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Commercial Legal and Institutional Reform (CLIR) Diagnostic Assessment Report for Poland



A USAID Initiative in Developing Countries

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I. Overview

The diagnostic assessment that serves as the basis for this study was conducted in Poland between October 5-23, 1998. This diagnostic provides the first component in a four-country study to assess the current commercial law environment in the CEE and the NIS regions. Each country included in this assessment - Poland, Romania, Ukraine, and Kazakhstan - was selected for its unique characteristics including location, geography, size, economic base, legal traditions and relative progress in transition toward a Market-oriented economy.

Poland was selected for inclusion in the sample for this study for many reasons including its size, geo-strategic position, and its comparative successes in meeting the challenges of making the transition to an open Market economy. Poland also serves as an informal "benchmark" for the sample selected for this study for several key reasons. First, it had one of the strongest pre-World War commercial legal traditions in Europe, and many of its core legal texts, including the Civil Code, managed to survive the Communist era intact. Second, the fact that Poland has pursued reform aggressively over the past decade and has attained among the highest sustained economic growth rates in the region suggested that Poland can serve as a useful benchmark for evaluating commercial law development in the region. Third, because Poland has anchored its future squarely within the broader political and economic framework of the European Union, it was judged to have a high degree of political consensus on the long-term direction of its political and economic development.

The purpose of this assessment is to better understand the dynamics of commercial law development generally, and what can be done to better assist transition economies in developing a pro-business legal and regulatory environment specifically. More than 160 years ago, Alexis De Tocqueville studied America as a newly emergent democracy and commercial power. In searching for an explanation for America's phenomenal success, he concluded that the manners and customs of the people were the fundamental differentiating factor, and that natural endowments of productive factors, and good laws were significant, but less important determinants of economic growth.¹ More recently, Landes has suggested that culture and institutions explain many of the differences in economic development between nations. Among other characteristics, he opines that if a society pursues stable growth and development, its social and political institutions must:

- Secure rights of property;
- Secure rights of personal liberty;
- Enforce rights of Contract;
- Provide stable, responsive and honest government; and,
- Provide moderate, efficient, and cost-effective government.²

What makes Poland "special" from the point of view of commercial life? Why has Poland managed the transition to a Market economy more quickly and successfully than almost any other country in the region? Do laws matter, or as De Tocqueville and Landes would have it, is it the "customs of the people" that matter most? Finally, if one accepts this as true, what are the implications for USAID, other donors, and the countries of the region themselves?

1 Democracy in America, Vol. I, Ch. XVII

2 Landes, David S., THE WEALTH AND POVERTY OF NATIONS – WHY SOME ARE SO RICH AND SOME SO POOR. (New York. W.W. Norton & Company, 1998), pp. 215-18.

II. Summary Indicator Results

The following table contains a summary of the indicator results derived from the Poland diagnostic assessment. The total possible raw score appears in the "REF" column of the table. Each country's raw score will appear in two forms in the adjacent columns; first the raw indicator score, and next as the raw score *stated as a percentage of the total possible raw score for that category*. The reader is urged to carefully read Section IV ("Notes on Scope and Methodology") before attempting to draw any specific conclusions either from the raw scores, or their associated results.

	SUBSTANTIVE AREA	REF.	POL	ROM	UKR	KAZ
A. BANKRUPTCY			79%			
	1. Legal Framework	280	224	80%		
	2. Implementing Institutions	170	136	80%		
	3. Supporting Institutions	200	151	76%		
	4. Market - Bankruptcy	290	225	78%		
B. COLLATERAL			77%			
	1. Legal Framework	140	126	90%		
	2. Implementing Institutions	210	165	79%		
	3. Supporting Institutions	190	123	65%		
	4. Market - Collateral	310	234	75%		
C. COMPANY			79%			
	1. Legal Framework	190	153	81%		
	2. Implementing Institutions	270	205	76%		
	3. Supporting Institutions	100	82	82%		
	4. Market - Company	270	211	78%		
D. COMPETITION			81%			
	1. Legal Framework	210	172	82%		
	2. Implementing Institutions	220	178	81%		
	3. Supporting Institutions	220	178	81%		
	4. Market - Competition	290	226	78%		
E. CONTRACT			80%			
	1. Legal Framework	90	75	83%		
	2. Implementing Institutions	180	150	83%		
	3. Supporting Institutions	70	55	79%		
	4. Market - Contract	310	234	75%		
F. FDI			78%			
	1. Legal Framework	290	253	87%		
	2. Implementing Institutions	190	155	82%		
	3. Supporting Institutions	200	131	66%		
	4. Market - FDI	310	234	75%		
G. INT'L TRADE			69%			
	1. Legal Framework	280	260	93%		
	2. Implementing Institutions	180	128	71%		
	3. Supporting Institutions	180	88	49%		
	4. Market - Trade	310	188	61%		
TOTAL		6150	4740	78%		

