous form of liability and is not conditioned on a prior, legally final judgment finding that an offence was committed by an individual (as is currently the case in Poland). Thus in France legal persons and natural persons may be convicted in the same criminal trial.

There, the basis for convicting a legal person is the behaviour of an individual which the court finds to fulfil the elements of an offence committed on behalf of a company by its authorities or other person authorised to represent the company (Art. 121-2 of the French Code pénal).

Company facing charges

Assertion of criminal allegations against a Polish company by foreign law enforcement authorities may generate numerous legal issues, particularly concerning the proper representation of the company during the criminal trial and exercise of the company's right to defend itself in court. For example, can a commercial proxy acting for the company in its business also exercise his empowerment to act for a company that is suspected and subsequently accused of committing a criminal offence?

The Polish Civil Code defines a commercial proxy as a commercial representative, thus empowered to take actions in or out of court connected with the pursuit of economic activity. In my own view, there are no grounds for accepting that the scope of a proxy also extends to empowerment to represent a legal person accused in a criminal trial, including taking decisions on the company's defence strategy. Such power should be vested in the members of the company's management authority, who have the most extensive knowledge of the company and the broadest legal authority to take decisions for the company as the company's "personification."

Otherwise there might be a risk of infringing the company's right to a defence, such as the right to be heard and the right to be informed of the accusations and allegations against the company.

It would appear natural in this context that responsibility for the company's awareness of the pending trial as well as the company's defence strategy should rest in the hands of the persons on the company's management board. This is also relevant in terms of the language in which the trial of the Polish company should be conducted in the foreign court system. As an entity with the status of a foreigner, a Polish company should have a right to indicate that it does not speak the official language there and request that the proceedings against it be conducted in Polish. This should also ensure that the company is served with Polish translations of procedural decisions relevant to the accusations and the trial.

In this respect, it would be reasonable to recommend that in the case of criminal charges against a Polish corporate entity, Polish should generally be selected as the language for the proceedings, regardless of whether at the time criminal charges are asserted or an indictment is filed with the court there happens to be a person in the company who speaks the official language of the jurisdiction where the proceedings are held.

Conviction and enforcement

It should be borne in mind that differences in the legal systems of EU member states are no barrier to cross-border enforcement of judgments. This arises out of the principle recognised in the EU of mutual trust between the member states and the related requirement of mutual recognition and enforcement of judicial rulings issued in civil and criminal cases.

Enforcement of rulings is more or less automatic, and enforcement can be denied only in situations expressly provided by law.

In criminal cases, it is not a barrier to enforcement that the state where the sentence against a corporate entity is to be enforced does not provide for a regime of corporate liability as in the state where the judgment was issued. This is articulated in Council Framework Decision 2005/214/JHA of 24 February 2005 on the application of the principle of mutual recognition to financial penalties, Art. 9(3) of which states: "A financial penalty imposed on a legal person shall be enforced even if the executing State does not recognise the principle of criminal liability of legal persons." Generally, the severity of the penalty also does not provide sufficient grounds to deny enforcement of the judgment.

When it becomes legally final, a foreign judgment sentencing a Polish company to a fine or other criminal sanctions, such as restitution, will become enforceable in Poland as the state where the Polish company has its registered office, or in any other member state where the company has assets.

Eyes in the back of the head

Lifting of inter-state legal and economic barriers is undeniably attractive for businesses seeking to internationalise their operations. But responsible business must also reflect the fact that internationalisation can strongly impact the legal environment of the enterprise and generate significant risks. Once a company begins to operate abroad, the company and its subsidiaries (if it chooses to establish them) fall under the legal system in force in that territory and the law enforcement practice there. The practice may pay no heed to the "foreign origin" of the company or any implications arising from that.

When deciding to enter foreign markets, it is therefore essential to examine thoroughly the legal regulations in force in that jurisdiction particularly relevant to business activity—including criminal provisions. This is especially important if there is a regime of criminal liability of corporate entities in force in the legal system of the country where the company wants to have a business presence.

After examining the legal ecosystem, the behaviours that could lead to criminal liability should be mapped out, reflecting the specifics of the company's business operations. A system of compliance procedures should also be developed as an important weapon of defence—including defence against criminal allegations, depending on the legal system in question. In some jurisdictions adoption of a compliance system is a statutory requirement, as for example will be the case in France from May 2017 with respect to risks of all types of corrupt practices.

Moreover, in the state of legislative inflation we currently witness, it is also essential to keep an eye on changes in law and practice in the countries where the Polish company has an economic presence.

Aleksandra Stępniewska, adwokat, *Business Crime practice*

What sort of Brexit?

Agnieszka Kraińska

We still don't know how Brexit will look, even though at the time of writing these words more than half a year has passed since voting on the fateful referendum. It takes time because a member state leaving the EU must review all of its existing legislation. Withdrawing from the EU is a daunting process. Here we examine some of the possible consequences using the example of the "European freedoms."

On 23 June 2016 the citizens of the United Kingdom of Great Britain and Northern Ireland voted in favour of withdrawing their country from the European Union. The UK joined the European Community in 1973 and it is the first member state that has ever decided to leave.

The procedure for leaving the EU is governed by Art. 50 of the Treaty on European Union, which was introduced on 1 December 2009 pursuant to the Treaty of Lisbon. Art. 50 provides that any member state may decide to withdraw from the Union in accordance with its own constitutional requirements. Under the withdrawal procedure, the member state will notify the European Council of its intention. Then the Union will negotiate and conclude an agreement with that state setting out the arrangements for its withdrawal and the framework for its future relationship with the Union. The agreement is concluded on behalf of the Union by the Council of the European Union, acting by a qualified majority, after obtaining the consent of the European Parliament. The EU treaties shall cease to apply to the withdrawing state from the date of entry into force of the withdrawal agreement or, failing that, two years after the notification of the intention of withdrawing (unless the European Council, in agreement with the withdrawing state, unanimously decides to extend this period).

The fact that the EU treaties cease to apply to the withdrawing state means that the withdrawing state ceases to be bound by the obligations arising under EU law and loses all rights arising under EU law. From the point of view of the member states remaining in the Union, the withdrawing state becomes a third country, and thus under their own laws they will cease to apply to the withdrawing state any provisions concerning EU member states. The withdrawing member state should conduct a review of all its existing legislation and decide to what extent it must make changes, as a significant portion of national law constitutes implementation of EU law and awards various entitlements to EU citizens and legal entities from EU member states.

A consequence of Britain's departure from the EU will be its citizens' loss of the status of EU citizens, as well as the loss of all of the advantages connected with the free movement of goods, the freedom of establishment, the freedom to provide services, the free movement of capital, and the free movement of EU citizens and businesses. To better depict the consequences of Brexit, we decided to present them using the example of selected regulations. These are only hypothetical solutions, because it is still not known what arrangements will be worked out for the relations between the UK and the EU going forward—whether their relations will resemble those with member states of the European Free Trade Agreement who are also members of the European Economic Area (i.e. Iceland, Liechtenstein and Norway), or the relations with Switzerland (also an EFTA member) established under bilateral agreements, or will involve some other unique set of arrangements. One thing is certain however: the EU will not grant the UK access to its internal market if the UK does not provide reciprocal advantages to citizens and undertakings from EU countries.

Free movement of goods

A direct consequence of the UK's withdrawal from the EU would be introduction of import duties on UK goods imported into the EU and vice versa. It will also be necessary to establish the rules for introduction of UK goods onto the EU market and vice versa. It should be borne in mind that EU law governs the rules for mutual recognition of goods introduced into trade in any of the member states, prohibits introduction of quantitative restrictions or similar measures, establishes technical harmonisation for various industries, and also establishes rules of liability for injury caused by dangerous products. All of these regulations would no longer apply to British goods and the UK would not be obliged to apply them.

Freedom of establishment

With respect to independent and ongoing conduct of economic activity through a fixed establishment in another member state, EU law guarantees the rule of national treatment for citizens and undertakings from other EU countries. If the UK leaves the EU, UK entities will no longer have the right to establish branches, agencies and affiliates in the EU under non-discriminatory rules, and sector rules such as the special regulations governing the practice of law will cease to apply to UK citizens. The extensive EU regulations governing corporate law and corporate taxation, which will cease to apply to UK undertakings or business conducted in the UK by EU entities, should also be mentioned.

Freedom to provide services

The freedom to provide services applies to all services provided for payment, for a limited time, in the territory of another member state, and guarantees the rule of national treatment for entities from other EU countries. The regulations governing the digital market are particularly vital for the contemporary economy. The freedom to provide services also covers sectoral regulations governing telecommunications, audiovisual media, transportation, energy and postal services. It is hard to imagine a definitive severing of the ties between the UK and the EU arising out of this freedom, but this would be a consequence of a "hard" withdrawal from the EU.

Free movement of people

The free flow of persons is tied to the freedom of establishment and the free flow of services. EU regulations ensure mutual recognition of professional qualifications (e.g. for the professions of doctor, nurse or architect), the ability to study at universities in all member states, and equal access to social benefits for workers and their families. EU citizens must be treated equally, and together with their families can exercise the freedom to move anywhere in EU territory. This free flow of people within the EU (particularly the influx of citizens from member states in Central & Eastern Europe) was the main frustration of the British who voted for Brexit. A "hard" Brexit would permit the UK to shut off the flow of citizens from the remaining member states. But conversely, the British would lose the right associated with EU citizenship to receive equal treatment in member states—including in countries in southern Europe where many UK citizens have vacation homes or spend their retirement.

Free movement of capital

With this freedom, the EU has created an extensive and highly complex set of regulations governing financial markets. Financial institutions from member states enjoy the freedom to operate throughout the Union. Thanks to uniform regulations and oversight principles, financial institutions do not have to apply for an operating licence in every member state: after obtaining a licence in their home jurisdiction, they enjoy a "European passport" to operate in other member states. The UK's withdrawal from the EU will deal a heavy blow to British financial institutions, whose growth, popularity and success are partly owed to their freedom to operate throughout the EU.

Other consequences

The functioning of the internal market is ensured by EU regulations governing competition, state aid, public procurement, VAT and excise tax, and judicial cooperation—all of which would cease to be binding for the UK. The internal market is a tool for the Union to achieve common goals such as lasting, sustainable growth, environmental protection, improved living standards, a high level of employment and social protection, as well as economic and social cohesion. These goals are achieved through member states' performance of their obligations (e.g. complying with EU law and contributing to the EU budget) and exercise of their rights (e.g. accessing the common market and receiving payments from EU funds). Upsetting the balance between obligations and rights would undermine a sense of solidarity and fairness.

For this reason, the EU will not permit a scenario in which the UK withdraws from the EU and on one hand applies protectionist practices and on the other hand benefits from access to the common market.

When considering international commercial relations and membership in international organisations, it should also be mentioned that the UK's membership in the World Trade Organisation and its commercial dealings with the EFTA countries (Iceland, Liechtenstein, Norway and Switzerland), which are regulated via its membership in the European Union, will also require renegotiation with these organisations when the UK withdraws from the EU.

The scope of changes and adjustments the United Kingdom will need to go through in connection with withdrawal from the European Union (of which we have given only a cursory overview) is overwhelming. Considering the diverging interests of the EU and the UK as it seeks to withdraw, the two-year period allowed for negotiating a "secession treaty," and the requirement for such a treaty to be ratified by all the member states, the Brexit process seems so complicated and painful that it borders on the impossible.

Agnieszka Kraińska, legal adviser, EU Law practice

Who can act for a company?

On the legal and practical aspects of actions by company representatives: Who can act for a company? Within what bounds? Must every authorisation to act be publicly disclosed? Can the information entered in the National Court Register be relied on without reservation?

Izabela Zielińska-Barłożek

Anna Dąbrowska

Maciej Szewczyk

A company in Poland, i.e. a limited-liability company (sp. z o.o.) or joint-stock company (SA), is a legal person, and thus, under Art. 38 of the Civil Code, it functions through its authorities. The authority vested with the right to represent a company under the Commercial Companies Code is the management board (*zarząd*).

But obviously not only management board members can transact matters for the company. If that were the case, their duties would include not only activities of great importance (e.g. signing key contracts) but also entirely trivial matters (like buying office supplies). That would be inefficient or irrational.

Fortunately, the management board can—subject to limitations provided for in the codes mentioned above and any provisions of the company bylaws—appoint representatives, such as a proxy (*prokurent*) or an attorney (aka "attorney-in-fact"— *pełnomocnik*).

KRS is not all

For a counterparty doing business with the company, it is vital to be certain that the person acting for the company is authorised to do so. Problems often arise in this respect.

Undoubtedly the fundamental means providing a degree of certainty is the commercial register of the National Court Register (KRS). The National Court Register Act provides for a presumption of common knowledge of entries announced in the official gazette *Monitor Sądowy i Gospodarczy* (Art. 15(1)) and of the correctness of such entries (Art. 17(1)), which certainly helps promote the safety of commercial dealings. But in practice blind faith should not be placed in the entries in the register, and these presumptions should not be treated as absolute.

New member of the management board

First, it should be pointed out that some entries in the register (for example amendment of the articles of association or increase of the share capital) are "constitutive," meaning that the entry makes the act in question legally effective. But many other entries are only "declarative." If a declarative entry is not made, or is delayed, that does not influence the effectiveness or validity of the underlying act. The set of declarative entries includes all those referring to the persons making up the authorities of the company (including the management board) and its proxies. This means that the persons indicated in the register as members of the management board are not necessarily members at the given time, and also means that it cannot be ruled out that the status of management board members is held by other persons not (yet) disclosed in the register. But until the KRS entry reflects the appointment of new persons, the company may face difficulties when acting through the new members, or if actions are taken by persons who still appear in the register but have lost that status (although in this case it would be an abuse of law, or a wrongful act, for them to continue acting for the company).

Example: *By a shareholders' resolution effective upon adoption, the existing members of the management board were recalled and new members were appointed. Immediately after adoption of the resolution a new management board member submits a notice to a counterparty of the company renouncing their contract and demanding payment of a contractual penalty. The counterparty disputes the management board member's authority, citing the KRS excerpt where the new management board member is not listed yet.*

In this case, the management board member's right to submit the statement in question (assuming for simplicity that the statement could generally be submitted at any time) cannot be denied, but the other party's position should also be upheld. The other party is entirely within its rights, under KRS Act Art. 17(1), to assert that it doesn't have sufficient grounds to regard the person it is dealing with as a member of the management board. On the other hand, the company itself, on whose behalf a management board member not disclosed in KRS is acting, cannot assert to a counterparty acting in good faith that the data in the register are not up to date (KRS Act Art. 17(2)). In this situation, admitting the new member to act for the company will typically depend on the good will of the other party.

Active and passive representation

Second, simply looking at the KRS entries can give the wrong impression when it comes to the rules of representation applicable to the company.

Example: *The authority entitled to represent a company is listed in section 2 of the commercial register for the company. If no special provisions are included in the articles of association or statute, it is often stated in this section of the commercial register that in the case of a multi-person management board, the company is represented in particular by two members of the management board acting jointly. So if a counterparty submits a statement to the company (e.g. renouncing a contract) into the hands of only one member of the management board, will the statement be ineffective?*

In this instance the statement (again assuming that it is has appropriate grounds in substantive law and the facts) will exert the intended legal effect, because regardless of the regulations governing active representation (i.e. the rules providing for the manner in which statements are made for the company), there is a legal rule in force that gives every member of the management board the individual right of passive representation (i.e. to accept on behalf of the company statements by third parties). But this is not mentioned anywhere in the commercial register.

It should be mentioned also that not every act for a company (taking legal or factual actions) constitutes "representation" of the company within the meaning of the Commercial Companies Code.

Manner of representation

Similar remarks can be presented with respect to the manner of representation of the company indicated in section 2 of the commercial register.

Example: *In addition to specifying the manner of (active) representation of the company by the management board, there is often an indication in section 2 of the register that one member of the management board acting jointly with a proxy is also entitled to submit statements for the company. In practice, such an entry is often interpreted to mean that the proxy can act only jointly with a member of the management board.*

This interpretation, although it unfortunately crops up in practice and—sadly!—is even shared by some public authorities and agencies, is clearly erroneous. In popular understanding any action "for the company" or on its behalf is referred to as "representation," but this is improper. Apart from representation (discussed above) and representatives, the company can also appoint other persons who can take legal or factual action on behalf of the company. The common denominator for persons appointed in this way is that their authorisation to act is determined under the Civil Code provisions governing agency (Art. 95 and following). They are, namely, proxies or attorneys.

Proxy not indicated in KRS

But can the counterparty learn from the KRS excerpt who other than the management board can act for the company? Partly yes, because proxies are disclosed in the register. But not all attorneys are subject to disclosure in the register (such as employees authorised to take certain actions and enter into certain types of contracts, or attorneys at law appointed for litigation). But certain doubts can arise even in the case of entries concerning proxies.

Example: *Apart from other forms of proxy, a company may grant a "joint proxy" authorising two or more people to act together. The proper practice in such case would be to indicate expressly in the commercial register that the given proxy may act together with one or more joint proxies similar to himself. But the actual practice is entirely different, and often the entry referring to such a company representative is limited to the statement that he was issued a "joint proxy."*

Thus if the register shows at least three proxies for whom it is indicated that they hold a "joint proxy," it can't be determined without analysing the documents under which the joint proxy was issued whether it takes two, three, or even more proxies to act.

Ordinary attorneys

Finally, we should mention "ordinary" attorneys, who are not subject to entry in KRS. The other party to a transaction may check their authorisation only based on the actual document granting power of attorney. Without going into the question here of how the other party can verify whether the power of attorney presented is still in force, it should be determined whether the power of attorney was validly issued.

Example: *If the person (e.g. management board member) who issued a power of attorney for the company was subsequently removed from the register, sometimes the attorney's continued authority is questioned. Correctly?*

This practice is also improper. If a power of attorney was issued not to represent a specific person who is a management board member, but was issued on behalf of the company, then unless otherwise provided in the power of attorney itself it remains in force regardless of the future fate of the person signing it. How the attorney can prove his proper authorisation is a different matter. The current KRS excerpt (including the electronic version that can be downloaded on the internet free of charge) will unfortunately not be helpful here. It would be necessary to obtain a "full" excerpt, containing historical data, including the data from the period when the person who signed the power of attorney was disclosed in the register. However such an excerpt is not available online but only at selected regional information centres and thus is not easily accessible to everyone at all times.

Widespread ignorance

Summarising these musings, it should be pointed out that the most common reason for confusion is not defects in the entries in the commercial register (whether due to the fault of the company or the court, or systemic, such as the construction of the register or the procedure for making entries). It is the quite common unfamiliarity with the regulations governing the rules of representation or disclosure of these rules in the register. This applies to the companies themselves, third parties, including contractors, and even—*horribile dictu*—public authorities and courts.

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When can a shareholder demand a dividend?

Dr Kinga Ziemnicka

In most companies, receiving dividends is one of the most important rights enjoyed by shareholders. Participation in corporate profits is not an absolute right, however. This raises the question of the circumstances when a shareholder can demand payment of a dividend.

