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I 'NATIONAL BASICS' AND NATIONAL LEGAL THEORIES OF DIRECTORS' LIABILITY

[A] Two-Tiered or Unitary Company Structure

Under Polish company law there is a two-tier system, which means that there are no executive and non-executive directors within one corporate body, but instead, the management and representation functions are vested in a management board *('zarząd'),* and the supervisory functions are performed by a supervisory board *('rada nadzorcza'),* an audit committee *('komisja rewizyjna'),* or by shareholders.

Under the Code of Commercial Partnerships and Companies (KSH),[1] a supervisory board is mandatory in joint stock companies *('spółka akcyjna'* (SA)), whereas in limited liability companies *('spółka z ograniczoną odpowiedzialnością*' (Sp. z o.o.)) it is facultative, unless there are more than twenty-five shareholders and, at the same time, the share capital exceeds New Zloty (PLN) 500,000; however, in such a case the shareholders may still decide to choose an audit committee rather than a supervisory board. The aforesaid regulation is justified by the stronger 'personal' link between the shareholders and the Sp. z o.o., where the shareholders have certain controlling rights. Such rights may be excluded or limited in those companies where a supervisory board or audit committee has been established. It is also possible to establish both a supervisory board and an audit committee in one Sp. z o.o.

As regards the relationship between the supervisory board and the audit committee, the former has broader statutory competences and acts continuously, whereas the later assesses the annual financial statements, the management board annual report and its recommendations as to the distribution of profits, and presents a report on the results of such an assessment at the shareholders' meetings.

1. The Act dated 15 September 2000, the Code of Commercial Partnerships and Companies.

The roles of the management board and supervisory board are separated. The members of the management board cannot be members of the supervisory board and vice versa. Generally, the role of the supervisory board is to supervise the company's activity in all its fields. However, the supervisory board cannot give the management board binding instructions concerning the company's management.

When a reference is made in the following sections of this chapter to a director without further indication, it should be understood as a reference to both a management and supervisory board member, whereas a reference to a manager should be understood as a reference to a management board member only.

[B] Chairman and CEO

A chairman's position is not defined under Polish law. Generally, there is no requirement to appoint a chairman, but if there is more than one management board member, a chairman is usually appointed. The chairman's position and functions are determined by the articles of association – for example, his or her vote may prevail if there are an equal number of votes at a management board meeting, or he or she may be vested with powers to direct the management board's affairs. The chairman sometimes has a stronger position with regard to representation powers – for example, he or she may be vested with the right of the single-person representation of the company, whereas the remaining management board members should act jointly or together with a commercial proxy holder ('*prokurent*'). Therefore, in such a situation, the chairman's position is, to some extent, similar to that of a CEO; however, under Polish law the concept of a CEO as such is not recognized.

[C] Board Structure

The management board consists of one or more members, and the supervisory board of at least three members (and in the case of a public SA, at least five members); and only natural persons may be appointed to the boards. The exact number is determined in the articles, or by the appointing authority.

[D] Directors' Election/Staggering

The rules concerning the appointment of directors are determined by the KSH and the company's articles of association. Unless agreed otherwise, the management board members in an Sp. z o.o. are appointed by a shareholders' resolution, and in an SA, by the supervisory board. Supervisory board members are usually appointed by a shareholders' resolution. In order to protect minority shareholders in an SA, the KSH introduced the procedure of group voting for the appointment of supervisory board members. This procedure is mandatory, and must always be applied at the request of the shareholders representing one-fifth of the share capital, even if a different method of appointment is set out in the articles. When such a request is made, the total number of shares is divided by the number of the supervisory board members to be appointed.

Shareholders holding the relevant number of shares may then create their own group to appoint one member – they do not participate in appointing the remaining members. This procedure enables minority shareholders to appoint their 'own' person to the supervisory board.