III. Narrative Assessment Results Overview

Initial results of the in-country diagnostic assessment confirm that Poland has strong overall legal, institutional, and "market" framework for commercial activity when compared to the baseline established for this assessment. Poland's total result (the average of Tier I results in each of the seven areas of commercial law examined) was 78%. Tier I results for each of the seven subject matter areas ranged from a low of 69% in International Trade, to a high of 81% for Competition. Other areas of relative strength include Contract (80%), company (79%), and Bankruptcy (79%). It should be emphasized that these results should not be interpreted as an indicator of progress toward a specific or idealized commercial system. Instead, the percentage values are intended to help evaluate existing conditions against a general "baseline" requirement for modern commercial activity.

Although these results are preliminary, a few interesting patterns emerge that are worth noting. First, as expected, the "Framework Law" Dimension is stronger, in relative terms, than any other Dimension of this analysis. Poland has received a significant amount of technical support in developing Framework Laws for Bankruptcy, Collateral, and FDI. The high results achieved in company and Contract law may be attributable, in part, to the survival of Poland's pre-war jurisprudence and practice in these areas. Interestingly, although Poland's trade laws scored highest in this Dimension, the Tier II result was the lowest of the seven subject matter areas. This can be explained in part by the fact that "Supporting Institutions" received the lowest Tier II score (49%) for the assessment. Finally, the process of approximation of laws in preparation for EU accession explains in part the relatively high result (82%) Poland's Framework Law for Competition received in the analysis.

Except in the case of company, the results for Implementing Institutions ranked second highest among the four Dimensions of this analysis. Overall, inadequate institutional capacity in the Implementing Institution Dimension was a common theme across all subject matter areas. In general terms, Poland's Implementing Institutions are viewed as overly bureaucratic, inefficient, and in the worst cases, arbitrary. Corruption, while it exists, was reported to be a relatively minor impediment to day-to-day commercial activity. Except perhaps in the area of Bankruptcy, end users reported that they were more likely than not to work through the bureaucratic channels of the Implementing Institution, than to circumvent them through self-help or avoidance. Areas of particular overall weakness were found in the commercial courts of general jurisdiction, and in the area of International Trade, with customs administration and regulation.

Because of the variety of forms that Supporting Institutions take across the seven subject matter areas, it is difficult to generalize the results obtained in this Dimension of the analysis except to say that the number of Supporting Institutions, and their overall level of their activity in Poland, were encouraging. In the areas where Poland's legal traditions are strongest, Contract and Company, Supporting Institutions were found to be the strongest. Here banks, notaries, bar associations, chambers of commerce, arbitration councils, lawyers' associations, law firms, business consultancies, and special interest groups were found to be playing an important, if sometimes indirect, facilitating role in these spheres of commercial activity. In the areas of

Collateral and International Trade, the results for this Dimension were comparatively lower. In the former, this result may be attributable to the relative newness of the Collateral system. In the latter, the result was brought down by a strong consensus that Poland's Custom's Service is an area where significant reforms remain to be implemented.