Shareholders in Polish companies—whether a limited-liability company (sp. z o.o.) or a joint-stock company (SA)—may select how the profit earned by the company in a given financial year is used, within the bounds established by law. Sometimes the interests of shareholders wanting to receive dividends clash with the current and prospective interests of the company requiring funds to be set aside for development. This makes decisions about allocation of profit vital for both shareholders and the company itself. How the profit is used can also have an effect on protection of the interests of the company's creditors, and thus the regulations provide for certain limitations on the amount of profit that can be paid out to shareholders.

Amount of permissible dividend

The first question that arises is which types of capital dividends may be paid out of, apart from profit from the most recent financial year. The answer always requires an examination not only of whether the given capital fund has money on hand to make the payment, but also the origin of the funds.

For example, in one case the management board of the company proposed in the additional information to the financial report increasing the dividend to shareholders to include amounts collected in the company's supplementary capital (*kapitał zapasowy*). But it turned out during drafting of the resolution on distribution of the profit that in reality the supplementary capital had not been created out of profit, but out of surcharges contributed by shareholders, which should be booked to reserve capital (*kapitał rezerwowy*) and cannot be distributed as a dividend. Consequently, the audited financial report had to be amended, and it was not possible to carry out the management board's proposal to increase the dividend with funds from the supplementary capital.

These limitations are tied to the need to protect the interests of the company's creditors. The regulations governing the amount of profit that can be distributed to shareholders are intended to prevent uncontrolled cash flows between the company and its shareholders.

The profit earned by a company in the past financial year must be distinguished from amounts earmarked for distribution among shareholders, which are calculated also in light of other items on the balance sheet. Under Art. 192 of the Commercial Companies Code (or Art. 348 §1 respectively), the amount designated for distribution among shareholders may not exceed the profit for the last financial year plus undistributed profit from previous years and amounts transferred from supplementary capital and reserve capital created out of profit which may be designated for distribution (in the form of a dividend). This amount must be reduced by uncovered losses, own shares, and amounts that pursuant to law or the company's articles of association (or statute) should be transferred from the profit for the past financial year to supplementary capital or reserve capital.

These regulations are mandatory, meaning that the shareholders cannot, pursuant to the articles of association or statute of the company or a shareholder resolution, designate an amount for distribution exceeding the limit provided by law.

In the context of the example given above, it should be pointed out that the supplementary capital or reserve capital may include amounts not deriving from the company's profit which are excluded from distribution as dividends. This applies in particular to agio, reflected in the supplementary capital, which does not constitute profit and thus cannot be designated for distribution to shareholders. Similarly, surcharges booked to "reserve capital from shareholder surcharges" cannot be used to pay dividends. This follows from the specific rules on repayment of surcharges set forth in Art. 179 of the Commercial Companies Code.

Unlike a limited-liability company, in a joint-stock company there is also mandatory retention of profit for supplementary capital. Under Art. 396 §1 of the code, at least 8% of the profit from a given financial year must be transferred to the supplementary capital to cover losses, until this capital reaches a level equal to at least one-third of the share capital. This amount also cannot be used to pay dividends.

It should be mentioned that if an advance has been paid against the dividend for the given financial year, this amount reduces accordingly the amount set aside for payment of a dividend after the end of the financial year (Art. 191 §1 or 347 §3).

Claim for payment of dividend and ability to assign the right to a dividend

Another issue tied to distribution of profit involves the situation where a shareholder may demand payment of a dividend in a specific amount and transfer this right to another person by an assignment of claims.

This issue requires a distinction between the general right to profit on the part of a shareholder, as part of its share rights, and the right to profit arising under a shareholders' resolution.

Shareholders acquire a subjective right to profit on the basis of the resolution approving the company's annual financial report, together with a designation of profit for distribution (pursuant to a resolution or the articles of association or statute). The difference between these rights is essentially that a shareholder's right to participate in profit pursuant to a resolution adopted by the shareholders' meeting includes a claim for payment of the dividend. By contrast, a shareholder's general right to participate in the company's profit, as one of the corporate rights connected with the shares, cannot be traded separately, apart from the entirety of the share rights. However, upon adoption of the resolution awarding shareholders a concrete right to participate in the profit, they obtain a claim against the company for payment of their share of the dividend. The claim arising for payment of the dividend due the shareholder is a property right and as such may be the subject of transactions—an obligation that can be the subject of assignment, setoff, ordinary pledge or registered pledge (Supreme Court of Poland judgment of 11 September 2002, Case V CKN 1370/00).

It should also be remembered that the regulations governing limited-liability companies, unlike joint-stock companies, do not condition distribution of profit on making payment for the shares, as the shareholders of a limited-liability company are required to cover the share capital in full prior to registration of the company (or registration of a capital increase, as the case may be). In a joint-stock company, however, profit is generally divided pro rata to the number of shares, but if the shares are not fully paid-up the profit is divided pro rata to the payments made for the shares (Art. 347 §2 of the Commercial Companies Code).

Possibility of challenging resolution on distribution of profit

If a resolution is adopted providing for the profit to be retained by the company, the further question arises whether a shareholder can challenge the resolution and demand that the court order payment of a higher dividend.

Retained earnings can be used by the company for different purposes depending on the company's needs. They may be used for a share capital increase, to cover future losses or existing losses from prior years, for redemption of shares, or to increase other forms of capital in the company, including supplementary capital or reserve capital.

Shareholders who don't agree with a resolution calling for retention of profit may apply to the court to set aside the resolution (based on Art. 249 or 422 of the code), but they have no instrument for enforcing adoption of a specific resolution. The court can set aside a resolution on retention of profit but has no possibility of issuing a ruling taking the place of a resolution on distribution of the profit in the form of a dividend to the shareholders.

It should also be stressed that any payments out of the company's profit made to shareholders (or other authorised persons, e.g. holders of certificates issued to founders or in exchange for redeemed shares, personal entitlements, or a profit bonus for board members) exceeding the maximum amount of dividends provided in Art. 192 or 348 §1 of the Commercial Companies Code constitute an unlawful payment and should be returned pursuant to Art. 198 or 350 of the code. These provisions are key for protecting the company's assets against the unauthorised flow of corporate assets to the shareholders, and thus for protecting the interests of the company's creditors.

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Appearances intended to mislead

Dr Monika A. Górska

Włodzimierz Szoszuk

Oscar Wilde said imitation is the sincerest form of flattery. Perhaps it is flattery that motivates competitors to market products with labels or packaging similar to that of existing products. But such tactics can reduce transparency, upset fair competition between sellers, and mislead consumers, as demonstrated by the reported cases.

When necessary, packaging and labelling can be protected by exclusive rights, e.g. by registration of a trademark or industrial design. But even if packaging is not protected by exclusive rights, it can be protected against misleading imitations under the Unfair Competition Act.

Similar general impression

The point at issue is labelling or packaging (carton, bottle or the like) that is similar because of words, graphics, trade dress and/or colouring, but not because it is dictated or determined by functional, technical, or sectoral requirements.

What can a producer do in a situation such as the dispute in the Court of Justice (C-498/07 P, *Aceites del Sur-Coosur v EUIPO*) involving olive oil labels?

The marks were basically not identical, but each had similar components. The La Española mark was to some extent similar to the Carbonell mark: a woman in traditional dress sitting under a branch of an olive tree, with an olive grove in the background. The La Española packaging presented a composition of colours, shapes, proportions and position of the name that was greatly similar to that of the competitor's. Therefore it could be taken that the common components of the two trademarks evoked a general impression that is similar to a great extent.

This example involved labelling protected by exclusive rights (an EU trademark and another mark filed for protection as an EU trademark). But if the packaging is not protected by exclusive rights, are there legal instruments protecting against competitors?

An Irish case in point is *McCambridge Ltd v Joseph Brennan Bakeries*, ([2012] IESC 46, described at the European Communities Trade Mark Association website). McCambridge had sold wholewheat bread for many years in distinctive clear packaging with a green and white colour scheme, an image of ears of wheat, and fixed placement of its inscription on the packaging. Brennans, a competitor, started marketing bread in similar packaging.

The court found that the size, shape, and transparency of the McCambridge packaging was not distinctive or unique to that brand. But the McCambridge packaging also had features that distinguished it from others, such as inscriptions in white letters against a green background, a stylised signature, and an ear of wheat. Those components combined to create distinctive packaging. The court held that the Brennans packaging was confusingly similar to the McCambridge packaging. The similarity remained even though the name Brennans was placed on the packaging. The court stated that in the era of supermarkets a consumer chooses a product because of a fleeting image left in the consumer's memory; even a careful consumer could give just a split second to examining a product.

In the olive oil and wholewheat bread cases, what was relevant for the assessment was the general impression of similarity that results from similar components of labelling or packaging. Prof. Marian Kępiński observed that consumers are guided by the main components of markings on a product, ignore discrepancies and, in the main, retain in their memory only a general image of a designation that interests them (Supreme Court of Poland judgment of 25 March 1997, Case III CKN 11/97). Therefore it is the image that remains in a person's memory that is important. This is one reason there is assumed to be a particular risk of confusion in online sales, where the customer may rely on only a description and a thumbnail picture of the product, where the colour scheme and graphic arrangement of the label or package play a particularly large role in identifying the product (Gdańsk Court of Appeal judgment of 7 February 2012, Case I ACa 1558/11).

Risk of an average buyer being confused

Establishing similarity between labelling or packaging is the first requirement in establishing infringement; it is then necessary to prove a risk of confusion for consumers. Protection against confusion as to the origin of goods is intended to ensure that a consumer can determine the origin of the product by distinguishing it from goods from a different origin. A risk of confusion exists when consumers could believe goods or services come from the same undertaking or economically linked undertakings (judgments of the Court of Justice in C-39/97, *Canon*; C-108/97 and C-109/97, *Windsurfing Chiemsee*).

A risk of confusion is assessed holistically by reference to an average consumer who is taken to be an informed and cautious person who makes conscious choices. But an average consumer could, depending on the type of product, pay varying levels of attention; it could be lower for items for mass consumption (such as sweets), but higher for luxury goods (such as certain perfumes). An average consumer could conclude that some degree of difference in packaging from that which he or she is familiar with is intentional on the part of the manufacturer and is not an attempted unfair practice by a competitor (Warsaw Court of Appeal judgment of 4 December 2013, Case I ACa 661/13). Consumers are aware that producers sometimes update or rebrand their products. Or consumers could assume, albeit erroneously, that similar packaging results from an extension of the product range or a licensing arrangement between producers (which would justify using slightly different packaging).

Use of numerous similar components from a competing product could be found to be a deliberate attempt to attract consumers and therefore exploit the market position built by a competitor. Such behaviour could be an infringement of exclusive rights or unfair competition—particularly considering that there are limitless means, artistic or otherwise, to make a product distinctive.

Riding on the coattails

The ruling of the Court of Justice in C-487/07, *L'Oréal v Bellure* is in point.

Lancôme, a member of the L'Oréal group, produces and sells what are known in the trade as fine fragrances. The defendant sold "down-market" perfume in bottles and packaging displaying a general similarity to the bottles and packaging of Lancôme's well-known trademarked fragrances.

The similarity between the bottles and packaging was insufficient to mislead consumers. The differences were sufficient for a buyer not to mistakenly buy the wrong brand; i.e. a consumer would realise that Trésor trademarked products are brand-name products and those bearing the La Valeur mark are imitations, and the two come from unaffiliated producers.

But the Court of Justice held that where, as here, a third party seeks to "ride on the coattails" of a reputed trademark, taking advantage of the distinctive character or repute of the trademark to benefit from the power of attraction, the reputation and prestige of the mark, and the marketing effort expended by the proprietor of the mark to create and maintain the mark's image, the third party is taking unfair advantage of that repute, and even if the similarity is insufficient to cause a risk of confusion, it is still wrongful.

Visual cues

Shoppers are often guided by visual cues. The shape, colour, or graphics of packaging and labelling help consumers to distinguish products and producers. Marketing and promoting products is costly and involves many phases; the efforts of a producer could be harmed if guided by the similarity in the packaging, the consumer buys a product in the belief that it comes from a manufacturer the consumer knows and trusts, or the consumer thinks there is some link between the products. Such behaviour disrupts fair competition.

But not every instance of similar packaging will be deemed to be impermissible. The facts of each case always require detailed analysis and assessment.

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Clean-label foods

The food products market is witnessing dynamic growth in the number of "clean label" products. Food manufacturers are simplifying the composition of their products so they can communicate to consumers that their products belong to this group. This raises the key question of how simple the ingredients must be and how to communicate this to consumers safely and effectively.

Joanna Krakowiak

What is "clean label"?

The notion of "clean label" doesn't really refer to the label of a food product as such but primarily to a product made of a few simple, natural ingredients.

The trend toward simplifying the composition of food products began with publication of the results of a study at the University of Southampton in 2007 which showed that six food colours used on a wide scale in gelatines and other desserts—known as the "Southampton Six"—can cause ADHD in children. A direct consequence of the report was inclusion in the EU's Food Additives Regulation (1333/2008) of an obligation to place warnings on products containing these colours that they could cause ADHD in children. The long-term effect of the report is that consumers began to pay attention to the ingredients of products and seek out those with a simple and understandable composition. The ingredients of the product, rather than for example the brand, became one of the key purchasing factors.

Although the clean-label trend has been underway for several years and about a third of new products launched on the market belong to this category, there is still no legal definition of this concept or guidelines for applying it. In practice it means two things: the product label is clear and understandable to the consumer, and the composition is simple, that is, based on a small number of natural ingredients.

A hypothetical producer takes the first step: simplification of the label without changing the recipe. It turns out that under Annex VIII to the Food Information Regulation (1169/2011), the producer does not have to declare the presence of certain ingredients. This applies for example to water added to hydrate an ingredient used in dehydrated form. The number of ingredients listed on the label decreases.

But merely simplifying the label is not enough. If the producer limits itself to improving the legibility of the label while leaving highly processed ingredients inside, and claims on this basis that it is a "clean label" product, the producer would be open to a charge of misleading consumers. After all, providing an understandable label is a requirement under Regulation 1169/2011, and not an added value for the consumer. The result would be similar if the producer removed one ingredient from a product with many different ingredients and then slapped a "clean label" claim on the product.

To launch clean-label products on the market, it is necessary to develop new recipes as close as possible to what the consumer might regard as homemade or traditional. It is essential to reduce the number of ingredients, eliminate chemical or highly processed substances, and replace them with ingredients of natural origin. In practice this is a costly and time-consuming process, requiring close cooperation with lawyers and production technicians.

The consumer decides

Consumers declare a desire to eat natural foods. But the term "natural" isn't defined by law, except for special cases such as natural flavourings. In determining whether a given ingredient is natural, the ruling by the Supreme Administrative Court of 16 December 2014 (Case II GSK 2033/13) can be applied by analogy. There the court held that placement on ketchup of the inscription "homemade taste" was impermissible when the product contained thickeners (E412 and E1422), as the claim could mislead consumers as to the characteristics of the product. Applying the court's approach to the term "natural," two aspects should be considered: the source of origin of the ingredient—whether it is natural (biological) or synthetic (chemical)—and the degree of processing which an ingredient of natural origin has undergone. While the first criterion is fairly straightforward, the second allows for some discretion. There is no boundary set in advance for the permissible degree of processing an ingredient can undergo and still be considered natural. It is not clear, for example, whether vegetable pulp is still a natural ingredient or not. It is even harder to judge how many ingredients can be used and still say the recipe is "simple." For example, is five ingredients a short enough list for a "clean label" cheese spread, or should it be limited to two or three?

So when developing new recipes for products, the ingredients must be analysed from the viewpoint of consumer expectations, to determine what ingredients the consumer regards as desirable or at least acceptable in the product for it to be regarded as natural. This assessment must reflect the type of food product, the geographical area and the time, as consumers' preferences aren't uniform, but evolve together with scientific reports on the health impacts of specific ingredients. One-off elimination of ingredients undesirable to consumers may prove inadequate; the producer should adopt procedures for periodic review of the recipes for products to ensure that they continue to comply not only with the regulations but also with consumers' expectations.

Of course, changes in the composition also impact the characteristics of the product (colour, consistency, aroma) and its price. The producer must make a business analysis to judge whether the consumer will pay a higher price for a natural product with possibly less-appealing sensory characteristics. With respect to a few products, our hypothetical producer decides to take a greater business risk and launch a niche premium product. With respect to its other products, it follows a strategy of small steps, gradually eliminating highly processed ingredients.

“No preservatives” is no longer enough

After developing new recipes, this should be communicated to consumers in a manner that is not only effective but also legally safe. The risk of the communication being challenged by consumers, regulators and competitors should be held to a minimum. The producer here decides that on the labels, the simplified list of ingredients will be accompanied by additional messages stressing the natural ingredients of the products.

“Clean label” claims can be formulated negatively (“no preservatives,” “no food colouring,” “no GMOs”) or positively, i.e. stressing what the product does contain. While including a list of ingredients is mandatory, placing claims on the product concerning the ingredients is voluntary. But this does not mean claims can be formulated however the producer sees fit, because they must meet requirements specified by law, particularly in Art. 36 of Regulation 1169/2011. Claims must not mislead consumers, must be unambiguous, and in certain instances must be based on scientific data.

Guidelines for assessing the permissibility of negative claims are laid out in the judgment of the Province Administrative Court in Warsaw of 11 January 2016 (Case VI SA/Wa 201/15). There the court held that providing information that an oil contained no cholesterol, gluten or dairy was misleading to consumers because it suggested that the product had special properties, where in reality the oil produced by competitors had the same characteristics. Although the claim was true, it could create a false impression that it was the only product, or one of only a few products, with the stated composition. This example shows that when drafting product claims, the producer should pay attention not only to how its own products are perceived, but also how its competitors’ products are perceived.

For example, in assessing the permissibility of the claim of “no preservatives,” the following test should be applied:

- Does the product contain preservatives?
- According to the law, can the product contain such substances?
- Do comparable products of competitors contain preservatives?
- Would elimination of preservatives have a positive impact on the product’s composition?

If the answer to the first question is negative, and the answer to all the other questions is affirmative, the producer can safely use the phrase “no preservatives.”

But claims of the sort “does not contain substance X” are used so broadly on foods that their impact on consumers is declining. Here our producer decides to build up the image of its products in a positive manner. It displays information on the label that the products are made of a certain (small) number of ingredients, and lists on the front of the package the names of ingredients that are understood by most consumers. It also posts information on its website about the new recipes and explains why specific ingredients are added.

The flow of information between the producer and the consumer is vital, because even the greatest expenditures on new recipes can go to waste if this information is not effectively communicated to consumers.

Clean label, and then what?

Experience shows that development of new products, reformulation of existing products, and the accompanying changes to product labels, promotional materials, and content on the producer’s website and social media are a continuous process. Quickly identifying and responding to consumers’ needs are fundamental elements of success.