As a rule, both the management board and the supervisory board are staggered, which means that the term of office of each director is separate from the others. However, the articles may provide the joint term of office, in which case the mandates of all the directors expire at the same time, regardless of the date of the individual appointments.

The supervisory board in an SA may delegate its member for a maximum period not exceeding three months, to temporarily perform the duties of those members of the management board who have been removed, have resigned, or are unable to perform their duties. As long as he or she is delegated, the supervisory board member cannot participate in the activity of the supervisory board.

[E] Directors' Term of Appointment

The director's term of office in an SA must not exceed five years; however, each director may be appointed for more than one term of office. There is no such length limitation in an Sp. z o.o., but if the term of office is not defined in the articles, the mandate of the appointed director expires on the date the shareholders' meeting approves the financial report for the first full accounting year in which he or she performed the director's duties.

[F] Delegation of Powers

The management board members may delegate their powers only for specified cases or transactions and not by way of a general power of attorney. However, it is possible that the company can appoint a commercial proxy holder who has very broad competences and, in fact, may be a 'substitute' for the managers. The Supreme Court has also confirmed the possibility of granting the power of attorney for a specified case by the management board members acting pursuant to the regular representation rules to one management board member having no single-person representation right.

The directors may agree on a division of the tasks; however, this has very little impact on their liability towards third parties.

[G] Removal and Suspension of Directors

Except for a self-imposed resignation, the general rule is that directors may be removed at any time by the shareholders' meeting. As regards an SA, supervisory board members may be removed at any time by the shareholders' meeting, whereas management board members may be removed by the shareholders' meeting or the supervisory board. In both types of companies, the articles may state a different method of removing directors or limit the possibility of removal to important reasons.

The articles of association of an Sp. z o.o. may grant the supervisory board the power to suspend management board members from performing their duties for important reasons. In an SA such power is granted *ex lege* to the supervisory board.

II TYPICAL SCHEMES/BEHAVIOUR TO AVOID A DIRECTORS' LIABILITY

Directors usually try to avoid or reduce their liability by:

- requesting a shareholders' resolution granting them a vote of approval; however under Polish law such resolutions neither prevent nor reduce a director's liability;
- requesting that a resolution of the board be adopted before undertaking any important activity – the director may express his or her objection and have it registered in the minutes of the board's meeting;
- dividing the tasks between themselves – although this has very little impact on their liability towards third parties, it may nevertheless regulate their internal relations and, consequently, determine the rules of the reimbursement of damages paid by any of them to a third party;
- adopting the management and supervisory board bylaws and internal procedures regulating the organization of work and responsibility, and ensuring the immediate notification of any important information concerning the company; and
- obtaining a legal opinion from an external reputable law firm, or an expert opinion on other important issues (e.g., accounting, environmental, technical, etc.).

III CORPORATE GOVERNANCE

[A] Management Board

Two functions of the management board should be distinguished, namely, managing the company's business and representing the company vis-à-vis third parties. As regards representation powers, if there are two or more members and the articles do not state otherwise, the company is represented by any two members of the management board acting jointly, or one member acting jointly with a commercial proxy holder. Representation powers cannot be effectively limited towards third parties.

The KSH sets out the standard working rules of the management board applicable unless the articles state otherwise. According to these rules, each management board member in an Sp. z o.o. has the duty and right to manage the affairs of the company and may, without the prior resolution of the management board, handle matters within a company's ordinary course of business. However, if any of the remaining management board members object to a specific matter, or where such a matter extends beyond the company's ordinary course of business, a prior resolution of the management board is required. In an SA the affairs of the company are managed by all of its

managers acting collectively. In the event of a conflict of interests between the company and a management board member, or director's related person, such a member should abstain from participating in determining such matter. The management board members are also bound by the non-competition obligation.

The KSH defines certain matters where a prior resolution of the shareholders or supervisory board is necessary. The list of such matters can be extended in the articles. If the management board members perform an act without a resolution required under the KSH, such an act will be void unless a resolution is passed within two months from the date of that act. Where a resolution is required under the articles alone, the act is valid, but the management board member may be held liable towards the company for breaching the articles.