The "Market" for commercial law reform in Poland is similarly strong in most areas. In relative terms, the result for Poland's Market for trade liberalization was somewhat low (61%), given the general consensus that seems to exist concerning Poland's future role in a wider Europe. Generally speaking, the low score in this Dimension may be attributable more to a lack of specific knowledge concerning Poland's obligations under various trade agreements, than of a lack of support for liberalized trade. Additionally, micro- and small-sized trading firms, important contributors to Poland's economic rebirth since the early 1990s, have been viewed by Polish society with a degree of suspicion as this sector has been a focal point for criminal and quasi-criminal activities. This lingering suspicion against entrepreneurial activity seems to be receding steadily, and would appear to be a lingering.

IV. Notes on Scope & Methodology

This diagnostic assessment was designed to help achieve the following objectives:

1. To provide a factual basis for characterizing the degree of development and the level of effectiveness of the commercial law reforms initiated in Poland since independence;
2. To provide a methodologically consistent foundation for drawing cross-country comparisons in an effort to identify and describe the root causes of the "implementation/enforcement" gap; and,
3. To provide analytical and planning tools and metrics that will help USAID design new approaches to sustainable, cost-effective C-LIR interventions in the region and elsewhere.

For the purposes of this effort, "commercial law" is defined to include the following substantive legal areas:

1. **Bankruptcy** - Mechanisms intended to facilitate orderly market exit, liquidation of outstanding financial claims on assets and rehabilitation of insolvent debtors.
2. **Collateral** - Laws, procedures and institutions designed to facilitate commerce by promoting transparency, predictability and simplicity in creating, identifying and extinguishing security interests in assets.
3. **Companies** - Legal regime(s) for market entry and operation that define norms for organization of formal commercial activities conducted by two or more individuals.
4. **Competition** - Rules, policies and supporting institutions intended to help promote and protect open, fair and economically efficient competition in the market, and for the market.
5. **Contract** - The legal regime and institutional framework for the creation, interpretation and enforcement of commercial obligations between one or more parties.
6. **Foreign Direct Investment** - The laws, procedures and institutions that regulate the treatment of foreign direct investment.
7. **International Trade** - The laws, procedures and institutions governing cross-border sale of goods and services

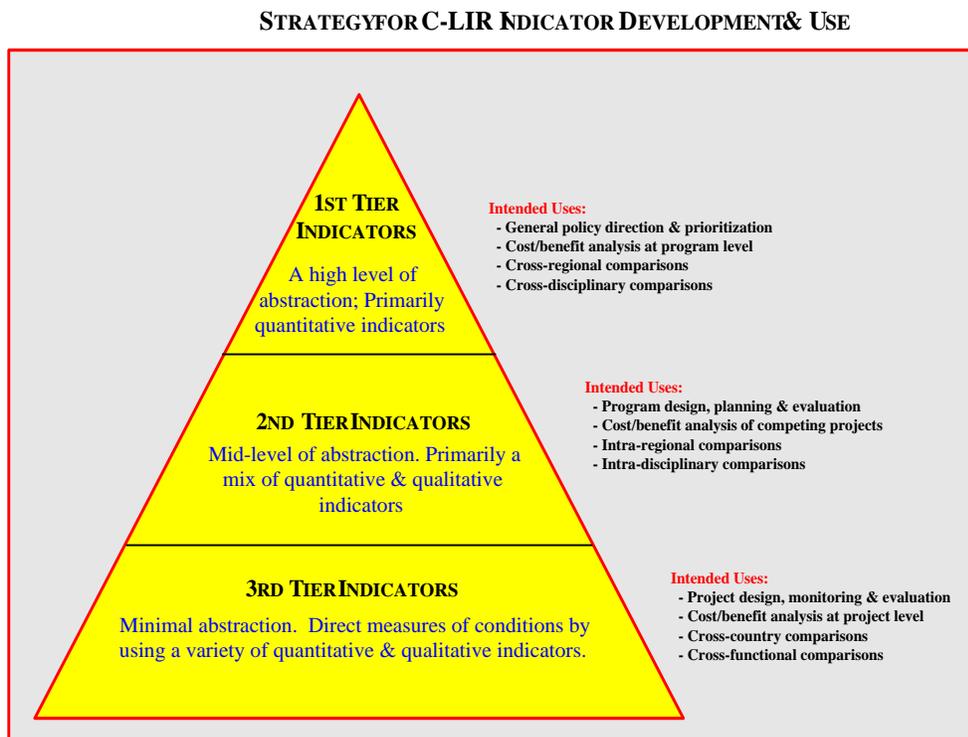
Each of these substantive areas will be assessed by collecting data across the four sample countries. Within each of these substantive areas, four "Dimensions" of C-LIR are proposed as a conceptual framework for comparison. These include:

- **Framework Laws** - Basic legal documents that define and regulate the substantive rights, duties, and obligations of affected parties and provide the organizational mandate for Implementing Institutions (e.g., Law on Bankruptcy, Law on Pledge of Moveable Property);
- **Implementing Institutions** - Governmental, quasi-governmental, or private institutions in which primary legal mandate to implement, administer, interpret, or enforce Framework Laws is vested (e.g., Bankruptcy courts, Collateral registry);

- **Supporting Institutions** - Governmental, quasi-governmental or private institutions that either support or facilitate the implementation, administration, interpretation, or enforcement of Framework Laws (e.g., Bankruptcy trustees, notaries); and,
- **"Market" For C-LIR** - The interplay of stakeholder interests within a given society, jurisdiction, or group that, in aggregate, exert an influence over the substance, pace, or direction of commercial law reform.

Within each substantive area, development indicators have been defined for each of the four "Dimensions" of C-LIR. The figure below provides a conceptual overview of how the development indicators are organized. The twenty-eight "cells" below represent groups of development indicators that collectively are designed to provide a "snapshot" of the current state of commercial law reform in each subject area. From a practical standpoint, the diagnostic assessment itself is performed by collecting and analyzing data through published sources, and face-to-face interviews, that are used to populate the development indicator tables.

The graphic below provides a conceptual overview of how the development indicators are organized.

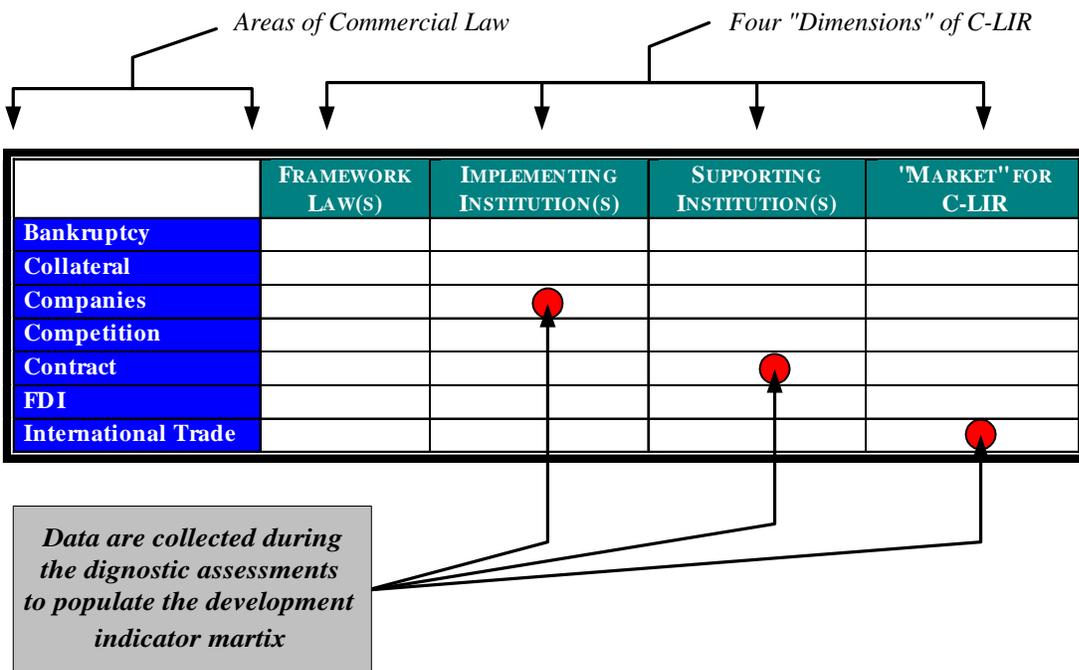


Each of the three sections or "tiers" of the pyramid in the diagram represent a different level of detail or "abstraction" generated by the indicators. The primary objective in creating three tiers of indicators is to provide varying levels of detail, depending on the needs of the user. Generally speaking, Tier I indicators are intended to be useful to high level policymakers who are