For now, the clean-label trend is going strong, but in the future consumers may demand more. They want to buy products not only based on a small number of natural ingredients, but also want to be sure that the ingredients were sourced ethically, using sustainable agriculture. These needs can be met by “clear labels,” enabling the consumer to trace the path of specific ingredients from farm to table. Considering the quantity of information connected with voluntary labelling of this sort, implementation of clear labels would require some of the information to be provided electronically, e.g. via a mobile app. So it seems that the letter “E” will not disappear from the food industry: instead of the E numbers used to identify additives consumers have grown suspicious of, “e” will be associated with “e-labels.”

Joanna Krakowiak, legal adviser, Life Science & Regulatory practice

Trade unions in litigation


Agnieszka Lisiecka Katarzyna Żukowska

In disputes involving collective labour law, although the point is debatable it should generally be accepted that there is a right to seek relief in the courts. But this does not necessarily mean that the trade union has standing to file suit in a collective dispute. A lack of standing will result in denial of the claim. Nonetheless, the validity of the claim should always be evaluated.

Dispute over raises

When pay negotiations between an employer and its trade unions failed, the trade unions, parties to a collective labour arrangement, applied to the labour court for declaration of the existence of a collective dispute over the employees' pay raises.

Following the breakdown of the negotiations, the trade unions sent a notice to the employer on commencement of a collective dispute concerning pay raises. Relying on Art. 4(2) of the Act on Resolution of Collective Disputes, the employer refused to recognise it as a lawful dispute, arguing that issues of annual pay raises in the event of failure to reach agreement by the parties to the collective arrangement were exhaustively and unambiguously addressed in the collective labour arrangement and the arrangement had never been terminated.

The collective arrangement provided that if the parties failed to reach agreement on pay by the end of the first quarter of a calendar year, the employees' base salaries would be mandatorily increased by the rate of inflation in the preceding year. In this case the inflation rate in the previous year was zero, resulting in no pay raises for the staff.

Under these circumstances, the trade unions applied to the labour court for a finding of the existence of a collective dispute. The suit fell within the controversial area of the permissibility of resort to the courts in collective labour law cases, and, if resort to the courts was upheld, an evaluation of the validity of the claim. Both issues were raised by the defendant company during the litigation.

Permissibility of collective dispute

A dispute over pay raises is generally covered by the area of collective disputes. But if there is a collective labour arrangement in force with the employer, a dispute over pay raises will not always be legal (i.e. permissible and consistent with the law). The legality of the dispute will depend on the scope of the demands and whether it is necessary to terminate the arrangement.

Under Art. 4(2) of the Act on Resolution of Collective Disputes, if a collective dispute concerns the content of a collective labour arrangement which the trade union organisation is a party to, then a dispute seeking to modify the arrangement may be initiated and pursued no earlier than the date notice of termination of the arrangement is given. This is known as the "social concord" clause, prohibiting commencement of collective disputes in situations where an arrangement is in force reflecting the terms negotiated by the social partners. This applies not only to initiating and conducting collective disputes seeking to modify an arrangement that is still in force, but also where the demand requires amendment of the arrangement. This was the case here, in the company's view, because the existing arrangement provided a clear and exhaustive mechanism for setting pay raises if the parties to the arrangement failed to reach agreement on salaries. In that situation, pursuing a collective dispute over pay raises would mean *de facto* conducting a dispute over the contents of the arrangement, that is, the rules for establishing employees' pay raises, which until notice of termination of the arrangement were given would violate Art. 4(2) of the Act on Resolution of Collective Disputes.

Permissibility of resort to the courts

In response to the statement of claim, the defendant alleged as a precaution that resort to the courts was not permissible, as the dispute was not a civil case within the meaning of Art. 1 of the Civil Procedure Code which could be heard by the general courts. A finding by the labour court that the dispute was not justiciable would result in dismissal of the claim.

The defendant argued that the only labour disputes that fall within the scope of civil cases are those listed in Civil Procedure Code Art. 476 §1, i.e. cases involving claims of individual employees connected with the employment relationship with a specific employer, asserted against the employer. A collective dispute, by its nature, is not individual, and the party to the dispute will always be the trade union, not the individual employees.

A specific procedure is provided for resolving collective labour disputes based on the Act on Resolution of Collective Disputes. Moreover, under Art. 37 of the Trade Unions Act, disputes between trade unions and employers concerning employee interests shall be resolved under the rules set forth in a separate act—which is the Act on Resolution of Collective Disputes.

However, the labour court did not grant the application to dismiss the claim. It found instead that the right of access to the courts is expressly provided for in Art. 45(1) of the Polish Constitution. The court also pointed out that the Constitution prohibits enactment of regulations foreclosing anyone's resort to the courts or preventing them from enforcing their rights and freedoms that have been violated, while Art. 177 of the Constitution establishes a presumption that the general courts have jurisdiction in all matters, except for those statutorily reserved for the jurisdiction of other courts.

Validity of the claim

The defendant made an alternative plea to deny the claim due to the lack of standing on the part of the trade union organisations under Civil Procedure Code Art. 189.

A substantive legal condition for the validity of a claim seeking a declaratory judgment on the existence or non-existence of a legal relationship or right pursued under Art. 189 of the code is the existence of a legal interest in assertion of the claim on the part of the plaintiff. As a rule, if the plaintiff has no legal interest in asserting the claim, the claim should be denied.

A legal interest exists if the effect achieved by issuance of the declaratory judgment will ensure the plaintiff protection of its legally protected interests, that is, definitively end an existing dispute or prevent a dispute from arising in the future. The need for legal protection in this respect must be objective, that is, actually existing. Conversely, no legal interest as grounds for a claim under Art. 189 exists when the plaintiff has no need for establishment of a right or legal relationship because the plaintiff's legal domain has not been violated or threatened.

In this case, in the defendant's view, the demand asserted by the trade union organisation for a declaratory judgment was essentially aimed at resolving an uncertainty as to whether the dispute initiated by the trade unions was a collective dispute within the meaning of the Act on Resolution of Collective Disputes, and consequently whether in the event of an industrial action, the plaintiff could be exposed to liability as the organiser of an illegal strike. However, a mere showing by the plaintiff of a legal need to resolve uncertainty as to a certain state of affairs is insufficient for an effective claim under Civil Procedure Code Art. 189. The plaintiff must also show that it has a legal interest in asserting the claim against the specific defendant.

The defendant also argued that the collective interests of the employees whom the trade unions are appointed to represent cannot be equated with the trade union's own legal interest for purposes of Art. 189. This provision refers to the plaintiff's own legal interest, not the legal interest of other persons. While the trade unions were appointed to represent and protect the rights and interests of the employees, this does not mean that the employees' interests can be equated with the trade unions' own interests (as legal persons or parties with capacity to sue and be sued). The trade unions are only supposed to represent the interests of employees, which means that these interests (which the trade unions only represent) are different from the interests of the trade unions themselves as distinct legal entities. Trade unions are supposed to defend and represent the rights and interests of employees, which means that their activity in this respect is a duty on their part, and not a legal interest.

In the defendant's view, in filing suit seeking a declaratory judgment, the plaintiff trade union organisations essentially sought only a determination in the interest of the employees in general whether the dispute initiated by them was a collective dispute—which is not the purpose of a proceeding under Art. 189 of the Civil Procedure Code.

This position and the reasoning presented above were upheld by the labour court. The court held that in this case the trade union organisations had no legal interest in obtaining a declaratory judgment on the existence or non-existence of a collective dispute, stressing that a claim asserted by trade unions for a declaratory judgment on the existence of a collective dispute will always refer to the interests of persons other than the plaintiff, namely the overall group of employees. The court pointed out in this regard that there is no collective dispute without the interests of the employees, as a collective dispute is genetically linked with the collective interests and rights of the employees. The labour court also shared the defendant's position and arguments that in this case there was no possibility of commencing a legal collective dispute, in light of the prohibition set forth in Art. 4(2) of the Act on Resolution of Collective Disputes. Consequently, the court denied the claim as groundless.

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Acquisitions in listed companies: How to handle inside information?

Danuta Pajewska Marcin Pietkiewicz

Transactions where listed companies are acquired or acquire other companies are subject to special legal restrictions on the possession and use of inside information, i.e. information that could affect the share price on the stock exchange. The recent entry into force of the Market Abuse Regulation governing how to deal with inside information of public companies is a good occasion to examine these restrictions more thoroughly.

When does information become "inside information"?

Inside information concerning a listed company is information not known to a broad group of investors which because of the significance of the events or circumstances involved could give a stock market investor an unfair advantage over other investors. The EU's Market Abuse Regulation (596/2014), known as "MAR," provides two conditions that must be met for information to be considered inside information: the precise nature of the information and its potential effect on the prices of financial instruments.

Inside information thus includes information about an event involving a listed company or its shares which a potential investor would consider when deciding on investing in the company's shares, and specific enough to determine the probable effect it would have on the price of the shares, while other investors do not have access to the information.

If inside information arises within a listed company, the company has an obligation to disclose the information promptly, to ensure that all investors have the same access to the information.

The criteria for determining whether information is inside information are framed in general terms. This presents great difficulty in applying the regulations, particularly when it comes to determining the moment when inside information arises in the case of events—like corporate acquisitions—that are not a one-off occurrence but a process spread out in time.

A public company goes shopping

A company listed in Poland plans to enter the market of another country by acquiring a company operating there with a similar business profile and an established position on that market. The management board of the listed company doesn't want to release information too soon about the steps it is planning and undertaking because they are concerned about the response of competitors and feel that disclosure of the information could have a negative impact on the negotiations for acquiring the local company.

Conception and realisation

First, the management board must determine the moment when the intention to conduct the transaction passes from the planning phase to the realisation phase—when steps are taken that might, but not necessarily will, lead to carrying out the transaction. Here it seems that the company's management are in a fairly comfortable situation, as they generate inside information by their own actions and can largely control the process while bearing in mind the company's business needs.

The company's past information policy and performance can have a large influence on whether a disclosure obligation arises during the first phase of an acquisition project. It will be much easier to manage the process if the company has previously not commented at all on planned acquisitions, or has given the market general information about its intentions and the steps taken are consistent with the disclosed plans. Management will be in a more difficult situation if they intend to take steps that could have effects that are the reverse of those previously signalled to the market.

Transaction in negotiation phase

The acquisition process should not be looked at solely from the perspective of the likelihood of closing the deal, i.e. achieving the end result of the transaction in the form of acquisition of the company. This is a process that is spread out over time, and events occurring during each phase may themselves qualify as inside information.

Commencement of negotiations toward acquisition of a specific company is clearly a moment when inside information may arise. Often the first significant event in the negotiation process, verbalising the acquirer's specific intentions with respect to a target, is signing of a letter of intent, confidentiality agreement, or comparable document. Such documents may establish the framework for further negotiations, such as conducting due diligence of the target, and then negotiation of the key elements of the transaction, which may lead to signing of a term sheet and entry into negotiation of the actual sale agreement.

Circumstances occurring in each of these phases may qualify as inside information if they meet the criteria in the definition.

Delay of disclosure of commencement of negotiations

Recognition of a given phase of the negotiations as inside information does not always have to lead to immediate disclosure by the listed company. If the management believe that disclosing the information immediately could prejudice the company's legitimate interests, for example by negatively impacting the negotiations with the seller, it can decide to delay the publication.

The management may take such a decision if the delay of disclosure is not likely to mislead the public (in other words, if it has not previously made announcements that could give the opposite impression) and they can ensure the confidentiality of the information (limiting the circle of persons with access to information about the negotiations, requiring them to maintain confidentiality and including them in a list of insiders).

Significantly, under the current regulations, at the stage of taking a decision to delay publication of inside information, the management board of the company is no longer required to notify the Polish Financial Supervision Authority (a requirement that existed before MAR entered into force). This obligation has been postponed until the time the company discloses the delayed information.

When a listed company is the target

Other difficulties arise in transactions involving acquisition of listed companies. These can be outlined using the example of a potential investor intending to acquire a majority stake of shares from a large shareholder who has a decisive influence on the composition of the supervisory board and management board of the listed company.

Access to information about the company

In such instances the negotiations for the transaction are conducted with the shareholder, and the company itself is not involved in the negotiations. However, investors expect access to documents and information about the company in order to conduct due diligence, and obtaining them may not be possible without at least partial involvement of company representatives. This means that through its representatives, the listed company becomes aware of the planned sale of shares—thus coming into possession of inside information.

In that situation, the listed company must identify the correct moment when it is deemed to have inside information, and react appropriately. If it is to be a friendly acquisition (only then will the potential investor be able to examine the company), the shareholder will inform the company of its intentions and the company can take a decision on disclosing the information or delaying disclosure.

The company's obligation to provide information to the investor will also be affected by whether the investor already holds shares in the company.

Other areas of heightened risk

Particular caution must be maintained in a situation where a shareholder selling shares, or its representatives, are also members of the management board of the target. Then the method of communicating with the potential investor and the content of the information provided must be watched closely. Shareholders may also be subject to additional restrictions on sale of shares during the "closed period" preceding publication of periodic financial reports.

From the investor's perspective it will be crucial that at the time of realisation of the transaction it does not hold information obtained from the company that qualifies as inside information. Otherwise, the investor will be exposed to allegations of insider trading.

The topic of inside information in acquisitions takes on particular importance as in many instances it will affect how the transaction is structured as well as the chronology for carrying out the specific stages of the transaction. This process should be managed to suit the specific business needs and assumptions—but clearly within the limits laid down by the new Market Abuse Regulation, which largely codified the existing market practice developed under EU case law and regulatory decisions.

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Employee elections on Facebook

Dr Szymon Kubiak

Kamil Jabłoński

Whether we like it or not, social media like Facebook, LinkedIn, Twitter and YouTube, and messaging services like Messenger, WhatsApp or Snapchat have changed the way we communicate—probably forever. Their impact and functionality can help employers conduct internal communications at the workplace, even during group layoffs.

It turns out that social media can be used for example to conduct elections of employee representatives required by the Group Layoffs Act of 13 March 2003. We recently encountered an example in our own practice.

Need for quick selection of employee representatives

Main insolvency proceedings within the meaning of the EU's Insolvency Regulation (1346/2000) were commenced against a company operating a call centre in Poland but registered in another EU member state. Upon commencement of the insolvency proceedings, the company ceased conducting any business, which under the Insolvency Regulation was subject to automatic recognition in Poland and made it necessary to terminate the employment of all staff in Poland under the procedure provided in the Group Layoffs Act. Pursuant to a decision by the bankruptcy administrators, all of the Polish staff of the company were immediately released from the obligation to perform work and the company's office was closed. It was in that situation that a decision was taken to commence the procedure for group layoffs set forth in the act.

A properly initiated group layoff procedure should begin with consultation of the intention to conduct group layoffs with the trade union organisations operating at the employer's workplace. If no workplace trade union organisation has been established, the consultations should be conducted with employee representatives selected "in the manner adopted by the given employer." There was no workplace trade union organisation established at this company, so employee representatives had to be chosen. The act does not specify how such election should be conducted. This raises numerous doubts, at least with respect to the form of the elections. The solution most often adopted is election of employee representatives through a referendum at the workplace, e.g. at a staff meeting.

In this case, it was not possible to conduct a typical referendum at the workplace, because all of the employees had been released from work and the workplace itself (the office) had ceased operating from one day to the next. Consequently, the employer could not properly launch the group layoff procedure, i.e. appoint employee representatives pursuant to Art. 2(7) of the Group Layoffs Act in order to consult with them the intention to conduct a group layoff and the rules for the group layoff. Because the staff no longer had access to their work email, the idea was floated to select employee representatives using online communications, voting through a Facebook group, as most of the company employees had access to the site.

Organising the election on Facebook did not pose a problem for the employees and enabled the group layoff procedure to be launched. This form of communication with nearly 300 employees proved to be the only feasible solution, particularly as Art. 2(7) of the Group Layoffs Act does not impose on the employer an obligation to conduct the selection using voting by employees physically present at the workplace (e.g. filling out ballots and stuffing them in a ballot box).

Employer's tasks in the election procedure

On one hand, there are no concrete statutory guidelines on the method for appointing employee representatives, but on the other hand the process obviously needs to comply with transparent, democratic standards. Thus the role and duties of the employer in the course of the election should be considered, and whether they were fulfilled in this case.

Undoubtedly the main task of the employer is to ensure the employees the organisational and technical possibilities for conducting the election. Typically this boils down to setting aside a space at the workplace as the "election precinct." In our view, the employer should prepare the election schedule, design the ballots, print them in sufficient quantity, and distribute them among the employees.

To ensure democratic standards, employees who for whatever reason are absent from work should be ensured the possibility of participating in the election. This applies for example to staff on sick leave or parental leave. In that case the recommended solution is to give them the opportunity to vote by mail within an established time.

And to ensure the proper and transparent conduct of the voting, the optimal solution is to entrust to the employees a number of tasks connected with organisation of the election. The employer should appoint several employees to carry out the task of organising the voting process, i.e. establishing an election committee and overseeing the transparent counting of the votes. It should also be up to the employees to forward the results of the voting to the employer.

In our view, entrusting employees with additional tasks is combined with releasing them from the obligation to perform work while retaining the right to be paid for the time necessary to organise and carry out the election.

The employer must also refrain from certain actions connected with the election. It must not exert any influence over the result, particularly by intervening directly in the choice of specific employees. It should also not take part in technical actions related to the voting, such as opening up the ballot boxes or counting the votes. Such activities should always be conducted by the employees themselves, in a manner that excludes the possibility of any manipulation of the results. However, there is nothing preventing a representative of the employer from acting as an independent observer during this process, monitoring the correct and unimpeded course of the voting.

Guarantee of democratic standards

We believe that under the example analysed here, holding the election of employee representatives via Facebook encouraged compliance with democratic standards and transparency of the voting process, if for no other reason because it prevented the employer from exerting any influence over the result of the voting. And because the social media servers are not located at the workplace, any manipulation of the voting by the employer or the staff was excluded.

Finally, and not without relevance, conducting the election via social media significantly reduces the cost of organising the election and cuts to a minimum the related organisational efforts, such as printing ballots or setting aside a location at work to hold the elections.

Social media are still a new and dynamically evolving area, and many phenomena related to social media do not yet have commonly recognised definitions. Thus it is hard to match social media to the conceptions and requirements rooted in labour law regulations which have existed for years and are often outdated.

In short, we believe that if all of the staff have the technical ability to take part in elections using social media such as Facebook, or other tools available online (such as an electronic voting system provided to the staff by the employer), excluding the possibility of manipulation of the result, such a procedure for election of the employee representatives should be regarded as permissible and fitting within the broad notion of “the manner adopted by the given employer.”

Not just group layoffs

It should be added that the need to appoint employee representatives arises not only in the case of group layoffs, but also applies to situations arising much more frequently. For example, employee representatives must be consulted concerning introduction of telecommuting, activities related to occupational health and safety, and the list of tasks that are particularly burdensome or hazardous to health for purposes of establishing shorter working time. Approval of employee representatives is also required, among other things, for agreeing on the rules of the workplace social benefit fund, inclusion in the pay rules of a provision not to establish a workplace social benefit fund, or conclusion of a workplace agreement establishing an employee pension programme. In all of these situations, organising the election of employee representatives through an online process would significantly reduce the time, cost and organisational efforts on the employer’s part, without detriment to the transparency and democratic standards of the elections.

