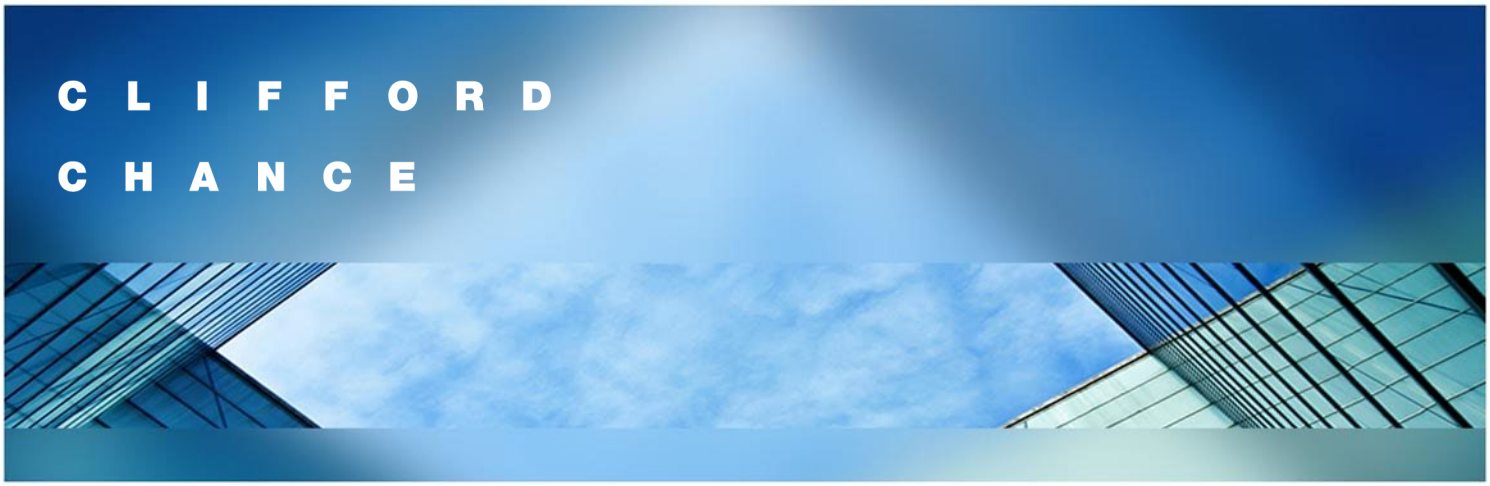

COMPREHENSIVE AMENDMENT OF THE COMMERCIAL COMPANIES CODE.

On 12 April 2022, the new legislation (the "**Amendment**") was published significantly amending the Commercial Companies Code (the "**Commercial Code**"). The Amendment will enter into force on 13 October 2022. This is the largest amendment to the Commercial Code in 20 years and includes:

- the introduction of a regulated group concept and related holding company law,
- changes in the rules regarding the liability of members of the management board,
- a reform of corporate governance regulation to apply to Polish companies; and
- clarification of the method of calculating the term of office of a company's corporate bodies.

Key issues

- Regulated group concept
- New rules on the liability of members of the company bodies
- A new dimension of corporate governance
- Method of counting the term of office of the company bodies

REGULATED GROUP CONCEPT

Background

The Amendment has created a group company concept to recognize the de facto economic control a parent company has over its subsidiaries. This is implemented by allowing the parent to give instructions to its subsidiaries. As a result, when complying with such instructions, the liability of the management boards of the subsidiaries concerned is limited whilst that of the parent is correspondingly enhanced. This concept is derived from a German concept whereby shareholders of a German limited liability company (GmbH) can give instructions to the Company's management bodies (with few limitations only). However, the way this is implemented into Polish law seems to be much more complicated and difficult to use in practise, especially in terms of issuing binding instructions to a subsidiary.

This structure could be of use in the following circumstances:

- Where the group is subject to financing arrangement requiring inter group guarantees and collateral and members of the group need to accede as obligors to or for facilities provided to the parent.
- Where there is a desire to impose business rules, policies and practices uniformly across a whole group, even though not obviously in the best interests of every member of the group.

As a corollary to this structure, various forms of protection to minority shareholders have been given and correspondingly enhanced powers of supervision have been given to the parent company.