responsible for establishing general policy direction and prioritization. Tier II indicators are intended to be most useful to senior program- and country-level officials responsible for program design, planning, and evaluation. Finally, Tier III indicators are designed to be most useful to those who need to make detailed analysis of specific areas of the commercial law environment in a given country, or between specific countries. In this case, those responsible for project design, monitoring, and evaluation are most likely to find the detail at the Tier III level useful

The organization of the data into tables that can be easily read and interpreted is also a challenge given the amount and complexity of the data required. As illustrated in the diagram below, basic indicator groups for a given country are organized into blocks of twenty-eight "cells". The four "Dimensions" of commercial law development appear across the top of the table, and the seven subject matter areas defined for this study appear in the far left column.

Conceptual Overview of C-LIR Development Indicators



Given that four countries have been selected for assessment, a total of 112 indicator groups (containing subject-matter specific indicators) have been developed and populated. For this reason, it is important for the user to have a firm grasp of the organization and logic of the indicator tables before attempting to interpret specific indicator scores or results.

V. How To Read the C-LIR Indicator Tables

The diagram below represents how Tier I and Tier II results are organized in the C-LIR indicator tables. The subject matter area ("Collateral") appears in the upper left portion of the table. Below it, the four "Dimensions" of commercial law are listed in their order of treatment. The column immediately to the right ("Ref.") contains a "reference value" (i.e., benchmark) against which the sample countries (i.e., "A" through "D") are compared. To illustrate, the total raw scores for Country A and Country B are 228 and 235, respectively, as compared against the reference value of 638. These are referred to as Tier I *raw scores*. To obtain a Tier I *result*, the raw score is divided by the benchmark reference value (REF) to obtain Tier I results of 31% and 33% respectively. This example suggests that Country A's Collateral law system is comparable in relative terms to Country B's *when viewed at the highest level of abstraction*.

BASIC INDICATOR TABLE ORGANIZATION

SUBSTANTIVE AREA	REF.	A	B	C	D
COLLATERAL LAW	638	228	31%	235	33%
Legal Framework	120	85	71%	90	75%
Implementing Institution	226	72	32%	25	11%
Supporting Institution	154	34	22%	67	44%
"Market" for C-LIR	138	37	27%	53	38%

4 "Dimensions" of C-LIR

Tier II Reference Value

Tier I Indicator Results Are The Average of Teir II Results

The same exercise can be performed at the Tier II level. If, for example the "Market for Collateral law reform in Country A is compared to that of Country B, a result of 27% and 38% respectively is obtained. From this it may be possible to infer that the "Market" Dimension for this subject matter area (Collateral) is *relatively* stronger in Country B than in Country A in aggregate terms, but relatively weak in comparative terms. It must be emphasized that a more detailed analysis of the underlying Tier III indicator raw scores and results would be required to draw more specific conclusions (e.g., a relative quality of policies "supplied" in Country A).

The Tier I and Tier II indicators in the example above are derived from the raw data collected in the course of the diagnostic assessments. This raw data is collected and scored against Tier III indicators. As a result, Tier III indicators provide the foundation for this analysis. In the illustration below, Tier III indicator results for the "Legal Framework" for Collateral are averaged to yield associated Tier II results. Individual Tier III indicator results provide the highest level of detail in the analysis. In this example, the result for Indicator B.1.3 ("Law recognizes bank guaranty.") is 43%, which can be interpreted to mean that this particular aspect of the Legal Framework for Collateral was found to fall well short of the benchmark Reference Value of 35. Where pertinent, a more detailed discussion of the basis on which this particular Tier III scoring was made would appear in the narrative portion of the diagnostic report.