Management board members are, in their relationship with the company, subject to the limitations set forth in the KSH, the articles, and the shareholders' resolutions.

[B] Supervisory Board

As regards the supervisory board in an Sp. z o.o., unless otherwise provided for in the articles, each member may exercise the right of supervision independently, whereas in an SA, the supervisory board performs its duties collectively, but can assign its members to carry out certain supervisory activities by themselves.

The supervisory board may adopt resolutions, if at least half its members are present at the meeting and all the members were invited. The supervisory board members can take part in passing resolutions by casting their votes in writing through another supervisory board member. It is also possible for the supervisory board to pass resolutions under the voting-in-writing procedure, or by using means of direct communication at a distance. However, the latter two voting procedures cannot be exercised in all matters. The shareholders' meeting can adopt, or authorize the supervisory board to adopt, rules on organization and work procedures.

IV LIABILITY ISSUES

When discussing the issue of directors' liability, two types of such liability should be distinguished, namely, liability in internal relations (i.e., towards the company) and external liability (i.e., liability vis-à-vis third parties).

[A] Liability Towards the Company

The KSH imposes a strict duty of care on directors who should perform their obligations with diligence and the proper care for the professional character of their activities.

Under the KSH directors are liable to a company for damage caused by an action or omission contrary to the law, or to the provisions of the company's articles, unless they prove that they are not at fault. Where two or more persons have jointly caused damage, they are jointly and severally liable. In addition to the aforesaid general rule, there are also detailed provisions dealing with specific cases of directors' liability.

For instance, directors are obliged to ensure that the company's financial statements and annual activity reports meet all the requirements applicable under accounting law,[2] and are jointly and severally liable to a company for any loss resulting from the non-fulfilment of this obligation.

Management board members are also liable for payments made to shareholders contrary to the law or the provisions of the company's articles. Members responsible for such undue payments are liable for a refund of the same to the company jointly and severally with the recipient of the payment.

The aforesaid rules are applicable to both an SA and an Sp. z o.o. Additionally, with regard to an Sp. z o.o. alone, in a situation where the value of non-cash contributions is substantially overestimated, the shareholder who made said contribution and those management board members who, while aware of this, applied for the registration of the company, are liable jointly and severally to make up the deficit to the company.

An action against supervisory board members should be brought by persons authorized to represent the company (i.e., management board members or commercial proxy holders), but in the case of an action against management board members, the company must be represented by the supervisory board or a proxy appointed by the company shareholders' meeting.

As regards the statute of limitations, it is three years from the day the company discovered the damage and person liable, but in any event no more than ten years from the occurrence of the injurious event.

[B] Liability Towards Third Parties

Under Polish law, a director's liability towards third parties is, as a rule, excluded, but there are certain situations where directors may be held liable. Most of them relate to the potential liability of management board members.

A Polish company has a legal personality from the moment of its registration in the relevant register, nonetheless it may commence its activity, incur obligations, and so forth from the very moment of its incorporation, that is, the execution of the articles. In the aforesaid period, it acts as a 'company in organization' *('spółka w organizacji')* and is represented by the management board or a proxy appointed by the shareholders' meeting. The liability for the obligations of a 'company in organization' is borne jointly and severally by the company and the persons that act on its behalf. The liability of such persons towards the company ceases with the approval of their performance by the shareholders' meeting, but does not cease vis-à-vis third parties. This means that even after the approval of the management board members' performance, a third party may bring an action directly against them. However, if such a member pays the third party as a consequence of such an action, he or she would have a claim against the company for repayment.