No doubt instances similar to those described in this case for using new technologies or social media, or perhaps much more complex examples, will occur more and more frequently in relations between employers and employees, and thus also in the practice of labour lawyers. The creation of new applications such as Facebook at Work can also speed up this process. Thus it may be warranted to call for legal changes expressly providing for the use of such channels for employer/employee communications in many instances (but without succumbing to overregulation, which is particularly harmful in the area of new technologies). It remains to be seen whether this approach is considered by Polish lawmakers, particularly by the Labour Law Codification Committee appointed in September 2016.

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Contractual liability for defects in structures

Stefan Jacyno

Dr Przemysław Szymczyk

In the event of defective performance of construction works, the investor can elect the form of compensation by the contractor. The investor may base its claim on the warranty (or guarantee) against defects in a structure, or general rules of contractual liability.

In market practice, one often encounters the incorrect position that a builder is liable to the investor exclusively on the basis of the statutory warranty or the guarantee issued by the contractor. Investors often ignore another possibility: a claim for damages under the general principles of liability for improper performance of an obligation (Civil Code Art. 471).

One reason to remember this is that the limitations period is different for these claims. Rights under warranty (and typically under an additional guarantee issued by the contractor) expire in the case of real estate after five years (the period was three years before 25 December 2014). But the limitations period for claims based on general contractual liability principles is 10 years (or three years if the structure was built for purposes connected with the investor's business).

Defects disclosed years later

In March 2011 an investor entered into a contract for construction works which involved construction of a building and the related transit infrastructure. The building was not intended for operation of the investor's business. Under the contract, the contractor granted the investor a guarantee of quality (not excluding or limiting liability under warranty) for a period of three years from signing of the final handover report and delivery of the building for occupancy. The report was signed on 12 December 2011.

By letter dated 19 December 2014, the investor raised with the contractor a number of defects disclosed in the course of operation of the building (numerous cracks in the walls and ceilings, leaky installation pipes, dampness in the flooring, improperly installed insulation of the foundation, and so on). The contractor refused to cure the defects, citing in particular the expiration of rights under the statutory warranty and the guarantee issued by the contractor. The correspondence between the parties continued for several months, but the contractor adamantly refused to make the repairs.

Because the defects were serious and threatened to spread, the investor hired another contractor to perform the repairs. The cost of the work was about PLN 150,000. Then, on 15 June 2015, the investor filed suit against the contractor demanding reimbursement of the repair costs. The claim was denied when the court upheld the contractor's assertion of the defence that claims under warranty and guarantee were time-barred.

At this stage, the investor requested an opinion from our firm on whether it would be worthwhile to appeal from this unfavourable judgment.

Guarantee and warranty period already over

After analysing the case, we confirmed that the investor's rights under the statutory warranty and under the guarantee against defects in the building issued by the contractor had expired, and thus the defence asserted by the contractor was valid. Under the regulations (Civil Code Art. 656 §1), the warranty against defects in a structure is governed as relevant by the provisions on contracts to perform a specific work, i.e. Civil Code Art. 638, which provides that in the case of a warranty against defects in a work the provisions on a sales warranty (Civil Code Art. 556 and following) apply as relevant, and under those provisions rights under a warranty against physical defects in real estate expire five years after the final acceptance of the construction works. But under the prior law which applied to this case, these rights expired three years from that date.

This period was extended from 25 December 2014 when the Consumer Rights Act of 30 May 2014 entered into force, amending provisions of the Civil Code, but contracts entered into before that date continued to be covered by the shorter, three-year limitations period. In the construction contract, the parties had agreed on the same period for the guarantee. This period overlapped with the period of the statutory warranty, which was not contractually excluded or limited. Because, as mentioned, this period was counted from the date of signing of the final handover report for the building (which occurred on 12 December 2011), the investor's rights under the warranty (and the guarantee) expired on 12 December 2014.

This is a preclusive period, and thus suit had to be filed with the court by that deadline. The investor did not file suit until June 2015—after the end of the three-year period, when its warranty rights had already expired.

A chance for damages

But we also pointed out in our opinion that the loss of rights under the warranty (and guarantee) against defects in an erected building does not automatically result in loss of claims for damages based on general rules of liability for improper performance of an obligation (Civil Code Art. 471 and following). This was particularly important in this case, as the client had not specified the legal theory in its statement of claim, limiting itself to a presentation of the facts and supporting evidence.

The client had not indicated in the statement of claim that it was exercising its rights under the warranty (or guarantee) and basing its claim on them. In other words, it could be assumed that the client's claim was for damages and was based on general rules of contractual liability (Civil Code Art. 471 and following), and not necessarily based on warranty or guarantee rights. Unlike rights under warranty or guarantee, this claim had not expired. The limitations period in this case was 10 years, as the building was not used by the client to operate its business (Civil Code Art. 118). Thus there was nothing preventing the client from seeking damages under general rules of contractual liability. All it needed to do was demonstrate to the court the grounds for such liability, namely:

- The fact of improper performance of its obligation by the contractor for the construction works
- The type and amount of the loss suffered
- The existence of a causal connection between improper performance of the obligation and the loss.

We persuaded the client that filing an appeal was entirely justified.

Favourable outcome

The appellate court entirely agreed with our evaluation, holding that the loss of rights under the warranty (and guarantee) against defects in an erected building presented no barrier to seeking damages from the contractor for improper performance of the construction contract. Independently of exercise of warranty (or guarantee) rights, the investor may seek damages from the contractor for improper performance of an obligation under general rules (Civil Code Art. 471 and following).

As the court stated, the selection of the method for obtaining recompense lies with the investor, but the election exerts certain legal and procedural consequences. If the investor elects the warranty regime, then it must prove the existence of a defect in the building. Warranty (and guarantee) constitute a specific type of protection provided to the investor, independent of the contractor's fault or knowledge or the occurrence of a loss in connection with the defective performance of the construction work. But if the investor pursues contractual liability, it must not only prove that the structure was not built properly, but also prove the loss caused thereby. This is because in the latter situation the contractor is not liable for the mere existence of the defect, but for the actual proven loss caused by non-performance or improper performance of the obligation.

The court also confirmed our opinion that although the investor rested its claim on invoices issued for curing of the defects by a substitute contractor, in reality it could be treated as a claim for damages for improper performance of the contract, rather than a claim based on the warranty or guarantee granted by the contractor. In the court's view, the costs of making the repairs to the building were a loss to our client, and the court awarded this sum to our client as damages.

Rules worth framing in advance

This example demonstrates that even if the investor loses rights under the statutory warranty or the guarantee granted by the contractor for construction works due to the passage of time, in certain situations the investor can still seek damages for defective construction, relying on general rules on contractual liability. This depends on several factors, including the date of conclusion of the contract and whether the structure is intended for conducting the investor's business.

From an evidentiary point of view, it is much easier to pursue claims on the basis of warranty or guarantee. In that situation the contractor is liable under the stricter liability regime for the very existence of the defect, rather than the loss caused by non-performance or improper performance of its contractual obligation (as in the case of general contractual liability). Thus it is important to properly frame the wording of the contract for construction work, including through proper modification of the warranty liability. This can help properly secure the investor's interest in advance of a potential dispute over defective construction of the building. This applies in particular to business activity, because in that case, with the short three-year limitations period, relying on general contractual liability rules will not be effective.

Stefan Jacyno, adwokat, *partner, head of the Real Estate & Construction practice and the Reprivatisation practice*

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A year of R&D tax incentives

Joanna Prokurat

Tax relief for conducting research and development activity has been in force since 1 January 2016. This relief, which replaced the relief for acquisition of new technologies, was intended to increase the attractiveness of fiscal solutions for taxpayers involved in R&D. The effectiveness of this relief increased from the beginning of 2017 with entry into force of the "Small Innovation Act," introducing major changes in the rules for applying these tax incentives.

Businesses operating in the innovation sector almost unanimously declare their approval for at least the direction the changes are taking, and those conducting R&D activity indicate a high level of interest in taking advantage of these tax incentives. But this is not necessarily reflected in the number of individual tax interpretations issued so far in this area (barely a dozen by the end of 2016). This may result from the signals emerging from the market and advisers of the imprecise wording of the regulations and interpretations disadvantageous to taxpayers. But a solid preparation for implementation of R&D relief shows that claims of limited effectiveness of the relief in most instances may be unfounded, and taxpayers can successfully take advantage of these tax preferences. The instances described below involving our clients are evidence of this.

From theory...

The mechanism for the relief is that a payer of personal income tax or corporate income tax conducting R&D activity is entitled to take an additional deduction from its tax base for costs incurred on such activity.

Certain expenditures incurred for R&D activity, as statutorily defined, qualify for the relief. Depending on the size of the taxpayer or the category of costs, a certain percentage of costs incurred on R&D activity can be deducted from the tax base. Qualified costs that may be deducted under R&D relief include:

- Salary and social insurance contributions of employees in the portion paid by the employer for staff employed to carry out R&D activity
- Acquisition of goods and raw materials directly connected with R&D activity
- Expert opinions and reports, advisory or similar services, as well as acquisition of the results of research provided or performed under contract by a research unit for the purposes of the taxpayer's R&D activity
- Paid use of scientific and research apparatus exclusively for R&D activity (but not under a contract with an affiliate of the taxpayer)
- Some of the costs of obtaining and holding certain IP rights (e.g. patents) borne by micro, small and medium-sized taxpayers
- Amortisation of fixed assets and intangibles used in R&D activity, apart from passenger cars and separately owned buildings, premises and structures.

In the case of all qualified costs listed above, the additional deduction is 50% for micro, small and medium-sized taxpayers. For other taxpayers, an additional 50% deduction can be taken for qualified salary costs and 30% for other qualified costs.

There are two exclusions for applying the deduction under this relief. They involve costs reimbursed in any form, and costs incurred by an enterprise which in the given year conducted activity in a special economic zone under a zone permit.

Deductions from the tax base for R&D relief can be taken over six successive years, if in the year when the taxpayer became entitled to take the deduction it generated a loss or had taxable income too low to take the full deduction.

...to practice

The practical application of the provisions on R&D relief generates numerous questions and concerns.

External services from anyone

One of the practical issues facing taxpayers interested in taking advantage of the relief, raised as early as the legislative stage, involves the category of costs incurred for external services. Art. 18d(2)(3) of the Corporate Income Tax Act provides that costs qualifying for the relief include "expert reports, opinions, advisory or similar services, as well as acquisition of the results of scientific research provided or performed on the basis of a contract by a research unit for the purposes of R&D activity." Many people conclude from the wording of this section that the costs of expert reports, opinions, advisory or similar services are qualified only if they are performed or provided on the basis of a contract by a research unit.

But a literal reading of this provision indicates that a research unit must be the source only of the costs connected with acquisition of the results of scientific research, and not all of the external services indicated. To persuade an uncertain tax authority, a taxpayer acquiring among other things services of ISO certification of components used for creation of prototypes within the R&D work it conducted relied on Polish grammar and the literal interpretation of tax regulations, taking precedence over other interpretations. Under Polish grammatical rules, "provided or performed" can refer here only to "results of scientific research"—as they are both in the genitive (thus "provided or performed" is *świadczonych lub wykonywanych*). By contrast, the phrase "expert reports, opinions, advisory or similar services" is given in the nominative, and thus "provided or performed" would also have to be stated in the nominative (*świadczone lub wykonywane*), and the word order would be different.

Full amortisation deductions

Another issue we had to tackle involved the scope of amortisation deductions on fixed assets used to conduct R&D activity that could count as qualified costs. The taxpayer was in the business of building industrial machinery and equipment but also conducted R&D activity under the same material conditions as its actual manufacturing operations, including use of a production line used for regular operations. In the case of this taxpayer, the tax authority initially questioned the qualification of the entire value of the amortisation deductions on the production line in question, and then on the portion corresponding to the period the line was used for regular operations.

Finally the tax authority was persuaded that Art. 18d(2)(4) of the CIT Act, which addresses this issue, does not contain any restrictions in this respect, and in particular does not limit the scope of use of the fixed assets or the intangibles "exclusively" or "only" to R&D activity, as the drafters of the act did for example with respect to the costs of using research apparatus. In the case of such apparatus, the law expressly states that the qualified cost is paid use of scientific research apparatus "exclusively in R&D activity."

Costs of development work also from prior to 2016

Another major topic was the time when costs contributing to development work are incurred, to determine whether they qualify or not. Relying on several individual interpretations in which the Minister of Finance limited the qualification of costs to those incurred on or after 1 January 2016, when the R&D relief entered into force, the taxpayer was nearly convinced that qualified costs making up the initial value of the development work conducted by the taxpayer begun before 2016 include only costs paid after 31 December 2015.

But neither Art. 18d(8) of the CIT Act, under which the deduction is taken in the return for the tax year in which the qualified costs were incurred, nor any other provisions of the CIT Act involving the R&D relief contain any detailed rule designating the time when qualified costs are incurred. Consequently, an effective argument was made based on a reference to the general rules for determining when a cost is incurred, set forth in Art. 15 of the CIT Act, including the cross-reference to Art. 15(4a) of the act concerning detailed rules for determining when costs of development are incurred, e.g. on a one-time basis during the tax year in which the development work was completed. In effect, the taxpayer can deduct qualified costs in the R&D relief regardless of the time when the subject of the qualified costs was acquired, even if it occurred prior to 2016. This significantly expanded the base of qualified costs under the R&D relief with respect to development work commenced before the provisions governing the R&D relief entered into force.

Summary

The tax relief for R&D activity undoubtedly offers an interesting financial instrument encouraging research and development. Previously taxpayers involved in R&D work could count on very limited opportunities for tax support for this work, and thus tended to seek out grants and other forms of direct support.

The goal of the relief is to increase the interest in conducting R&D activity and the scale of such activity in Poland. The attractiveness of the relief was additionally increased by the changes that entered into force on 1 January 2017, namely an expansion of the catalogue of qualified costs, an increase in the limits for deduction of qualified costs, extension of the carryforward period when the tax relief can be taken from three to six years, and the option of obtaining a cash refund of the amount of the deduction for qualified costs.

But the experience to date has already shown that this relief can offer significant tax advantages. The scale of these benefits may be leveraged beyond what was originally assumed through careful reading of the standards set forth in the CIT Act and their effective implementation.

Joanna Prokurat, tax adviser, Tax practice and New Technologies practice

Inheritance proceedings involving a minor heir

Resolving the legal issues arising after the death of a family member is no easy task, particularly when one of the heirs is a minor. In that case, the first priority is to ensure the fullest protection of the minor's rights, in the shortest possible time, while meeting the most pressing needs of the minor and minimising the risks connected with acceptance of an inheritance from an estate that may be encumbered with debts.

Barbara Majewska

Decedents often die suddenly, without having made a will, leaving a spouse and minor children as survivors. Then the heirs need to take care of inheritance matters. The situation becomes complicated when the interests of the minor for example call for sale of an inherited home but it is not certain whether the inherited assets are encumbered by debts.

Notarial certification of inheritance also for minor heirs

Inheritance issues are generally resolved through the courts. An alternative form for confirming acquisition of the inheritance, with the same legal effect, is a notarial certification of inheritance. Despite the clear advantages of this method, it is rarely used by notaries in the case of minor heirs.

Within six months after learning of the entitlement to the inheritance, heirs can arrange the following during a single visit to the notary:

- If there is a likelihood that the estate has debts, heirs can file a declaration accepting the estate with the benefit of an inventory—i.e. limiting liability for debts of the estate to the positive value of the assets—in their own name, or through a statutory representative in the case of a minor.
- They can obtain a protocol of the inheritance, followed by a deed certifying the inheritance, which upon entry in the Inheritance Register maintained by the National Council of Notaries has the same effects as a legally final order of the court confirming acquisition of the inheritance.

Banking secrecy and determination of the elements of the estate

Acceptance of the inheritance with the benefit of an inventory, i.e. with a limit on liability for the debts of the estate, requires a determination of the value of the inherited assets, demarcating the scope of the heirs' liability for debts of the estate. But the heirs do not always have complete knowledge of the condition of the inherited assets, and in particular obligations affecting their value. Information on the state of the decedent's finances can be provided by various institutions, including the credit bureau Biuro Informacji Kredytowej (BIK).

The decedent's credit history which BIK can provide is made up of information forwarded by banks and savings institutions concerning credit, loans, and the use of credit cards and lines of credit tied to savings and payment accounts. Access to the decedent's credit history helps the heirs determine the debts that are part of the estate. It must be borne in mind, however, that information concerning the decedent's credit history is subject to banking secrecy. No information about the decedent's financial obligations can be obtained until the heir presents a legally final order of the court confirming acquisition of the inheritance or a deed certifying the inheritance.

Inventory list vs. full inventory

Once the heirs have complete knowledge about financial obligations incurred by the decedent, they should determine the positive value of the inherited assets, which sets the limit of their liability for debts of the estate. Until 17 October 2015, the rule was that when accepting an inheritance with the benefit of an inventory, the positive value of the inheritance could be determined only through a full inventory (*spis inwentarza*) made by the bailiff at the instruction of the court. This statutory solution was time-consuming and costly, as the inventory required payment of a fee and during the inventory it was often necessary to appoint appraisers to value elements of the estate, particularly when the estate included real estate. This saddled the heirs with significant additional costs and greatly prolonged the whole procedure. The broad criticism of these legal solutions in the literature and case law spurred the introduction of a new institution in Polish inheritance law: the "inventory list" (*wykaz inwentarza*). It serves the same function as a full inventory but is much more accessible and cheaper.

The inventory list is just a private list of assets and liabilities making up the inherited estate, as well as items subject to specific bequest, reflecting their condition and value as of the date of opening of the estate, and the amount of the debts of the estate as of the opening of the estate. Although the regulations do not set a deadline by which the inventory list should be prepared, it should not be put off because the effect of accepting the estate with the benefit of an inventory, in the form of the limitation on liability for debts of the estate, generally occurs only from the time the inventory list is prepared.

It should be borne in mind that the inventory list, unlike the full inventory, is a private document which can be filed with the court or a notary. Valuation of assets for purposes of the inventory list does not require the involvement of property appraisers, significantly reducing the costs connected with determination of the components of the estate. In the case of filing of the inventory list directly with the court, the mandatory contents of the list are enumerated in the executive regulation specifying the form for the inventory list. But the form specified in the regulation can be followed as an example if a notarial inventory list is prepared, which is also deposited with the court.

Despite preparing the inventory list with due care, it may turn out after preparing it and filing it with the court that it is incomplete. Sometimes the heirs receive subsequent information about additional elements of the estate which should also be included in the list. In that case a supplemented inventory list including the new items may be prepared. Preparation of the inventory list (or supplement as the case may be) completes the process of determining rights to the inheritance.