Tier III Indicator Table

		Reference value for "Legal Framework"	Raw Score	Tier II Result
B.1	LEGALFRAMEWORK- COLLATERAL	140	75	49%
.1	Law recognizes personal guaranty	35	20	57%
.2	Law recognizes 3 rd party personal guaranty	35	10	29%
.3	Law recognizes bank guaranty	35	15	43%
.4	Law recognizes security interests in real property (mortgage)	35	30	86%

Tier III Indicator s Tier III Indicator results

These examples are intended to help show how indicator results "roll up" from one level to the next in terms of abstraction. This design is intended to dilute the impact that any single indicator *raw score* may have on the overall indicator *result*. It is our intention that the impact of a small discrepancy (or bias) in scoring at the Tier III level from one country to the next would be minimized provided the assessment methodology is applied consistently in each case.

VI. Narrative Summary of Diagnostic Findings

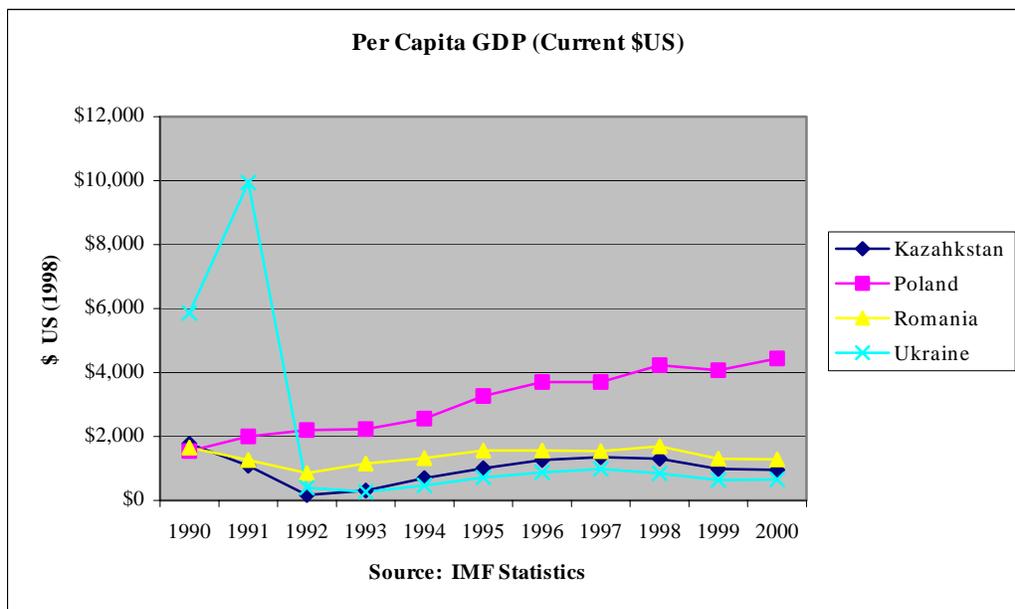
A. Overview

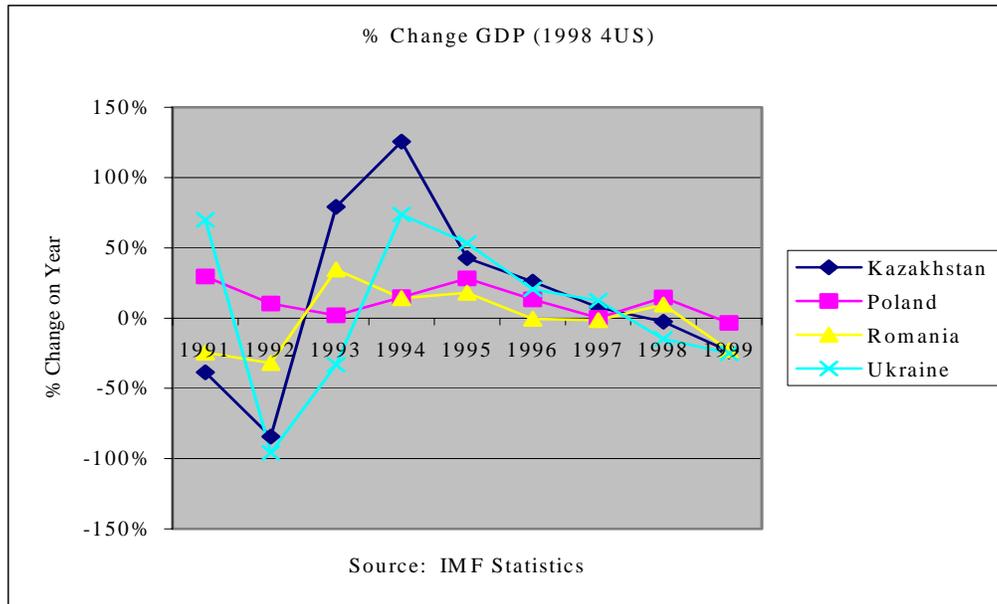
"Yet having begun, we must go forward to the rough places of the law..."