2. The Act dated 29 September 1994, the Accounting Law.

Where management board members have deliberately or negligently made false statements to the registry court that the payments for shares were made as stipulated in the articles or in respect of a share capital increase, and as regards an SA, also in the case of such a statement confirming that the transfer of the contributions in kind to the company is ensured in the prescribed time, they are liable to the company's creditors jointly and severally with the company, for three years from the company's registration date, or the share capital increase registration date. This liability relates to all company obligations, but if a member pays a third party as a consequence of an action brought directly against him or her, he or she would have a claim against the company for repayment, unless he or she caused damage to the company as a result of such false statement.

The KSH also provides for separate grounds for liability with regard to an SA, namely, that whoever participated in the company's issuance of shares, bonds, or other titles to the participation in profits or the distribution of assets is liable for damage caused, if he or she inserted false data in announcements or records, or otherwise disclosed such data, or, while furnishing data on the financial standing of the company, concealed circumstances subject to disclosure under the relevant provisions. This liability also relates to the relevant activity of the management board members.

The KSH provides rules on the management board members' liability towards the company's creditors; however, these only apply to an Sp. z o.o. If a debt collection against the company has proved ineffective, the management board members are jointly and severally liable for the company's obligations. A management board member can release him- or herself from such liability by proving that: (i) a petition for the declaration of bankruptcy was filed or arrangement proceedings were instituted in due time; or (ii) the failure to file a petition for the declaration of bankruptcy or institute arrangement proceedings was not his or her fault; or (iii) the creditor suffered no damage even though no petition for the declaration of bankruptcy was filed or no arrangement proceedings instituted. It is sufficient that the creditor proves that the enforcement would not make possible the satisfaction of his or her claims. Additionally, the creditor should submit to the court a valid enforcement title confirming the creditor's claim against the company.

In addition to the liability under KSH provisions, directors are liable vis-à-vis third parties under the general rules of tort law – namely, if they, through their own fault, cause damage to another person, they are obliged to repair it. If damage has been caused by two or more persons, they are liable on a joint and several basis.[3] In such a situation, the third party has a choice, to bring an action either directly against the relevant director, or against the company, which is obliged to redress the damage caused through the fault of its statutory body. In the latter situation, the company might then bring a corresponding action against the liable member of its body.

There are also provisions in other laws providing for the liability of management board members in explicitly defined circumstances. In particular, under the Bankruptcy Law,[4] each management board member, irrespective of the company's

3. See the Act dated 23 April 1964, the Civil Code.
4. The Act dated 28 February 2003, the Bankruptcy Law.

representation rules, should, no later than within thirty days from the day on which grounds for the declaration of bankruptcy arose, file a bankruptcy petition with the court. Such members are liable for any damage that may arise due to a failure to file the petition within the prescribed time limit.

Under the Tax Ordinance Act,[5] if execution against the company's assets has proved ineffective in whole or in part, the management board members are liable jointly and severally for the company's tax arrears relating to the obligations arising while they were carrying out the duties of a management board member. Release from that liability is possible provided they: (i) show that a petition for the declaration of bankruptcy was filed or arrangement proceedings were initiated in due time; or (ii) show that failure to file a petition for the declaration of bankruptcy or initiate arrangement proceedings was not their fault; or (iii) indicate the company's property, the execution against which will make possible the satisfaction of a significant part of the company's tax arrears. The liability of the management board members is established in administrative proceedings – under a decision issued by the relevant tax authority.

The aforesaid rules relating to liability under the Tax Ordinance Act also apply to the liability of management board members for the company's obligations in respect of payment of social security fees, but in this situation, to hold the relevant members liable, a civil action should be brought before the relevant court.

[C] Derivative and Class Actions

If the company fails to bring the relevant action within one year from the disclosure of the injurious act, there is the possibility of a derivative action, namely, that each shareholder can bring an action for repairing the damage caused to the company. In the latter case, at the defendant's request, the court can order a security deposit to be provided as security for the damage the defendant stands to suffer. Should the security deposit not be delivered on time, the claim will be dismissed.