There is, inevitably, a certain amount of bureaucracy associated with the adoption of this structure. It is also unlikely to be popular with a group where minority shareholders are present. Furthermore, tax rules will still mean that subsidiaries will need to receive financial benefit on market terms for giving guarantees in a group financing structure which means subsidiary companies will always receive a "benefit" for participating in these arrangements without the need for the regulated group structure to protect against liability. It, therefore, remains to be seen how useful this structure becomes in practice.

These new provisions are independent from the rules for creating tax capital groups for the purpose of common settlement of corporate income tax. So far the latter have not been popular because of the restrictive nature of Polish group taxation rules. These have recently been relaxed. In particular, a requirement for a minimum profitability ratio has been removed. The relaxation in the tax position may also encourage the creation of group structures using Polish companies introduced by the Amendment.

Companies that can participate in the structure

The group to which the Amendment refers comprise a parent company and a subsidiary or subsidiaries guided by a common economic strategy in order to pursue a common interest, justifying the exercise by the parent company of uniform management over the subsidiary or subsidiaries, in each case established by the resolutions of shareholders of subsidiaries fulfilling the criteria described below. However, three is no need to demonstrate that such "common interest" exists in order to adopt such a resolution.

The companies that can participate in the structure (referred to in this briefing as a "regulated group") have to satisfy the general tests for a parent company / subsidiary company relationship set out in the Commercial Code. The companies that cannot participate in this structure as subsidiaries are: public companies (i.e. with listed shares), companies in liquidation and companies in bankruptcy.

However, it is likely that mainly companies in a group where the subsidiaries are wholly owned by the parent will participate in this structure due to the complications arising out of minority shareholdings, as described below.

The Amendment does not explicitly say whether or not a non-Polish company can participate in a regulated group (whether as parent or subsidiary). However, there is a reference to non-Polish companies in the Amendment. If a foreign company is to be included in a regulated group, a check would need to be made to ensure the regulated group concept did not conflict with the non-Polish legislation, applying to that entity.

Participation in a group of companies:

The procedure for establishing a regulated group is as follow:

- A shareholders' resolution has to be passed with the approval of 75% or more of the votes cast by each subsidiary participating in the regulated group stating the identity of the parent company. There is no requirement for a resolution of the parent; and
- Membership of a regulated group has to be disclosed in the register (in Poland the National Court Register - KRS) for each member of the regulated group, including the parent company. If the parent company has its registered office abroad, it is sufficient to disclose this participation in the register maintained for the relevant Polish subsidiaries. The vast majority of the provisions on participation in a regulated group apply from the moment of such disclosure.

Binding instructions

Under the Amendment, the parent company will be able to issue binding instructions to a subsidiary participating in the regulated group on the conduct of the subsidiaries' affairs, if this is justified by the interests of that group (with some specific exceptions). For the instructions to be valid, they must be issued in writing or in electronic form.

These instructions should specify at least (1) the expected conduct of the subsidiary as a result of the instructions, (2) the interest of the group justifying the instructions being carried out, (3) the expected benefits or damage that the subsidiary will obtain or incur as a result of carrying them out (if applicable), and (4) the envisaged manner and deadline for the remedy of any damage suffered by the subsidiary as a result of carrying out the instructions.

A subsidiary must refuse to carry out the instructions:

- if this would lead to its insolvency or a risk of its insolvency; and/or
- in the case of subsidiaries other than those which are wholly-owned, also if there is a justified concern that they are contrary to the interests of that company and will cause it damage which will not be remedied by the parent company or another subsidiary participating in the regulated group within two years from the date on which the event giving rise to the damage occurs. In determining the amount of damage, the subsidiary must take into account the benefits obtained in connection with its participation in the group during the last two financial years. However, this possibility for refusing can be excluded in its articles / statutes.

Additional grounds for refusing to carry out binding instructions may be introduced in the articles of association/statutes of the subsidiary, provided that the shares of those shareholders of the subsidiary who oppose a change introducing such additional grounds are bought out.

The performance of the instructions or refusal to do so takes place on the basis of a prior resolution of the management board of the subsidiary.

Additional powers of the supervisory board

The supervisory board of the parent company must supervise the pursuit of the interests of its regulated group by each subsidiary participating in such group. Its articles of association/statutes may provide otherwise. For subsidiaries, this will mean being subject to double supervision – not only at

the level of the company itself, but also at the level of the entire group. In order to exercise this right of supervision, the supervisory board of the parent may require the subsidiary to make available its books of account and other documents and to provide information to it. In the absence of a supervisory board, these powers will be vested in the management board of the parent company. The supervisory board of the parent is also obliged to prepare a report on its activities for each financial year.