Tax obligation on acquisition of inheritance by minor

It must be borne in mind that acquisition of an inheritance, including by a minor, entails a tax obligation with respect to estate and gift tax. This obligation arises when the order of the court confirming acquisition of the inheritance becomes legally final, or upon registration by the notary of the deed certifying the inheritance. But if the heir is a close family member of the decedent (i.e. spouse, descendant, ascendant, stepchild, sibling or step-parent of the decedent), the heir is entitled to an exemption from estate and gift tax. In order to claim the exemption, the heir must file a notice of acquisition of the property with the relevant tax office by the strict deadline of six months after the inheritance order becomes legally final or the notarial deed certifying the inheritance is registered. This is a preclusive deadline, which means that it cannot be reinstated, and failure to meet the deadline will result in taxation of the inheritance under the rules set forth in the Estate and Gift Tax Act for recipients in the first tax category.

Administration of the estate and judicial protection of the interests of minor heirs

Completion of the inheritance proceeding on behalf of a minor heir, followed by disclosure of the minor's rights for example in the land and mortgage register for inherited real estate, does not mean the minor can freely dispose of the inherited assets, because as a minor the heir lacks legal capacity (or has only limited legal capacity). Any transaction involving a minor's property outside the ordinary course of business—which would certainly include sale of a home acquired by the minor through inheritance, or purchase of a new home for the minor—is subject to judicial protection, which means that such a transaction requires prior approval of the guardianship court. The court will give its consent if it is shown that the transaction is justified and advantageous for the minor.

Summary

Until recently, actions in an inheritance proceeding involving a minor heir required judicial oversight at all stages. Additionally, determining the property included in the inheritance was handled by the bailiff preparing a full inventory of the estate. This was a costly and time-consuming procedure. Now the legal solutions provide the possibility for quick and much more advantageous confirmation of rights to the inheritance. The new procedure is worth using.

Barbara Majewska, legal adviser, Reprivatisation practice and Private Client practice

EU trademarks protected by criminal law


Ewa Górnisiewicz-Kaczor Anna Pompe

Trademark infringers seeking to avoid criminal liability sometimes argue that only national trademarks, not EU trademarks, are protected by criminal law. But this defence is groundless. Criminal law protection does not depend on the procedure under which the trademark was registered.

There may be many reasons businesses decide to register EU trademarks, sometimes even replacing earlier national or international registrations. The choice is primarily dictated by economic considerations. The possibility of quickly obtaining exclusive rights to a mark valid throughout the EU is attractive. While an EU trademark is territorial, it offers protection in 28 states simultaneously through a single registration.

The assumption behind creation of the EU trademark was that the rights under this registration cannot create a situation worse for the owner than if the owner held a national trademark registered in any of the countries that are members of the common market. But the question arose whether the owner of an EU trademark is entitled to pursue the same measures of protection as the owner of a national trademark. If counterfeit goods appear on the Polish market, can the owner of an EU trademark use Polish criminal measures to prosecute and punish the manufacturers or sellers of the infringing goods?

Counterfeit luxury goods on the criminal docket

The police determined that goods were being sold that were suspected of bearing a counterfeit trademark of a renowned producer of luxury goods. It was confirmed beyond any doubt that the seized goods were not produced by the trademark holder or any licensee authorised to use the trademark. The client asked us to help them pursue the case. From the start the client was determined to defend its rights to the renowned trademark, because it was well aware how damaging the presence of counterfeit goods on the market can be to the image of the brand.

A criminal case was launched. The perpetrators were accused of committing the offence under Art. 305 of Poland's Industrial Property Law in connection with trading in goods with a counterfeit trademark. The accused, represented by counsel, took a line of defence that included the claim that EU trademarks do not enjoy protection under Polish criminal law. The prosecutor's office and the proprietor of the trademark, appearing in the case as an auxiliary private complainant, argued from the start that there is no distinction in criminal protection between national trademarks and EU trademarks: an EU trademark can also be found to be counterfeited for purposes of the criminal laws in force in Poland.

In this case the issue of criminal protection of EU trademarks was examined thoroughly by the district court and by the regional court on appeal. Opinions were also submitted in the case by law professors and the Ministry of Justice. Ultimately the court found that the EU trademark had been infringed and found the defendant guilty of the offence. The defendant appealed. The appellate court upheld the conviction and the judgment became legally final.

Trademark registration systems

A business seeking to protect its trademark in Poland has three registration systems at its disposal, via different registration bodies:

- National procedure: filing a trademark at the Polish Patent Office leads to protection effective only in the territory of Poland.
- International procedure: filing a trademark with the World Intellectual Property Organisation leads to protection in the territory of the countries indicated by the applicant, but only after the relevant procedures are conducted involving the national registration offices operating in the individual countries.
- EU procedure: filing a trademark at the European Union Intellectual Property Office leads to issuance of a single decision providing uniform rights with the same legal effect throughout the European Union.

Each of these tracks is independent and results in the proprietor of the registered trademark obtaining a monopoly on the use of the mark. This means that regardless of the procedure under which the mark was registered, no one can use it without the owner's consent. Infringement of exclusive rights to a trademark exposes the infringer to liability under both civil law and criminal law.

Counterfeit mark

The criminal provision in Industrial Property Law Art. 305, used to combat trademark piracy, states that any trading in goods with "a counterfeit trademark" is subject to criminal liability. The act further defines a counterfeit trademark to mean "marks used unlawfully which are identical to, or under ordinary conditions of trade cannot be distinguished from, registered marks." The term "registered mark" is not defined in the act, but leaves no doubt how it should be understood. A registered mark is a mark that is the subject of a decision awarding rights, that is, registration issued by a registration body.

On numerous occasions, the criminal courts in Poland have convicted perpetrators of trading in counterfeit EU trademarks. In just a few of these cases, the defendants attacked the possibility of applying standards of Polish criminal law in their cases, but they were ineffective. In the case involving our client, the courts thoroughly examined this issue, considering a broad range of arguments raised by the parties, and confirmed the existing, consistent line of judicial rulings.

Why the diverging views?

The proponents of limiting the scope of criminal law protection to national trademarks primarily point to the fact that Art. 305 of the Industrial Property Law refers to a "registered mark" but does not mention an EU trademark or an international trademark. Only acts expressly identified in a statute can be penalised. They also argue that Art. 4 of the act, which provides that national law should be applied as relevant in matters not governed by international agreements or directly applicable provisions of EU law, obviously conflicts with the principle of *nullum crimen sine lege* (there is no crime without law) because it is impermissible to define crimes by analogy.

But this view is wide of the mark. First and foremost, it does not reflect a linguistic or systemic interpretation of the Industrial Property Law. An EU trademark fulfils the criteria for recognition as a "registered trademark" or "counterfeit trademark," and the fact that Art. 305 does not advert to the accepted division of trademarks into national, international and EU marks does not exclude application of this provision to each of them.

This provision ignores the procedure under which the registration occurred and ascribes relevance only to the very fact of obtaining rights deemed to be effective in the territory of Poland. The courts rule in this spirit, holding that "the term 'registered trademark' should be understood to mean any trademark, regardless of the procedure under which it was registered, so long as the procedure is recognised in Poland. ... This leads to the conclusion that an international trademark or EU trademark should be treated like a national trademark and is entitled to the same protection—including criminal protection—as national marks" (Olsztyn Regional Court judgment of 30 March 2012, Case VII Ka 210/12, unpublished). The courts also stress that there is no statutory reservation that a "registered trademark" is only one that was subjected to the procedure set forth in the Polish Industrial Property Law and registered at the Polish Patent Office. Thus it should be clearly stated that the concept of a "registered trademark" also includes an EU trademark.

In this case the court held that from the perspective of the Polish legal system, Art. 4 of the Industrial Property Law is decisive. This provision creates the possibility of applying the act as relevant, including the criminal provisions in the act, in all matters not governed by international agreements or provisions of EU law laying down a specific procedure for granting trademark protection directly binding in Poland. The EU Trademark Regulation does not address criminal liability, and thus the criminal regulations provided by Polish law apply as relevant to protection of EU trademarks against piracy.

But extension of this protection to EU trademarks does not constitute an expansive interpretation of criminal law leading to a broader scope of penalisation than arises from principles of linguistic interpretation. A purely rational justification also supports the holding that a product unlawfully bearing an EU trademark is a counterfeit good for purposes of Polish criminal law. EU registration of a trademark is only an alternative path to reaching the same result as national registration. There is no purposive justification for holding the producer or seller of counterfeit goods bearing a national trademark, but not an EU trademark, criminally liable. In social perception, these goods do not differ in any respect. They both falsely exploit someone else's trademark. To hold otherwise would enable easy avoidance of criminal responsibility for trademark theft.

The fact of trademark registration is determinative

From the perspective of criminal law, an EU trademark is subject to the same protection as a trademark registered under the national procedure. There is no justification for distinguishing between trademarks when it comes to imposing criminal liability on a person producing or selling counterfeit goods. What is decisive is acquiring the right to the trademark valid in the territory of Poland, regardless of the procedure that was followed or the office that made the registration.

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Collapse of cryptocurrency exchanges: Legal protection of users

“Site unavailable”—“Service suspended”—“Down for maintenance”… The message may vary, but for users of online cryptocurrency exchanges, such a message could mean that their funds have vanished. Then legal recourse can be the only way to regain at least a portion of the funds, or even just to determine what really happened. But are the law and the courts adequately prepared to handle problems arising with cryptocurrencies and blockchain technology?

Łukasz Lasek

Jakub Barański

Jacek Czarnecki

What are cryptocurrencies?

Over several years we have observed the emergence of digital currencies based on blockchain technology—Bitcoin being the best-known example. Each of these currencies is based on a somewhat different algorithm, but the philosophy behind them is the same. There is no centralised entity issuing the currency and then administering the entire payment system. This is done by an algorithm that maintains a register of funds and accounts in a distributed peer-to-peer network, generally taking the form of a history of all executed transactions. The same register is stored separately by all participants in the network in the form of a blockchain, i.e. a database in the form of a chain of blocks where individual transactions are grouped.

One of the fundamental assumptions of blockchain technology and cryptocurrencies is elimination of the reliance on a trusted third party for the functioning of the entire payment system. Cryptocurrencies exist exclusively in cyberspace. Cryptocurrency "wallets" are nothing but two series of characters: an address (comparable to a bank account number) and a private key (analogous to a PIN code). To dispose of cryptocurrencies assigned to a given address, you have to know the private key. A person in possession of the private key—whether the rightful owner or a cyber criminal—can decide on the fate of the cryptocurrency units associated with the given address.

Cryptocurrencies as the target of attacks by cyber criminals

The blockchain technology itself is very safe and resistant to manipulation. Its dispersed character makes it hard to conduct an effective attack seeking to falsify or modify the data in the blockchain. Hundreds of thousands of computers would have to be attacked simultaneously.

But theft of individual cryptocurrency units is fairly simple: it's enough to gain access to the private key associated with the wallet to which the units are assigned. Because the key is just a set of characters, in practice theft of the funds need not require any complex hacking. The private key might be stored on a piece of paper. Perhaps it is recorded in an unencrypted file on our computer. Obtaining such a key need not present any serious difficulty for a hacker.

Cryptocurrency exchanges

But it is online cryptocurrency exchanges that are most exposed to attacks. These are internet services enabling cryptocurrency units to be bought, sold and exchanged for other currencies, traditional or digital. To become the holder of cryptocurrency units, it is sufficient to open an account on one of the exchanges (which also operate in Poland), pay in the appropriate amount of traditional funds, and then place an order to buy digital currency.

As a rule, after making such a transaction we should deposit our units in an individual wallet on the blockchain over which we have exclusive control. But users often do not do this, and store their funds in virtual accounts of currency exchanges. Such exchanges are often treated by users as a kind of substitute for a bank. Often they hold quite large sums of digital money. Obtaining the private key to the exchange wallet provides access to the funds.

The eight-year history of Bitcoin is full of examples of successful attacks on exchanges and thefts of funds held there. The most spectacular cases include the loss of some BTC 750,000 (currently valued at about USD 620 million) from the Mt Gox exchange in early 2014 and about BTC 120,000 from Bitfinex in mid-2016 (c. USD 99 million). Funds have also been stolen several times from Polish exchanges and their users, with these losses estimated at millions of zlotys.

Does the law effectively protect holders of cryptocurrencies?

Polish law provides appropriate legal means to seek recovery of lost funds. But these cases are not easy, and raise a number of practical problems.

It is often difficult to determine exactly what claim we are entitled to pursue. Should we seek return of the cryptocurrency units, or damages in traditional currency? If we seek return of the cryptocurrency, how can the eventual judgment be enforced? Sometimes it is also unclear whom the claim should be asserted against. It is not always known who was the administrator of the exchange or who was the owner of the bank account or digital wallet in which the user's "deposit" was stored.

Injured users of an exchange seeking to pursue their rights must struggle with these and other difficulties. Most of these problems are caused by the fact that cryptocurrency exchanges are not specifically regulated in Poland.

What to do when a problem arises

Users injured as a result of a hacker attack against an exchange or who in some other way have lost their funds can pursue individual legal recourse, i.e. asserting a civil claim or commencing criminal proceedings.

Practice shows that speed of action is a key factor. The faster we act, the better chance we have to secure evidence (e.g. IT data) and assets from which our claim can be satisfied. An application for interim relief should be considered to secure our claims and essential evidence, e.g. by making a binary copy of the contents of the server on which the exchange was operated.

The institution of interim relief to secure claims enables temporary protection for the duration of the judicial proceeding. Its purpose is to ensure that if and when a judgment is obtained, it will be enforceable in practice. A judgment in our favour offers cold comfort if after the case ends the defendant no longer has any assets and is unable to satisfy the judgment. On one hand we can seek to secure the virtual currency as such, by prohibiting the exchange from disposing of the currency in question or requiring it to transfer the currency to the account of a trusted person indicated by the court (e.g. the user or the bailiff). On the other hand, we can try to attach the traditional assets of the exchange operator: bank accounts, movable or real property and so on.

The institution of securing evidence enables us, even before filing the claim, to demand that evidence that is relevant and at risk of loss be secured for use during the trial. In order to effectively pursue a claim for return of the funds, the user of the exchange will first have to prove the amount of the funds entered in his virtual account. If the exchange's website ceases to operate, and we do not hold for example account statements sent to us by email, or screen shots showing the last balance in our account, it could be practically impossible to prove our loss, as the essential data are in the exclusive control of the exchange or could have been damaged or lost as a result of the attack.

In civil proceedings, the possibilities for searching and seizing evidence in the other party's possession are limited. But very often in cases of this type parallel criminal proceedings are conducted. Then it may be considered whether to seek the assistance of the law enforcement authorities, who have legal instruments at their disposal enabling them to secure the relevant data. Injured parties have a right to apply for specific measures to be taken by prosecutors. Users can suggest to prosecutors for example that they secure databases of the online exchange containing information about the accounts of specific users. If the integrity of the data is compromised, the prosecutor may immediately request the relevant specialists to recover the data and store it in the form of a binary copy. As a rule, materials obtained in the course of a criminal investigation can also be used in a civil proceeding. Thus involvement in a criminal case can be essential even if we are not interested in identifying the perpetrator who caused the funds to be lost via the exchange.

Summary

Cryptocurrency exchanges have become a necessary gateway between traditional and digital currencies. But they are also the weakest leak in the entire system, exposed to the most serious threats.

Ensuring effective legal protection of users of cryptocurrency exchanges will be one of the most important challenges for the legal system in this area. It seems that the exchanges which users trust with their savings will ultimately have to submit to regulations like other financial institutions. The ownership structure of the exchange, the security systems it applies, and the methods for protecting data will have to be clearly defined. Without these changes, the use of cryptocurrency exchanges will continue to carry a high risk. The legal system does provide for protection against loss of cryptocurrencies, but resorting to the available protection may not always be effective.

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Pre-pack sale of a debtor's enterprise

Karol Czepukojć

The pre-pack sale has been available in Poland since 1 January 2016. The debtor's enterprise can be sold in this procedure upon application of the debtor, or a creditor who independently seeks out a buyer and negotiates the terms of sale; the buyer can also be a creditor. The transaction will close shortly after announcement of the debtor's bankruptcy.

This article describes a hypothetical case where at a certain stage, upon application of the principal creditor, the debtor is declared bankrupt and its enterprise is sold, without the debtor's consent, in a pre-packaged insolvency.

Investment credit

A Polish limited-liability company conducting manufacturing activity took out investment credit to finance the upgrade of its machinery and equipment. For simplicity we will assume that the credit was to be repaid all at once, with interest, in January 2017. The credit was secured by establishment of registered pledges in favour of the bank against a set of movables and intangibles constituting an economic whole (including machinery and inventories), and by mortgages on land with a manufacturing plant. The collateral was owned by the company free of other encumbrances.

A threat of insolvency

In the 4th quarter of 2015 one of the company's key customers fell into serious financial difficulties, driving it into bankruptcy. The official receiver appointed for the customer in bankruptcy terminated the framework agreement with the company and ended the cooperation that had generated 30% of the company's annual revenue. The management board decided that the company had to win new customers by the end of January 2016 to make up for the shortfall if it wanted to avoid its own insolvency.

In case the efforts to win new customers were unsuccessful, the company hired a licensed restructuring adviser with experience restructuring enterprises from the same industry to prepare the company for filing an application to commence in-court restructuring.

Remedial proceeding

The company did not win enough new customers. Obligations that fell due began to go unpaid. In February 2016 the management board of the company decided to file an application with the restructuring court to open a remedial proceeding (*postępowanie sanacyjne*, a type of in-court restructuring), with permission for the management board to continue managing the company's enterprise. It was hoped that the company would be restructured and in the interim it would receive protection from its creditors, including the bank.

Within two weeks the court opened a remedial proceeding and appointed as the administrator of the company the licensed restructuring adviser who had supported the company in preparing to file its restructuring application. However, the court did not consent to the existing management board's continuing to exercise management of the company's enterprise. In the court's view, effective conduct of the restructuring proceeding did not require the personal involvement of the management board. Management of the company was fully entrusted to the administrator appointed by the court.

Restructuring of debt

According to the preliminary restructuring plan which the company enclosed with its application to open the remedial proceeding, the debt to the bank would be partially written off (25% of the principal and 100% of the interest), and the rest would be paid off in instalments over five years beginning from January 2017. The administrator included this proposal in the restructuring plan. In the view of the administrator and the management board, the company's condition did not enable it to present any more favourable repayment proposal. The restructuring plan then received a positive opinion from the creditors' council, over the "nay" vote of the bank as a member of the council, and was confirmed by the judge-commissioner.

The bank was not interested in restructuring of its claims under the proposed terms. Thus it decided to sound out the market for possible sale of the company's enterprise or specific assets in order to satisfy its claims out of its collateral. However, the administrator ruled out the sale of assets representing a significant portion of the company's assets in the remedial proceeding to satisfy part of the claims, as in his view this would prevent performance of the restructuring plan and the subsequent arrangement with creditors.