Directors, when sued by the company, usually try to release themselves from liability on the basis that they have been granted a vote of approval by the shareholders' meeting, confirming the discharge of their duties. However, in the case of a derivative action brought by a shareholder, as well as in the event of the company's bankruptcy, those liable to repair the damage cannot invoke the relevant resolution of shareholders, or the company's waiver of its claims.

Class actions are possible under Polish law; however, the relevant legislation in this regard has been adopted relatively not long ago and there has been no practice developed in this field yet with respect to the class actions against directors.

5. The Act dated 29 August 1997, the Tax Ordinance.

[D] Costs

To commence court proceedings against management board members, the plaintiff must pay a court fee equal to 5% of the claim value, but the maximum fee cannot exceed PLN 100,000. This fee does not cover legal fees.

In Poland, the loser-pays principle applies, which means that the plaintiff is entitled to a full reimbursement of the court and legal fees, although generally in the amounts as defined by the relevant fee regulations. Consequently, in practice the actual legal costs incurred often exceed the amount of such reimbursement.

[E] Criminal Liability

Except for the civil liability referred to above, the KSH, the Penal Code, and other acts of parliament provide for the criminal liability of management board members for acts breaching certain provisions. These include, *inter alia*, acting to the detriment of the company, failure to file a bankruptcy petition despite the existence of relevant grounds, or the disclosure or providing of false data to the governing bodies of the company or government authorities, and so forth. The presentation of all such regulations exceeds the scope of this publication.

V INDEMNIFICATION

[A] Liability Towards Third Parties

A company is obliged to repair damage caused by its statutory body, but it may claim that a director who caused damage through his or her fault should repay the indemnity paid by the company to the injured party. Generally, it is possible for the company and its directors to enter into an agreement under which the company will be obliged to answer any liability the directors may incur while performing their duties. Entering into such an agreement would not secure the director from any direct claims of third persons, but in such a situation the company would be obliged to pay an indemnity or reimburse the indemnity previously paid by the director. In practice, such agreements are not often concluded, as insurance is a more efficient means of protection. Additionally, such an agreement would in fact be equal to a waiver of the company's claims, and such waiver is not effective in the case of a derivative action.

The grounds justifying the exclusion of a manager's liability towards the creditors of an Sp. z o.o., as well as their liability under the Bankruptcy Law and the Tax Ordinance, were presented above.

[B] Liability Towards the Company

As regards liability vis-à-vis the company, the situation of directors is much better should they have been granted a vote of approval confirming the discharge of their duties. The company may also waive its claims against them. However, there are two

exemptions. In the case of a derivative action brought by a shareholder, and in the event of the company's bankruptcy, those liable to repair the damage cannot invoke the relevant resolution of the shareholders, or the company's waiver of its claims. The vote of approval also does not improve the situation of directors with respect to their liability for damage caused by actions or omissions that had not been known to the shareholders at the moment when such vote of approval was granted.

VI DIRECTORS' AND OFFICERS' INSURANCE

It is possible to insure the third party liability of directors. Such insurance is becoming increasingly common, especially with respect to larger companies, in particular for the SA. The directors can insure their liability themselves, but usually it is a company that enters into the relevant insurance contract covering the liability of its directors. It should be borne in mind that most insurance policies tend to exclude many areas of liability.

VII LAWYER DIRECTORSHIP

Lawyers are rarely appointed as management board members. At this point one assumption should be made, namely that 'lawyers' should be understood as 'qualified lawyers' – that is, advocates ('*adwokaci*') and legal advisors ('*radcowie prawni*'). Under the advocates' code of ethics, they are explicitly prohibited from holding the position of management board member. There is no such explicit prohibition in a legal advisor's code of ethics, but in practice they are not appointed as management board members either.

The situation is different with a supervisory board. In this case, lawyers are often appointed as its members because of their professional knowledge of the legal environment, useful in the supervisory functions of that body. However, legal advisors and advocates cannot be supervisory board members if they are also employees of the company.