Exclusion of liability of the subsidiaries' management board

According to the new regulations, a member of the management board of a subsidiary will not be liable for damage caused by carrying out of the parent's instructions in a manner consistent with the Amendment or damage caused when acting in the interests of the group.

Additional liability of the parent company

As a mirror to the limitation of liability of the subsidiary's management board, the liability of the parent company is correspondingly enhanced. The parent company will therefore be liable on a fault basis for damage caused by its binding instructions if the damage is not repaired by the parent company within a prescribed period. Although it is not explicitly stated, we believe the repair should be at the parent's company's cost. For wholly owned subsidiaries, liability only arises if the instructions concerned result in the company's insolvency. Therefore, it operates to protect creditors.

Where the subsidiary has minority shareholders, the parent company will be responsible for a reduction in the value of their shareholding, if this occurs as a result of carrying out the instructions given by the parent.

The parent company will also be liable to the creditors of any subsidiary if such creditors cannot recover from the subsidiary, unless the parent company is not at fault or the damage did not arise as a result of the carrying out of its binding instructions.

Minority shareholders' protection

The legislator decided to introduce in the Amendment several provisions to protect minority shareholders of companies participating in a regulated group.

Right to demand buy-back

Shareholders will have the right to require the parent company to buy back their shares in three situations:

- if, directly, indirectly or by way of agreements with other persons, the parent company represents at least 90 % of the share capital of the subsidiary participating in the regulated group. The company's articles of association or statutes may lower this threshold to 75%;
- if they do not consent to the adoption of a resolution to amend the articles of association/statutes by introducing conditions (in addition to the statutory ones) for refusing to comply with the parent's binding instructions; or
- if they do not agree to the introduction in the articles of association/statutes of the subsidiary of a provision pursuant to which the parent company representing less than 90% (but at least 75%) of the share capital may demand the compulsory buy-back of shares from the minority shareholders.

A buy-back is carried out on terms similar to the buy-back of shares in a joint-stock company in connection with a change in the subject of its activity. The price of the shares is determined by an expert appointed by the shareholders' meeting of the company.

Right to request an audit of the group's activities

A minority shareholder of a subsidiary belonging to a regulated group, representing individually or together with other shareholders of that company at least one-tenth of its share capital, will be able to request at any time the appointment by the registry court of an audit firm in order to examine the accounting and activities of a regulated group. The costs of the audit are generally borne by the requesting shareholder. However, if the audit shows abuse and/or, actions detrimental to the company, or a flagrant breach of law or its articles of association/statutes, that shareholder may request reimbursement of these costs from the audited company.

The scope of the audit may be limited in two ways. First, the articles of association/statutes of a subsidiary, may limit the audit only to that company and its relations with the other companies belonging to that regulated group. Secondly, at the request of the parent company or the subsidiary whose shareholder has made the request, the registry court may limit the subject of the audit or determine how the results of the audit are to be made available, taking into account the legitimate interests of the applicant or of the other companies belonging to the regulated group, with particular regard to the need to safeguard trade secrets or other legally protected information.

NEW RULES ON THE LIABILITY OF MEMBERS OF THE COMPANY BODIES

The "obligation of loyalty" will apply to members of the management board and supervisory board of a limited liability company and a joint-stock company. The concept of "loyalty" is not defined but is generally understood to mean acting in each case in the interests of the company including avoiding conflicts of interest.

The Amendment also introduces what is commonly described as the "business judgment" rule already existing under case law. This means a member of the company's management board / supervisory board will not be liable for his/her actions if acting within the limits of a justified economic risk including on the basis of information, analyses and opinions which should be taken into consideration in the relevant circumstances, even if such actions prove to be harmful to the company. For example, if the management board decides to obtain funding on certain terms, which, based on the analyses and opinions they made/received, may be regarded as being on arm's length terms its members should generally be exempt from liability if this funding proves in the end be difficult for the company to maintain. However, this does not override the duty to act with professional due diligence or to comply with the duty of loyalty described above.

A NEW DIMENSION OF CORPORATE GOVERNANCE

The Amendment extends the scope of the information obligations and powers of the supervisory board, in a manner consistent with market practice for many Polish companies.

Expanded scope of information obligations of the management board of a joint-stock company

The management board of a joint-stock company will be obliged to inform the supervisory board about, among other things:

- the situation of the company, including the state of its assets. This concept is both broad and vague and will need to be clarified through case law.
- any significant event in the conduct of the company's affairs;
- progress in the implementation of any documented business objectives and deviations from them. Again, the law is vague as to the meaning of this; and
- transactions and other events or circumstances that materially affect or may affect the company's financial position, including its profitability or liquidity.