Industry investor

Nonetheless, the bank contacted an investor from the same industry as the company which was interested in acquiring the debtor's enterprise as a whole. The investor was not affiliated with the debtor. It was vital for the investor to have a chance to acquire the enterprise as a going concern and to limit the risk connected with the company's existing debt. The investor wanted to close the sale by the second half of 2017 at the latest. The parties agreed that the preferred procedure would be a sale in a pre-packaged insolvency, because of the legal conditions, the speed of the procedure, and the consequences of a sale through this procedure. Such a sale has the effect of a sale in execution: essentially, the buyer acquires "clean" assets, free and clear of the prior encumbrances and obligations.

Description and valuation of enterprise

The bank hired an appraiser, at its own cost, to draw up a description and valuation of the company's enterprise. The appraiser was one included in the list of court-appointed experts, with special knowledge on valuation of enterprises and experience appraising enterprises from the industry in question. Significantly, in connection with the provisions of the investment credit agreement and the documentation concerning the security established in favour of the bank, the administrator allowed the appraiser physical access to the assets of the enterprise. Without that, it would be difficult to prepare an accurate description and valuation, or impossible in the case of many items.

The description and valuation to be used by the bank for the purposes of the pre-pack sale contained information including:

- The subject of the business, the real estate included in the enterprise (including the area and a designation of the land and mortgage register), other fixed assets and rights, easements and the like
- The mortgage and registered pledge against the enterprise, their value and the value of the encumbered assets, as well as the ratio of the value of the specific encumbered assets to the overall value of the enterprise
- The estimated costs of a bankruptcy proceeding involving liquidation under general rules, and under the pre-packaged insolvency, which would have to be incurred on sale of the enterprise as a whole.

The valuation reflected the conditions of a forced sale of the enterprise comparable to what would occur in a bankruptcy proceeding involving liquidation under general rules. The resulting value served as a point of departure for the bank in its negotiations with the investor. To obtain judicial approval of the terms of the pre-pack sale, the price could not be lower than the forced-sale valuation (less the costs of the proceeding that would have to be incurred in connection with liquidation of the enterprise in bankruptcy under general rules but would not have to be incurred in a pre-pack sale).

Discontinuance of the remedial proceeding

The bank agreed with the investor on mutually beneficial terms of sale, including a price that was higher than the value of the enterprise adopted in the valuation and enabled the bank's claims to be satisfied in full. A draft of the sale agreement was drawn up accordingly.

Acquisition with the effects of an execution sale enabled the investor to limit the transaction risk enough that it decided to acquire the enterprise without conducting due diligence, relying on information from the market, the restructuring plan, the description and valuation, and other documents included in the file of the in-court restructuring proceeding.

To obtain judicial approval of the terms of the pre-pack sale and carry out the transaction, it was first necessary to close the remedial proceeding and declare the debtor's bankruptcy. In the remedial proceeding, in December 2016 the judge-commissioner convened a creditors' meeting to vote on the arrangement with creditors. The bank agreed to include its claims in the arrangement, took part in the voting, and voted against the proposed arrangement. On the strength of the bank's vote, the arrangement was rejected, as creditors representing over a third of the total claims held by the voting creditors had voted against the arrangement. The restructuring court was thus required to discontinue the remedial proceeding. The company filed an appeal against the discontinuance, but the appeal was denied as unjustified.

Simplified bankruptcy petition with application to confirm terms of pre-pack sale

Within the period provided for filing an appeal against the order discontinuing the remedial proceeding, the bank filed a simplified application with the bankruptcy court for declaration of the debtor's bankruptcy. It enclosed an application for approval of the terms of the pre-pack sale of the enterprise negotiated with the investor, together with the description and valuation of the enterprise, the bank's written consent to the transaction, as pledgee, and a draft of the sale contract. It should be pointed out here that in a pre-packaged insolvency it is also possible to sell an organised part of the enterprise or a set of assets representing a significant portion of the enterprise. In none of these cases is the debtor's consent required.

Consideration of the bankruptcy petition was stayed until the appeal against the order discontinuing the remedial proceeding was decided. The court only appointed a temporary court supervisor, who was requested to prepare a report addressing, among other things, the proposed terms of the pre-pack sale of the company's enterprise. The temporary court supervisor did not raise any objection to the proposed terms of sale.

Declaration of bankruptcy and approval of terms of pre-pack sale

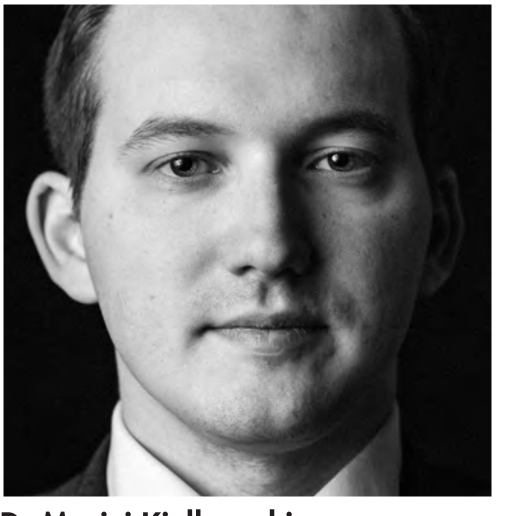
When the order discontinuing the remedial proceeding was legally final, the court declared the debtor bankrupt, appointed an official receiver, and confirmed the terms of the pre-pack sale of the enterprise, citing the conditions set forth in the draft sale contract. Three creditors filed appeals against the order approving the terms of the pre-pack sale, disputing the adequacy of the sale price, but their appeals were denied as unjustified.

Execution of sale agreement and transfer of enterprise

Within 30 days after the order approving the terms of the pre-pack sale became legally final, and after obtaining payment of the entire price for the bankruptcy estate, the official receiver executed the sale agreement with the investor. The official receiver then transferred possession of the enterprise to the buyer.

Karol Czepukojć, licensed restructuring adviser, Restructuring & Bankruptcy practice

You can—and should—demand that your case be resolved



Dr Ewa Bułkiewicz Dr Maciej Kiełbowski

The title may seem a truism, but in the case study we discuss here, an administrative proceeding to invalidate a decision, the administrative authority didn't seem to think it was necessary to decide the case. It took the administrative court to explain that in a proceeding to invalidate a decision, the case can't be discontinued without issuing a decision, even if the decision in question was previously amended or even vacated.

The case involved the rules for marketing authorisation for medicinal products and related issues.

Alfa—the entity responsible for the original medicinal product—filed an application to invalidate the administrative decision under which the president of the Office for Registration of Medicinal Products, Medical Devices and Biocidal Products (URPL) had granted marketing authorisation to Beta for a generic medicinal product. Alfa alleged that URPL had committed a gross violation of law by failing to recognise the data exclusivity period for the reference medicinal product (violating Art. 15(1)(2) of the Pharmaceutical Law of 6 September 2001).

But the regulator discontinued the proceeding initiated by Alfa, finding that the marketing authorisation decision was no longer in legal circulation because the entity responsible for the generic drug had changed from Beta to Gamma—which the office in fact did not disclose, although it was obliged to do so. As a result of the change in the responsible entity, a new decision was issued, bearing a different date and file number, but containing the same permit number and EAN UCC code.

Alfa applied for reconsideration of the case, alleging violation of Art. 105 §1 of the Administrative Procedure Code and improper interpretation of Art. 32(1) of the Pharmaceutical Law. In justification for its application, the party argued that the decision changing the responsible entity (from Beta to Gamma) did not go to the actual substantive grounds for issuing the marketing authorisation for the drug, but only changed the name of the responsible entity. Such a decision was derivative or technical in relation to the original decision granting marketing authorisation for the drug, which remained in circulation.

But the president of URPL upheld the decision discontinuing the proceeding, essentially repeating the earlier arguments. Then Alfa filed a complaint with the province administrative court.

The complaint raised several procedural objections, but mostly focused on the issue connected with the alleged mootness of the proceeding. Alfa sought to vacate both of the decisions issued by the regulator in the case, and moreover sought a holding that the decision issuing marketing authorisation for the generic medicinal product and the decision changing the entity responsible for the generic drug were invalid, or—based on the possibility provided for in Art. 145a of the Administrative Court Procedure Law—instructing the president of URPL to issue such decisions.

The president of URPL moved to deny the complaint.

The province administrative court issued a judgment vacating the regulator's decision and the earlier decision discontinuing the proceeding. In the justification for the judgment, the court addressed firstly the effects of issuing the decision changing the responsible entity on the original decision admitting the medicinal product onto the market. According to the court, "Issuance of a new permit in the case of a change in the responsible entity transfers to a new entity the rights and obligations of the previous responsible entity arising out of the original decision." This conclusion was in line with Alfa's arguments.

The court pointed to a number of grounds leading to this conclusion. The Pharmaceutical Law does not require an applicant seeking to become the new responsible entity to file the full documentation necessary for admission of the medicinal product onto the market and go through the marketing authorisation procedure again. Apart from the subjective element (the change from Beta to Gamma), it is only required to submit a statement that the remaining elements of the permit and the documentation remain unchanged.

Maintaining the current permit number and EAN UCC code in the new permit also pointed to the continuity of the original decision on marketing authorisation. In this respect, the pragmatic argument was also used that if the EAN code changed along with the change in the responsible entity, the drug would be "lost" in the list of drugs eligible for reimbursement through the national health service. Thus the legislative intent in enacting Art. 32 of the Pharmaceutical Law was to adopt the notion of succession, i.e. that the new responsible entity (here, Gamma) would enter into the rights and obligations of the previous entity (Beta). The change in responsible entity is thus irrelevant for the reimbursement system.

The court stressed that from the perspective of the legal system, succession to the rights and obligations under administrative decisions is the exception, and its permissibility and scope must be determined under an express provision of substantive law. Such a basis is Art. 32 of the Pharmaceutical Law, and a new decision issued under Art. 32(2)(f) "constitutes a legally permissible form of change of an existing decision only with respect to the designation of the addressee, while maintaining all the other conditions provided in the decision." The court also pointed out that this position had been presented before (in the judgment of the Province Administrative Court in Warsaw of 12 April 2008, Case VII SA/Wa 8/07). And prior to that, before the regulations were amended to move the competence in this category of cases from the Minister of Health to the president of URPL, the Minister of Health as the body granting marketing authorisation for drugs and making changes in the responsible entities had no doubt on this point.

The court did not share the regulator's argument that issuance of the decision changing the responsible entity terminated the legal existence of the original decision. The court reminded the authority of the need to issue a decision in this case on expiration of the permit based on Art. 162 §1(1) of the Administrative Procedure Code. In the court's view, there was no basis for finding such a decision to be moot in a situation where administrative succession had occurred, nor did any provision of law require a finding that the original decision on marketing authorisation had expired under Art. 162 §1 of the Administrative Procedure Code as a result of a change in the responsible entity. Thus the original decision on marketing authorisation for the generic drug (originally issued to Beta) remained in legal circulation.

The court pointed out that the administrative authority with whom the application for invalidation of the decision was filed had an obligation to conduct a proceeding to evaluate the legality of the decision. As the court held, "A proceeding for a finding of the invalidity of a decision is a separate administrative proceeding whose essence is to determine possible existence of the grounds set forth in Art. 156 §1 of the Administrative Procedure Code."

The court underlined that the legality of the decision should be assessed, and this should happen even if the decision had been amended or vacated, as the legality of a decision is determined on the basis of the legal status as of the date of issuance of the decision.

Modification or setting aside of the decision does not change the fact that it could have been so defective that it was invalid from the start. Nor could it be ruled out that due to even temporary functioning of such a decision in legal turnover, the party suffered a loss for which it has a right to pursue damages, depending on the specific instance, against the administrative authority or the addressee of the decision. But if the authority does not address the legality of the decision, but only—as in this case—discontinues the proceeding as moot, the party will be deprived of the ability to enforce its rights. The court stressed that such a situation is impermissible, and thus it overturned the regulator's decision and the one preceding it.

This is how the case in question was resolved by the Province Administrative Court in Warsaw in its judgment of 22 January 2016 (Case VI SA/Wa 1864/15). This judgment, although not yet legally final, indicates the right way to understand and apply the regulations on invalidation of an administrative decision. This procedure is extraordinary and will not always be followed, but if the party initiates it (when it is essential for protection of its interests, as in the case described here), it can insist on obtaining a ruling on the merits.

Dr Ewa Butkiewicz, legal adviser, Life Science & Regulatory practice

Dr Maciej Kiełbowski, adwokat, *Dispute Resolution & Arbitration practice*

Who to sue for unlawful use of real estate, for what and for how much?


Krzysztof Wiktor Leszek Zatyka

It's not easy being the owner of real estate in the unlawful possession of third parties. The law might be expected to prioritise ownership rights. But life can have other plans, and sometimes courts in Poland issue conflicting rulings.

Possession of real estate without a legal basis typically occurs when a lessee or tenant refuses to return the property after termination of the lease or tenancy agreement. But in Poland a major source of this problem is cases where the former owners of property unlawfully taken by the state during the post-war period regain title to the property.

The Civil Code provides serious consequences for an unauthorised possessor of real estate. Depending on the specific facts of the case, such a possessor may be:

- Required to pay for non-contractual use of real estate during the period that is not time-barred, which may include 10 years or even longer if the owner of the real estate took measures to secure its claim within the proper time
- Required to turn over benefits obtained from the property, as well as benefits that were not obtained due to poor management
- Charged with liability for deterioration of the real estate and loss of market value.

The liability of the unauthorised possessor to the owner will not always be that broad, as it depends on whether the possession is in good faith or bad faith, but the law nonetheless gives the owner many possibilities to make up for the inability to benefit from ownership of the property.

It might seem that regulations governing protection of the right of ownership, as a fundamental constitutional right, should be well-recognised and uniformly interpreted in the case law of the Supreme Court of Poland and the lower courts, and in the legal literature. But in fact these issues generate many difficulties and result in inconsistencies in cases decided by the courts.

Who to sue

In a number of court cases concerning settlement of accounts between the owner of real estate and the unlawful possessor, we have most often encountered the defence that the defendant is not the proper party to sue for this claim. The plaintiffs argue that the possessor is the only logical person to sue.

This defence was raised for example in a case seeking payment for non-contractual use of real estate in which our firm represented the owner of a Warsaw apartment building regained after a legal battle lasting over a decade before the administrative authorities and the courts.

As the repossession proceedings showed, the administrative decisions under which public entities had obtained rights to the property were void from the beginning and without legal effect. In reality the public entities had never held rights to the property, and thus were independent possessors not holding legal title.

The attractively situated building was in the possession of public entities without interruption from the 1950s until it was finally regained in 2010. Public entities (first the State Treasury, and then, pursuant to communalisation in 1990, the City of Warsaw) had used the property for 60 years, benefitting from the property in the form of rental income from tenants of residential and commercial units in the building, without incurring any obligations to the rightful owners.

The City of Warsaw did not use the building itself by operating city offices there, but used the building to further the city's residential policy. For this reason as well, during the judicial proceeding the city argued that it was not the city that had any obligation to the owner for non-contractual use of the property, but rather the individual tenants who actually occupied the leased premises.

This argument was rejected by the Warsaw Regional Court, which held in favour of our client, ordering payment for non-contractual use of the building in the amount demanded, corresponding to the level of rent for premises of this type. But the Warsaw Court of Appeal took a different view, holding that the City of Warsaw was not the possessor of the property, and liability to the owner should be borne by the tenants.

This decision in turn was not accepted by the Supreme Court of Poland, which through a cassation appeal filed by the law firm vacated the judgment below and remanded the case to the Warsaw Court of Appeal for reconsideration. The Supreme Court held that as an independent possessor of the real estate, the City of Warsaw did not relinquish that status by delivering possession to a dependent entity pursuant to a lease. The independent possessor maintained contact with the property, influencing its use by the dependent holder, and could even terminate the lease. The court stressed that the tenants could not be charged with paying rent twice for use of the property when they had already paid rent to the City of Warsaw.

On rehearing of the case, the Warsaw Court of Appeal awarded the firm's client payment from the City of Warsaw for non-contractual use of the property.

The issue of the capacity to be sued on the part of an independent possessor of real estate which had delivered the property to a third party for occupancy is currently the subject of a number of controversies, which has led the Supreme Court to review the matter again in the near future in an expanded panel of judges. In cases conducted by our firm, the Supreme Court has upheld the City of Warsaw's capacity to be sued three times, and one time refrained from issuing a ruling until a resolution is issued by an expanded panel of the Supreme Court.

What to sue for

A no less complicated problem is determining the scope of liability of the independent possessor for holding the property without legal title. As mentioned, the Civil Code suggests broad liability of the possessor on this ground, including payment for non-contractual use, turnover of benefits obtained or not obtained by the possessor, as well as liability for deterioration of the property.

The view may be encountered in the case law and the literature that the owner of real estate should not be enriched due to non-contractual use of the property at the cost of the possessor. This would suggest that the owner may assert only one of these claims.

This position is favoured however by the factual state of possession of property and drawing benefits from it, while imposing on the wronged owner disproportionately heavy obligations and the need to incur much higher costs to defend the right of ownership (litigation costs and risk). But on the side of the unlawful possessor of the real estate there is only a threat of having to pay for use of the property or turn over the benefits. The only negative consequence for such a possessor would thus be the obligation to pay an amount economically comparable to what it would have had to pay if it had used the property legally.

Such activity may thus pay off economically for an independent possessor in bad faith, particularly when the owner's claims become time-barred.

Thus it would be appear justified to take the opposite view, that these claims are not competing but complementary in protecting the owner's interests. This position was also adopted recently by the Supreme Court in another case conducted by the firm concerning claims by the owner against the unlawful possessor of real estate.

We may ponder in this context whose rights should take priority in the event of a conflict between the right of ownership and the rights of those holding real estate unlawfully.

It appears that under the rule of law, the state should protect rights founded on the statutory law in force. Without doubt, the right of ownership is such a legally protected right.

How much to sue for

Another thorny issue is the value of the claims that can realistically be sought. The amount is influenced by a number of legal and factual circumstances, but primarily by the timing of the moment when the possession by the unauthorised holder became possession in bad faith. Claims can be asserted against the possessor only when it is in bad faith, and bad faith exists if the possessor should have been aware that its state of possession has no basis in law. The length of the period for which the owner may assert claims thus runs from that date, as determined by the court.

The value of claims is also influenced by the factual and legal nature of the property and the individual units. Generally, the possessor's liability should be determined on the basis of market value, i.e. the prices that the possessor would have had to pay if it had used the property legally. But some courts hold that this value should be reduced in a situation where during the period in question the property was covered by regulations preventing the possessor from obtaining benefits from the property at market value.

An unenviable position

As is apparent from the foregoing, the situation of owners of real estate in the possession of an unauthorised holder is not an enviable one. Their situation would appear even bleaker if we described the hardship and threats they face in attempting to pursue legal measures seeking to regain actual control over their property. But that is another story altogether.

Krzysztof Wiktor, legal adviser, partner co-heading the Reprivatisation practice

Leszek Zatyka, legal adviser, Reprivatisation practice

Environmental permits can expire faster than it seems


Dominik Wałkowski Martyna Robakowska

Conducting business often requires obtaining permits for abstraction of water, discharge of wastewater, generation of waste, or emission of substances into the atmosphere. Most permits are issued for a defined period. But in certain situations permits can terminate early.