The management board must provide the information without any specific request from the supervisory board, (regarding the information in the first 3 points) at each meeting of the supervisory board or (regarding the information in the last point) immediately after the occurrence of the relevant specific events or circumstances. The latter also applies to any changes in any information previously provided to the supervisory board, if these changes significantly affect or may affect the company's situation. It is also important to note that the information obligation with respect to the management board of a parent company also cover information on its subsidiaries and related companies (i.e. not being subsidiaries but where the parent company has a shareholding of 20% or more).

The statutes of a joint-stock company may exclude or limit these information obligations. However, by law, a change of these statutes requires a shareholders resolution passed by at least 75% of the votes cast.

Right to request documentation related to the company's activities

The Amendment also provides that the management board should at the request of a shareholder (submitted starting from the date of convening its annual shareholders' meeting) will be obliged to provide documents to the shareholder corresponding to the content of the management board's annual report on the company's activities, financial statements, supervisory board's report or auditor's report immediately, but no later than within two working days from the date of submission of the request. If the shareholder so requests, the documents should be made available by the board in electronic form. It should be noted that obligation to make these documents available to a shareholder at least 15 days before the annual shareholders' meeting already exists. However, the Amendment makes it more specific.

Additional powers of the supervisory board

The Amendment clarifies and expands the powers of a company's supervisory board as regards the pre-existing right to request information and documents from the company's management board. The Amendment requires this information to be provided within 2 weeks of any request. This toughens up the previous rules where no time limit was set out for compliance. The sanction for non-compliance is a fine of up to PLN 50,000 and prohibition on holding office as a member of a management board or supervisory board or acting as a commercial proxy for 5 years.

The supervisory board of a joint-stock company has also been granted the power to veto a transaction with any of its parent companies, subsidiaries or related companies. However, this applies only if the value of such a transaction, when added together with previous ones carried out within the same financial year, exceeds 10% of the total gross assets of the company. This power does not apply to groups of companies and public companies and may be excluded by the company's articles of association/statutes.

In addition, the Amendment regulates in detail the possibility of the supervisory board engaging its own advisers. This possibility has to be included in the articles of association/statutes. In the agreement with the advisor the company will not be represented by the management board, but by the supervisory board. This is an important practical change in enabling the supervisory board to separately engage its own professional advisers.

Another added power is the introduction of the possibility for the supervisory board to establish ad hoc or standing committees from among its members. So far these committees have existed in practice, but they have not been regulated by the provisions of the Commercial Code.

Organisational regulations

The Amendment also extends the hitherto very perfunctory provisions on the manner of convening and holding meetings of the supervisory board by introducing some matters that have so far been regulated on a voluntary basis only in the articles of association/statutes of companies or supervisory board's regulations. In particular, the obligation has been introduced to convene a meeting within 14 days from the date of receipt of a request to convene a supervisory board meeting made by the management board or a member of the supervisory board.

METHOD OF COUNTING THE TERM OF OFFICE OF THE COMPANY BODIES

A short but important provision has also been introduced specifying that the term of office of a member of a company body of a capital company is counted in full financial years. This should put an end to long-standing disputes over the calculation of the term of office of members of the management board and the supervisory board.

SUMMARY OF CHANGES

The introduction of the holding law concerning regulated groups of companies has aroused great controversy from the very beginning. Although this institution is known in other European jurisdictions, the provisions introducing it have been quite widely criticised as both lacking in clarity in certain respects and, in others, being too detailed. It can also be assumed that the management boards of subsidiaries in a regulated group, for fear of their liability, may take advantage as widely as possible of the grounds for refusing to comply with the parent company's binding instructions. For all these reasons, we assume that many capital groups will not implement the regulations regarding regulated groups.

Some other provisions in the Amendment should be assessed positively. In particular, the clarification of the rules regarding the liability of members of the corporate bodies of capital companies and the method of calculating the length of their term of office, which have long been controversial.

On the other hand, the increase in the scope of the information obligations of management board members and severe sanctions for not observing them, in particular in a joint-stock company, may raise greater concerns. Although it is difficult to disagree with the intention of providing the supervisory board with the ability to react immediately to specific situations, this may lead to a further overloading of management boards, which must already be familiar with the ever-changing legal environment.

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