Sometimes an operator erroneously believes that a permit is valid because the term stated in the permit has not expired yet, when in fact the permit has expired pursuant to special regulations.

Regulations resulting in early termination of permits can be divided into two groups.

The first group involves situations where environmental authorities issue a ruling limiting or withdrawing a permit due to the occurrence of certain circumstances. For example, this will happen if an installation is not properly operated, thus creating a risk of extensive harm to the environment or a threat to human life or health (Art. 193(1) of the Environmental Protection Law). Such a decision may also be issued if an installation is operated in violation of the terms of the permit (Art. 194(1)(1)) or environmental regulations have changed to a degree not allowing the emissions or environmental impacts under the terms set forth in the permit (Art. 194(1)(2)). But for the holders of permits, such situations are not a great surprise, because a ruling on limitation or withdrawal of a permit is preceded by a proceeding leading to issuance of a decision served on the holder of the permit. An appeal can be filed against the decision. The holder is therefore aware that further operation of the installation may lead to imposition of fines or an obligation to pay increased fees.

The second group of regulations govern trickier situations where emissions permits expire by operation of law as a result of occurrence of circumstances provided for in the regulations. Thus the permit holder may be unaware that the permit has ceased to be valid for some time. Often the operator learns of this only during an inspection—sometimes months or even years after the permit has expired. Thus financial sanctions, whose amount depends among other factors on the length of time the installation has been operated without a required permit, can be hefty in such cases. Sometimes the environmental authorities will even be required to shut down operation of the installation due to lack of a valid permit.

In our practice we encounter such situations, where the regulations and frequent amendments can surprise even the most experienced operators.

Failure to operate installation for two years

One company decided because of extended restructuring and the need to obtain financing that it would suspend its operation of an installation for some time. After overcoming these difficulties it restarted its operations, only to be accused by inspectors of operating the installation without the required permits. The company pointed out to the inspectors that the installation had not been modified since obtaining the permit, and the permit was still appropriate for the operations the company conducted. The company also stressed that one of the points of the permit indicated its period of validity, which had not expired yet. Finally, the company argued, it should have been informed of early termination of the permit. Since the permit was issued by serving the relevant decision on the operator, cancelling of the permit should occur in the same manner.

Unfortunately the environmental inspectors were right. Cessation of the activity covered by the permit for a period of at least two years results in termination of the permit (Art. 193(1)(5) of the Environmental Protection Law). This occurs by operation of law, and thus it is not necessary for an administrative proceeding to be conducted to cancel the permit. While the administrative authorities do issue decisions in such cases confirming termination of the permit, such a ruling is only formal confirmation that the permit has already expired. Similarly, an emissions permit (an integrated permit, a permit to release gases and dusts into the atmosphere, a water permit to release wastewater into water or ground, or a permit to generate waste) expires by operation of law if the operator of the installation does not commence the activity covered by the permit within two years after the permit becomes final (Art. 193(1)(4)).

Lack of integrated permit

It would seem that determining whether a given activity requires the operator to obtain an integrated permit should not present great difficulty. After all, the list of such types of installations is set forth in a regulation of the Minister of the Environment. In practice, however, proper classification of an installation sometimes generates serious doubts. An erroneous determination that an integrated permit is not necessary in the given case can have grave consequences. At the time when an installation becomes one that requires an integrated permit, the existing emissions permits expire (i.e. a water permit to abstract water or discharge wastewater to water or ground, a permit to release gases and dusts into the atmosphere, or to generate waste—Art. 193(2) of the Environmental Protection Law). Apart from the risk of incurring increased fees for lack of a permit, a harsh sanction is the obligation imposed on environmental inspection authorities to suspend the use of an installation operated without an integrated permit (Art. 365(1)).

Why these doubts? Typically they are caused by an erroneous calculation of production capacity, a failure to total up the parameters of the same type, or simply failure to verify whether the equipment operated at the plant makes up an installation of the type listed in the regulation. And sometimes after expansion or upgrading of the plant the operator does not notice that the installation has reached a threshold of production capacity requiring an integrated permit to be obtained.

Even if the operator is familiar with the regulation, determining whether operation of the given installation requires an integrated permit is often highly problematic as a result of the unclear wording of the regulation.

Such difficulties may be encountered by companies operating plants with installations for combustion of fuels. Under the regulation, if the nominal capacity of such an installation exceeds 50 MW, an integrated permit should be obtained to operate the installation. But this requirement refers only to the group of installations "for production of energy and fuels." The operator must therefore determine whether its installation for combustion of fuels can also be deemed to be an installation for production of energy—when often the combustion of the specific fuel is only one of a number of processes occurring within the installation.

A similar problem was faced by an enterprise that operated an installation for production of paper. It upgraded the plant with installation of new equipment enabling it to produce over 20 tonnes of paper per day. Because of difficulties in starting up the renovated wing of the plant, the actual production quantity did not exceed 15 tonnes per day for several months. The enterprise should have obtained an integrated permit from the time it met the formal criterion, i.e. the date when the production capacity of its plant exceeded the threshold of 20 tonnes per day indicated in the regulation. The explanation given to the environmental inspection authorities relying on the actual production levels could not protect the company against sanctions for failure to obtain an integrated permit.

Changes in regulations and interim provisions

Frequent changes in law are a headache for nearly all businesses. Often the changes affect permits obtained in the past which must be adapted to the new regulations within a designated period. Sometimes the law expressly provides that existing permits will expire on a specific date, even if they were issued for a longer period. Many examples of this legislative approach could be found in the recent new Waste Act, which provided that decisions approving instructions for operation of landfills would expire two years after entry into force of the new act, i.e. on 23 January 2015 (Art. 240(1)). Permits for collection, recovery or disposal of waste, in turn, remained valid for three years, i.e. until 23 January 2016 (Art. 232(2)).

Necessary vigilance

The precise determination of the period of validity of a permit can be a difficult task. Sometimes the regulations calculate the expiration date from the date of launching of a public register, and sometimes this period is modified when amending the regulations. The law thus requires businesses to maintain constant vigilance.

Poland's environmental protection statutes provide several major exceptions to the rule that emissions permits expire at the end of the period stated in the permit. The most crucial for businesses are the regulations that cause permits to terminate by operation of law. This risk must be considered when deciding to upgrade or expand an installation. An operator that applies for issuance of a new permit in due course will not only avoid harsh administrative penalties but also the possible need to suspend operation of the installation.

Dominik Wałkowski, adwokat, *partner heading the Environment practice*

Martyna Robakowska, Environment practice

They cut off the power—what next?

Marek Dolatowski

It's an ordinary early morning at a large industrial plant. The production lines are humming along at full speed to keep up with orders coming in. Suddenly it all grinds to a halt. The factory floor is plunged into darkness but for a few streaks of light through the tiny windows. A few moments later the generator kicks in to provide emergency lighting. There's no power! The plant manager nervously picks up his mobile phone and dials the chief electrical engineer to find out what happened.

Planned and unplanned outages

The engineer in turn immediately calls the electricity distributor. There's an outage. No one knows how long it will last, but it's serious. After he puts the phone down and notifies the plant, the engineer reaches for the power distribution service agreement they spent so much time negotiating. The negotiations centred around the provisions on permissible interruptions in service, planned and unplanned. For such customers (in the 3rd connection group), the law requires the permissible length of interruptions to be addressed in the contract. It's different in the case of households and other small customers (groups 4 and 5), for whom the length of permissible outages is specified by law. The engineer quickly found the appendix outlining the permissible length of a one-off unplanned interruption. It was unplanned in this case because the distributor had not notified the plant earlier in the manner provided by law.

His phone rings again. This time it's the management board member responsible for production. He nervously explains to the engineer how tight the schedule is for order fulfilment. But the breakdown on the distributor's side means that they have to wait. There's just one question: How will the power distributor be responsible for all this?

This is why the contractual provisions on permissible interruptions are so important. If the length of interruptions exceeds the permissible time, customers are entitled to rebates. The rebates are equal to 5 times, or even up to 10 times (for small customers), the average price of electricity on the competitive market (in 2016 PLN 169.99/MWh) for each undelivered unit of electricity. Rebates are due regardless of the reason for the interruptions (they don't depend on whether the supplier was responsible for occurrence of the interruption), and are also owed in the event of *force majeure* (e.g. when the outage is caused by atmospheric conditions).

Moreover, the law does not provide for any circumstances excluding the obligation to pay rebates. The courts have thus held that the obligation to pay rebates is mandatory for electricity enterprises. This means that payment of rebates for undelivered electricity is owed regardless of the provisions in the contract, but with one reservation: the interruptions in supply of electricity must exceed the length specified in the contract or in the law.

The rebates also do not constitute damages and do not exclude pursuing damages. This means that if there are outages exceeding the permissible length, the customer may alongside rebates pursue damages for losses caused by the interruption in supply of electricity (e.g. losses incurred because it was necessary to interrupt production and orders could not be filled on time). The amount of the rebates should not affect the quantum of damages sought (i.e. the damages should not be reduced by the amount of the rebate).

Unjustified failure to apply rebates exposes the energy supplier to a fine imposed by the president of the Energy Regulatory Office (URE) of up to 15% of its revenue from concession activity in the prior tax year.

These rules mean that the distributor has an incentive to fix the outage as quickly as possible, and businesses have remedies if the interruption exceeds the permissible duration.

Limitation on supplies

The events of 10 August 2015 reminded older customers of the notion of "degrees of supply," last introduced during the communist era, and brought younger customers up to speed on this notion. On that day, as a result of simultaneous occurrence of a number of unfavourable phenomena (breakdowns, heat wave, drought and windless weather), power generation capacity reserves in Poland fell below permissible levels, which forced the transmission system operator to limit deliveries of electricity. Then the Council of Ministers adopted a regulation confirming that the limitations would remain in force through the end of August 2015.

Failure to comply with limitations on consumption of electricity is subject to a fine imposed by the president of URE. The maximum fine is 15% of the customer's revenue in the prior tax year. There are currently many proceedings pending relating to fines imposed for failure to comply with the limitations, because many enterprises did not manage to reduce their power consumption quickly enough (or couldn't cut their use because of ongoing manufacturing processes).

In the case study we posed here, the plant was luckier. Its production could be halted almost immediately. Now the customer service division only needs to notify the customers of the delay in delivery of the goods they ordered and check the contracts to determine whether the company faces any consequences for the delays. The plant itself does not face any consequences from URE.

Besides a low level of capacity reserves, limitations on consumption of electricity in order to ensure the security of supplies may be imposed for such reasons as:

- Declaration of a state of emergency
- A natural disaster or direct threat of occurrence of a technical emergency within the meaning of the Natural Disasters Act
- Introduction of an embargo, blockade, limitation

or non-delivery of fuels or electricity from another country to the territory of Poland, or disruptions in functioning of power systems linked to the national power system
- Strike or social unrest.

Power customers whose contractual capacity is set above 300 kW are subject to these limitations.

There is no entitlement to rebates for failure to meet customer service standards or power quality standards resulting from the actions taken and the measures applied in these circumstances, particularly for interruptions and limitations in delivery and consumption of electricity, and the operator's liability for damages is subject to restrictions set forth in the Energy Law.

The level of planned limitations on consumption of electricity is defined in degrees of supply from 11 to 20, where 11 degrees means that the customer can consume the capacity specified in the contract. Degrees of supply from 12 to 19 should ensure even reduction in the power consumed by the customer, up to 20 degrees, where the customer may consume up to a fixed minimum not causing a threat to human safety or damage or destruction of technical facilities.

It should be borne in mind that the maximum permissible limitation on supply and consumption of electricity and the manner of notifying customers of degrees of supply in force should be addressed in contracts for sale, distribution or transmission of electricity. When negotiating these contracts, special attention should be paid to the levels of consumption specified for each degree of supply. In particular, it should be ensured that 20 degrees will ensure human safety and not cause damage or destruction to technical facilities.

To sum up, electricity is a special type of good which should be delivered without interruption, and deliveries may be restricted or halted only in exceptional situations. The Energy Law imposes on electricity enterprises an obligation to maintain the capacity of equipment, installations and networks to provide a continuous and failsafe supply of electricity. Electricity providers can be released from this obligation only in specific situations.

Because the reliability of power supplies in Poland falls well short of the standards in place in many other EU countries, it is worth knowing what rights customers have when the power goes out.

Marek Dolatowski, adwokat, *Energy Sector practice*

M&A and EU funding

In the case of companies pursuing projects receiving funding under the EU's cohesion policy, involvement in mergers and acquisitions requires cooperation with the institutions providing funding and overseeing the beneficiary's performance of its contractual obligations. It is often necessary to agree on terms with the funding institutions. Otherwise the beneficiary may have to return the funding.

Agnieszka Kraińska

Poland's accession to the European Union provided Polish businesses access to financing out of European structural funds. One of the ways funds are absorbed under the EU's cohesion policy is through national and regional operational programmes, providing funding for enterprises pursuing projects consistent with the goals of these programmes.

Expenditure of EU funds is intended to secure lasting improvements in the economies of the member states. For this reason, funding agreements impose obligations to maintain the durability of the project for several years following implementation (generally five years, or three years for SMEs).

The definition of project durability is set forth in Council Regulation (EC) 1083/2006 (for projects implemented in the 2007–2013 financial perspective) and Regulation (EU) 1303/2013 (for projects implemented in the 2014–2020 financial perspective).

These regulations provide that cessation of a productive activity or a change in ownership of an item of infrastructure (understood to cover transactions in either shares or assets) is or may be a violation of project durability requiring the contribution from EU funds to be repaid.

The specific conditions governing the rules for provision of assistance and the method of realisation of supported projects are found in the funding agreements concluded by the relevant institutions with the beneficiaries of the funding. When analysing the EU funding risks related to a given transaction, it is first and foremost the funding agreement concluded by the parties to the transaction that must be examined.

The general rule applicable to recipients of financing from EU funds is that during the project durability period, both share deals and asset deals require special care to maintain the character, purposes and conditions of the project and to ensure that the shares or assets are sold at market value.

Conducting transactions involving such entities requires cooperation with the institutions providing the funding and overseeing the beneficiary's performance of the obligations under the funding agreement. Often, it is also necessary to reach an appropriate understanding with the institutions providing the funding.

Below we discuss two examples of transactions from the past year involving enterprises implementing projects financed with EU funds.

Long-term arrangements with intermediate body

Company A sold assets to company B in the form of an enterprise. Company A was the beneficiary of two projects funded by the EU under national operational programmes, and each project was supervised by a different intermediate body (project 1 and project 2).

As of the intended date of closing of the transaction, project 1 would have three months to go before reaching the end of the five-year durability period, and project 2 would have 40 months to the end of its five-year durability period.

With respect to project 1, discussions were arranged sufficiently far in advance with the intermediate body, which presented its opinions and recommendations concerning the framework in which it would be willing to approve the buyer's acquisition of the project. The relevant application was prepared and the intermediate body presented its position concerning possible annexes to the project funding agreement.

With respect to project 2, the intermediate body was unable to present its position prior to the planned closing date for the transaction, so the closing was postponed. Ultimately the intermediate body did not consent to acquisition of project 2, but agreed to shortening of the project durability period and repayment of a portion of the funding by the beneficiary.

While the closing date was being postponed, the durability period for project 1 ended, and in this respect the transaction could be conducted without restrictions. With respect to project 2, the beneficiary repaid the specified portion of the funding.

Consequently, the transaction was completed, but later than originally planned.

Loss of status of recognised producer organisation

A group of producers of fruit and vegetables (company A) received financing from EU agricultural funds to achieve the status of a recognised producer organisation for fruit and vegetables. The group pursued a five-year programme for achieving this status and obtained recognition. But in the three years following achievement of recognition, the group's financial condition deteriorated. The group decided to seek a strategic investor, and found one.

A recognised producer organisation for fruit and vegetables must meet corporate governance requirements laid down by Polish and EU law. One of the requirements is to include a provision in the organisation's statute that no member, shareholder or other person can hold more than 49% of the shares or hold more than 20% of the votes at the general meeting, even indirectly.

As the strategic investor, company B intended to acquire a majority stake in company A. This action would violate company A's articles of association, and amending these provisions would violate the legal requirements concerning the status of a recognised producer organisation for fruits and vegetables.

Uncertainty also arose concerning whether loss of the status of a recognised producer organisation would create a risk of having to repay funding obtained in order to achieve recognition as a producer organisation.

These doubts had to be resolved during the preparations for the transaction. Requests for statement of a position on the matter were submitted to two agencies under the Minister of Agriculture responsible for supervision of fruit and vegetable producer organisations. Correspondence over several months and an exchange of views led to presentation by the agencies of an opinion that there was no obligation to repay the funding received, but also led to loss of the status of a recognised producer organisation.

Consequently, the transaction was closed without further hurdles.

Conclusions

Transactions involving entities that have received financing from EU funds require planning allowing the time necessary for reaching agreement with the institutions providing the funding and monitoring implementation of funded projects.

Carrying out a transaction that breaches the funding agreement will not only entail consequences for the beneficiary of the funds arising under the contract, including financial consequences (repayment of the funding plus interest, or enforcement of the blank promissory note issued as security for public claims), but can also lead to criminal liability as an action detrimental to the EU budget.

Such a transaction can also generate negative consequences for the acquirer, not only in the case of acquisition of the beneficiary's shares, but also when acquiring an enterprise, understood as a set of tangible and intangible assets through which the funded project is implemented. Nor can such consequences be ruled out in the case of acquisition of EU-financed assets that do not make up an enterprise.

Our experience teaches that transactions of this type must be conducted in close cooperation with public institutions, and the planning and preparation must allow time for obtaining clarifications and coming to terms with the institutions involved as well as potential modifications to the funding contracts.

Our experience also shows that necessary agreements with the public institutions can be time-consuming, particularly in cases presenting unusual issues. Thus such arrangements cannot be put off to the last minute.

Agnieszka Kraińska, legal adviser, EU Law practice

Two years of CFC regulations: Still lots of doubts

Michał Nowacki

In 2016 Polish taxpayers filed their first CIT-CFC and PIT-CFC returns, reporting income earned from controlled foreign corporations (CFC) in 2015. A total of 125 such returns were filed, and the combined tax due under these returns amounted to only PLN 11.5 million. But in tax advisory practice many questions arise about application of the CFC regulations, and the practice of the tax authorities has not provided many answers yet.

Below we examine several issues and doubts Polish businesses must face if they operate outside of Poland. We discuss them using the example of a Polish limited-liability company operating part of its business abroad, via a foreign branch. The facts are hypothetical but based on a range of experiences and observations by the author over the past two years of advisory practice.

Foreign branches of a Polish company

The company operates in the financial sector, and any financial surplus is devoted to lending. The company also operates abroad, via two branches constituting a permanent establishment. The branches are not established in countries treated by Poland as tax havens (i.e. applying harmful tax competition). Poland has treaties on avoidance of double taxation in force with both of the countries.

Branch A was established in country A. The tax treaty with that country provides that if a Polish tax resident conducts business in country A via a permanent establishment in that country (e.g. a branch), the income of the establishment is subject to taxation in country A and Poland will exempt this income from tax in Poland (exemption method).

Branch B was established in country B, which provides for a two-step method of paying income tax: at the local level (for example at the level of a state in the US, a land in Germany or a canton in Switzerland) and at the central level. The nominal income tax rate is 8% at the local level and also at the central level. Additionally, the internal regulations of country B provide for the possibility of a lump-sum reduction of the income tax base for interest income (known as a "notional interest deduction") and licence fees (an "IP box regime"), which means that the effective income tax rate is very low.

The Polish CFC regulations provide among other things that these regulations also apply respectively to taxpayers who conduct business via a foreign permanent establishment, unless the income of the establishment is reflected in the tax base under general rules. In practice this means that the CFC regulations do not apply if the relevant tax treaty provides for the tax-credit method. Under that rule, the income of the foreign establishment is subject to tax in Poland, but the tax paid on the income abroad is credited toward the Polish income tax—in which case the purpose behind the CFC regulations is achieved without having to apply the CFC rules directly.

Respective application of the CFC regulations to foreign permanent establishments (branches) means among other things that the regulations apply if:

- At least 50% of the income derives from passive sources (e.g. interest, licence fees, dividends and capital gains), and
- At least one type of such income is subject to taxation in the state where the foreign permanent establishment (branch) is located at an income tax rate at least 25% lower than 19% (i.e. 14.25% or less) or is subject to exemption or exclusion from income tax.

The regulations also provide for certain exclusions from application of the CFC rules even though the foregoing conditions for CFC taxation are fulfilled.

For purposes of this article, we assume as follows:

- Branch A in country A meets all the conditions for treating it as a CFC under the Polish regulations. The only doubt concerns whether the CFC provisions are consistent with the tax treaty in force between Poland and country A.
- In the case of branch B in country B, leaving aside the issue of whether the CFC rules are consistent with the tax treaty between Poland and country B, branch B will not constitute a CFC for the company so long as the income tax rates in force in country B are high enough to exclude application of the CFC rules and the provisions on reduction of the tax base (notional interest deduction and IP box) are not deemed to be an exclusion or exemption from income tax.

Doubts

The following doubts arise under the facts presented:

- Are the Polish CFC rules consistent with the tax treaties if the treaty provides that income of an establishment taxed in one state (in this case country A) is exempt from taxation in Poland?
- Assuming conservatively that the CFC rules are consistent with the tax treaties, how should the tax rate in country B be evaluated, as income tax is payable at various levels within the administrative division of country B, and while none of the rates by itself is higher than 14.25%, together they amount to a sufficiently high nominal rate of income tax to exclude application of the CFC rules?

CFC and tax treaties

In the author's view, insofar as the CFC rules impose tax in Poland on the company's income from branch A in country A, they conflict with the treaty on avoidance of double taxation between Poland and country A. Considering the hierarchy of sources of law in Poland and the primacy of international agreements over statutes, it should be recognised that the provisions of the tax treaty between Poland and country A "overwrite" the CFC provisions of the CIT Act. In the author's view, the only path to achieving the goal of the Polish lawmakers in this state of facts should be to renegotiate the tax treaty to ensure that the Polish CFC rules comply with the treaty (e.g. by changing the method of avoiding double taxation from the exclusion method to the credit method or by including anti-avoidance provisions in the treaty).

The issue of the inconsistency of the CFC rules with tax treaties was raised during the legislative process. So far this alleged inconsistency has not been recognised by any court rulings. Although in the author's view this position has strong grounds, it should be treated as only one argument in analysing the CFC regulations. Without support from the courts, it should not be treated as the sole ground for excluding tax obligations under the CFC rules.

Tax rate

In many countries income tax is payable at various levels of the state or local government administration. In Poland income tax is paid only to the State Treasury, but then a certain percentage is allocated to the budget of the local government at the place where the taxpayer resides. In effect the same purpose is achieved, i.e. funding the state budget and lower-level units, but in Poland this is done through indirect financing of local government, and in some other countries a portion of the income tax is paid directly to lower-level units.

In the author's view, these differences between Poland and country B should not negatively impact the status of branch B for CFC purposes. As the total income tax rate paid by branch B in country B is higher than 14.25%, this means that branch B does not meet the conditions for treatment as a CFC, even if the base for calculation of income tax were different at the central level and the local level. It appears that the tax authorities share this view.

Exclusions and exemptions

Polish tax statutes quite clearly specify what constitutes an "exemption" from tax: an accretion of wealth that constitutes income for purposes of the tax act and as such should be subject to income tax, but via a specific regulation is exempt from income tax.

What lawmakers intend by an "exclusion" generates greater doubts. An analysis of the income tax acts indicates that there is an exclusion when a given accretion of wealth could be subject to income tax, but for some reason the drafters exclude the given accretion of wealth or category from the scope of the act. For example, the income tax acts exclude income from agricultural activity from their scope.

The tools for reducing the tax base provided for in country B (notional interest deduction and IP box) are most often structured similarly to lump-sum tax-deductible costs (unrelated to the actual costs incurred by the taxpayer), which are also provided for to some extent in Polish income tax acts. In the author's view, mechanisms of this type reducing the tax base should not be treated as an "exemption" or "exclusion" for CFC purposes.

Conclusions

The modest scale of CFC reporting for 2015 in Poland suggests that taxpayers have either appropriately reorganised their foreign business operations, or resolved any doubts in their own favour to conclude that they do not have any foreign controlled corporations. Further development of tax practice (interpretations and case law), as well as the tax authorities' approach to CFC issues when exercising their auditing powers, will determine the practical significance of these regulations within the Polish tax system.

Michał Nowacki, legal adviser, tax adviser, partner in the Tax practice

Leniency: Whistleblowers' dilemmas

When a company finds that the actions of its employees may qualify as an anticompetitive arrangement, it faces a dilemma: should it not only put a stop to the violation but also notify the competition authority? Taking advantage of the leniency programme for self-reporting of violations is a strategic decision involving certain discomforts, but it can be much more costly not to report irregularities.

Sabina Famirska

The case involved a Polish company that was part of an international group operating in various regions around the world. The parent company is based in the United States. In Europe the group is present in several EU member states. The leaders of the group place great emphasis on operating in accordance with the law, following the group's compliance programme which has been implemented across all of the company's subsidiaries, including in Europe. One of the key elements of the programme is competition compliance.

The group has had antitrust problems in the past, and was the subject of proceedings by the US Department of Justice in connection with a price-fixing cartel. The actions of the group also came to the attention of the European Commission, as one of the companies in the group was involved in an illegal practice at the European level several years ago and was fined several million euro.

Fruits of internal investigation

In connection with its problems in the past, the company undertook a review of the effectiveness of its existing compliance programme and an internal investigation to identify any irregularities. During the internal investigation it was discovered that the Polish staff had intense contacts with competitors, meeting at various conferences and during activities by industry associations. They frequently entertained and travelled together. During these meetings they mainly talked about the general market situation, but sometimes employees discussed with their colleagues from the competition their terms of cooperation with customers and the timing and amounts of price increases. A legal opinion ordered by the company found that the employees' behaviour could be regarded as an anticompetitive arrangement.

The management board of the Polish company faced the dilemma of what steps to take in this situation, and in particular whether to inform the Polish Office of Competition and Consumer Protection (UOKiK) of the irregularities and file an application under UOKiK's antitrust leniency programme. The obvious question was whether filing a leniency application would cause specific financial impacts for the company apart from any fines. Individual members of the management board were also concerned about personal consequences, particularly as they also acted as directors within the company and were the immediate supervisors of the employees in question. They thus wondered whether they could be held personally responsible by UOKiK or third parties, or whether the shareholders might have claims against them for improper supervision of employees or failure to alert UOKiK of the irregularities they had uncovered.

The management board asked us to present the advantages and drawbacks of the leniency programme, as well as the potential liability of the management board members for antitrust irregularities.

Pros and cons of leniency

The leniency programme rewards a participant in an anticompetitive arrangement who decides to cooperate with the competition authority. The programme is governed by the "first come, first served" principle. The first participant to inform UOKiK of the arrangement can count on total waiver of a fine, which in antitrust cases can be severe. (The maximum fine can be as high as 10% of the company's turnover in the preceding year.) Subsequent whistleblowers can obtain lesser reductions, of 50%, 30% or 20%, depending on where they stand in the queue.

But it's not enough to inform UOKiK of irregularities. The applicant must show initiative in seeking evidence of the arrangement. Sometimes this requires the involvement of several coordinators to check documents and emails or interrogate staff involved in the cartel.

Nor is filing of a leniency application sufficient to guarantee success. An applicant cannot benefit from the programme if on the date of the application it has not ceased its participation in the arrangement—for example, if after filing the application the company's staff continued impermissible discussions with competitors or applied illegally agreed prices, despite being prohibited from doing so by the management board. The quality of the evidence may also fall below UOKiK's expectations, resulting in withdrawal of the benefits of the leniency programme after the applicant has presented testimony against itself.

In short, filing a leniency application will always carry certain risk. This decision must be taken responsibly and conscientiously, with the full commitment of the company's management and staff.

A company that decides to cooperate fully with UOKiK under the leniency programme may take the further step of voluntary submission to punishment. In exchange for declaring that it will not dispute the factual findings by UOKiK and will not appeal against the regulator's decision, the company may obtain a reduction in the fine by 10% of the amount which UOKiK initially planned to impose. This option is not very interesting for the first leniency applicant (which is entitled to a complete waiver of punishment), but may be attractive for applicants further down the line.

Liability of management board members

Under current law, the principal liability for participation in an anticompetitive arrangement is borne by the business entity involved—in this case, the Polish company. The members of the management board may bear antitrust liability only for their own intentional involvement in the anticompetitive practice. In this case the management board was not directly involved in discussions with competitors and did not direct or encourage employees to take part in illegal discussions. The board can at most be accused of inadequate supervision of staff. The members of the management board should thus not fear personal fines by UOKiK (which can run as high as PLN 2 million). But it should be added that even if they were directly involved in the cartel, they could also file their own leniency application protecting them against punishment—together with the Polish company or in a separate application.

The management board members are also unnecessarily worried about liability in damages to the company for improper supervision of staff or failure to report irregularities to UOKiK after uncovering them in the internal investigation. Polish law lacks strong legal grounds for assertion of such claims. Art. 483 of the Commercial Companies Code provides for liability in damages for a member of the management board for an act or omission contrary to law or provisions of the company's statute, unless the person is not at fault. In this respect, a management board member is held to a heightened standard of care arising out of the professional nature of the office. But it appears that mere inadequate supervision of employees will not be sufficient to assign such liability, even under the heightened duty of care expected of the management board. Nor can the management board members be accused of unlawful action for failing to file a leniency application, as there is no legal obligation to file such an application. This decision can be assessed only in terms of selection of the optimal strategy to pursue.

Obviously, potential consequences flowing from a negative assessment by the shareholders of the attitude of a given member of the management board are another matter. Loss of the shareholders' confidence, or an unsatisfactory response to the irregularities identified in the company, may result in refusal to issue a release to the management board for performance of its duties, or removal of the person from the management board.

Risk of civil claims

The company must expect to deal with claims for damages by persons injured by the cartel, such as customers who had to pay higher prices for the products sold by the Polish company. A leniency applicant's situation is not easy. As the first company to notify UOKiK, in practice the applicant will naturally be the first candidate as a potential defendant. Plaintiffs assume that because the leniency applicant has admitted its unlawful actions to UOKiK, it will not be in a position to defend against a claim for damages and obtaining damages will thus be much easier than in the case of other participants in the cartel. Some protection is provided for leniency applicants in the form of a bar against using statements in the leniency application as evidence in a dispute seeking damages.

Theoretically, it is imaginable that similar claims for damages could be asserted by third parties against individuals, such as management board members, on a tort basis. But in practice such a scenario appears unlikely because it would be much easier to prove the liability of the company as a participant in the procedure, especially after issuance of a decision by UOKiK.

Safer cooperation with UOKiK

After evaluating all the pros and cons, the authorities of the Polish company decided to cooperate with UOKiK. It was relevant here that filing of a leniency application was consistent with the compliance culture promoted within the capital group. The company does expose itself to a higher risk of civil claims, but to a certain degree it is protected by the evidentiary ban. The advantage could be waiver of a fine, or at least mitigation of the amount.

Sabina Famirska, legal adviser, Competition practice

Data protection in 2018


Sylwia Paszek Agnieszka Szydlik

The approaching entry into force of the General Data Protection Regulation, as well as the recent invalidation of the European Commission's decision enabling the transfer of personal data to the US under the Safe Harbour programme, has spurred many of our clients to review the grounds they rely on for transferring personal data outside the European Economic Area.

Under the existing system, personal data have been transferred to "third countries"—i.e., outside the EEA—most often on the basis of:

- Consent of the data subjects
- Individual approvals by the data protection authority to transfer a specific filing system to a specific recipient in a third country
- Agreements between the exporter and the importer of the data implementing standard contractual clauses
- The former Safe Harbour programme for transfers to the United States.

In May 2018 the EU's General Data Protection Regulation (2016/679) will enter into force, significantly expanding the models under which it will be possible to transfer personal data outside the EEA, while maintaining the general requirement to ensure that the degree of protection of individuals guaranteed under the European regulation is not infringed.

Mechanisms remaining in force

The GDPR maintains and in some instances clarifies the main models for transferring data outside the EEA which have become well-grounded from the practice in earlier years.

The first model is transfer of data at the consent of the data subject. Transfer of data on this basis will still be permitted, but only when the consent is explicit and the data subject was informed of the possible risks due to the absence of an adequacy decision by the European Commission and appropriate safeguards. In effect, transfer of data under this procedure will require greater involvement by the data controller, which will have to evaluate, quantify and identify the potential risks, provide proper and understandable information to the data subject, and obtain confirmation of provision of such information in the proper time and form, for evidentiary purposes.

It will also still be possible to transfer data on the basis of a Commission decision confirming that the destination country provides an adequate level of data protection. But the GDPR establishes complex criteria for this evaluation, as well as requiring periodic reviews of the facts justifying issuance of the decision.

Other models being retained are binding corporate rules and standard contractual clauses adopted by the Commission, discussed more extensively below.

Transfer of data will also be possible in certain situations specified in the GDPR, such as:

- Transfers necessary for performance of a contract between the data subject and the controller
- Transfers necessary for conclusion or performance of a contract made in the interest of the data subject between the controller and another natural or legal person
- Transfers for important reasons of public interest
- Transfers necessary to protect the vital interests of the data subject or other persons, where the data subject is physically or legally incapable of giving consent.

New mechanisms for transferring data outside the EEA

The newly added mechanisms for transfer of data outside the EEA primarily authorise contractual constructions and certification systems created from the bottom up, at the initiative of entities involved in processing of personal data and reflecting the specifics of their own activity. Such mechanisms will have to be approved by data protection authorities; nonetheless, it is significant that data controllers and processors will be empowered to seek their own solutions in factual situations where existing rules are not well-suited, for example when new processing technologies are used.

The new models will include codes of conduct approved by regulators and certification schemes, which must be backed by a binding and enforceable commitment by the controller or processor in the third country to apply the appropriate safeguards, including with regard to the rights of data subjects. It will also be permissible to use contractual clauses individually agreed between the data controller and the data recipient in a third country, when approved by the competent authority.

Alongside models created by processors of data, new mechanisms may be created with the active involvement of the public administration:

- Standard data protection clauses adopted by a supervisory authority and approved by the Commission
- Provisions inserted into administrative arrangements between public authorities or bodies which include enforceable and effective data subject rights.

Additionally, an escape hatch has been created enabling data to be transferred outside the EEA when none of the foregoing guarantees are available, when the transfer is necessary for the purposes of compelling legitimate interests pursued by the controller which are not overridden by the interests or rights and freedoms of the data subject, and the controller has assessed all the circumstances surrounding the data transfer and provided suitable safeguards for protection of the personal data. This route may be used only if the transfer is not repetitive and concerns only a limited number of data subjects. The controller will also be required to inform the supervisory authority of the transfer, and inform the data subject of the transfer and the compelling legitimate interests pursued.

While this procedure raises fears of abuse, the drafters of the regulation should be praised for their foresight in providing for this possibility. Practice has shown that in a rapidly evolving reality, situations arise where protection of important values and interests requires steps to be taken outside the schemata created by the regulations, which sometimes do not account for all relevant circumstances. Active involvement by data protection authorities in the use of this procedure should prevent abuses from occurring.

Standard contractual clauses and binding corporate rules (BCR)

Based on our practice, to ensure the legality of data transfers businesses are most inclined to follow the route of using standard contractual clauses, developed and adopted by a decision of the European Commission. Data controllers and processors may conclude a contract following the wording established in a Commission decision and complying with these clauses to ensure data protection at a level regarded as adequate within the EEA.

But if the business model requires transfers between numerous entities acting as both data controllers and processors hired on an outsourcing basis, concluding contracts using standard contractual clauses may present organisational challenges. In such situations, adoption of binding corporate rules—a comprehensive set of rules governing data protection, typically in force within large corporations or international groups—should be considered.

BCR in practice

In one of the cases we handled, an international corporate group developed BCR based on recommendations issued by the EU's Article 29 Working Party. Data protection authorities from the EU member states use this coordinated procedure for assessing BCR developed by interested corporations. Under this procedure, the authorities evaluate the provisions of the BCR applicable to international transfers of data between entities implementing the rules, confirming whether they meet the requirements for data protection under the directive (or in the future the GDPR).

In our client's case, the authority verifying that the BCR provide adequate protection of privacy and ensure the fundamental rights and freedoms of data subjects was Luxembourg's National Commission for Data Protection. The regulator issued a decision approving the group's BCR pursuant to the Luxembourgish Data Protection Act. For the Polish group companies to transfer data based on the BCR, they had to implement the BCR as well as apply for additional approval from Poland's Inspector General for Personal Data Protection (GIODO).

Based on the Polish Personal Data Protection Act, GIODO has the right to examine independently whether the wording of BCR complies with the requirements set forth in the Article 29 Working Party guidelines. In this case, GIODO took part in the coordinated proceeding conducted by the Luxembourgish authority and could follow its decision.

Approval of BCR by GIODO at the request of one of the Polish companies from the group means that other group companies in Poland can use the same BCR without seeking approval again from GIODO, assuming that they properly implement the BCR within each company (with a resolution by the competent corporate authority adopting the BCR, proper notification of staff, and implementation of the control mechanisms established in the BCR).

Data transfers may be conducted based on BCR only following implementation of the BCR by the specific data controllers in the group. But an advantage of binding corporate rules is that they also cover future data transfer operations, and the scope of those operations may change depending on the factual circumstances.

Sylwia Paszek, legal adviser, Data Protection practice, M&A and Corporate practice

Agnieszka Szydlik, adwokat, *Data Protection practice, M&A and Corporate practice*

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