Plato's Republic, Book V.

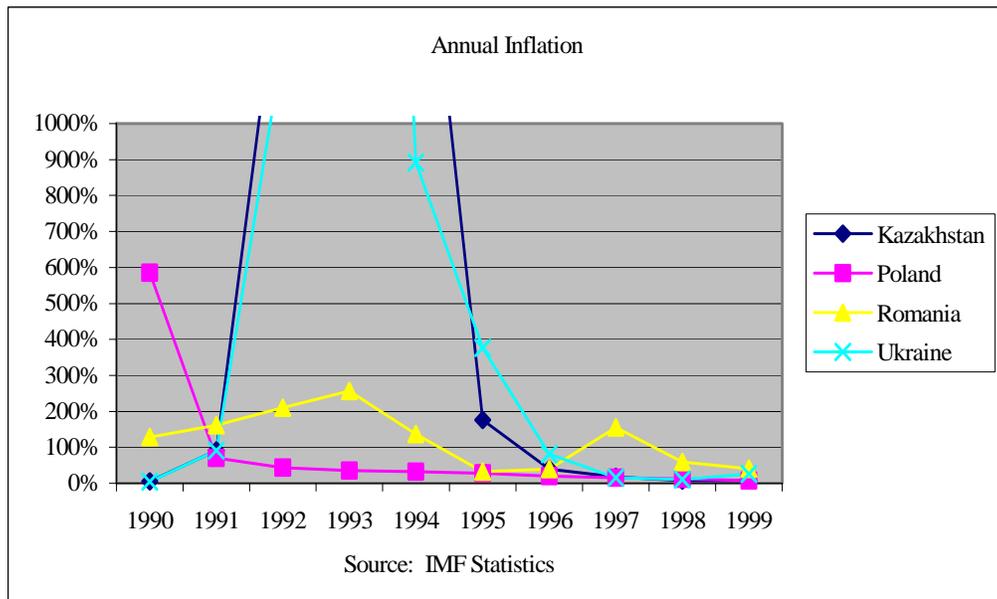
Poland is a leader in the political and economic transition of Central and Eastern Europe and has been a recipient of substantial USAID technical assistance. The technical assistance has focused on overcoming what remains of major impediments to sustainable, long-term economic growth and resilient democracy, building on lessons learned and a strategy that employs the mutually reinforcing objectives of private, public, financial and democratic sector development. USAID has provided extensive assistance for key aspects of Poland's transition to a viable market economy and democratic civil society, such as economic restructuring, private and financial sector development and governmental decentralization. In addition, USAID has promoted and fostered private sector development through assistance to small and medium scale enterprises, and by supporting privatization and restructuring, and addressing barriers to commercial activity.

Poland's GDP has expanded by 5% or better in every year since 1994. Private direct foreign investment has continued to grow, with the U.S. leading at over 30% of the current total of just under \$4 billion. Legislation conducive to free enterprise has been enacted, and a vibrant private sector is now estimated to employ 64% of the work force (including the shadow economy) and to account for about two-thirds of the GDP. Capital markets have evolved slowly, but systematically. As reflected in the charts below, Poland's economy has grown and stabilized as market reforms began to take root and propagate in the middle of the decade.





Poland has enacted some of the most profound reforms in the region, resulting in major productivity increases within the private sector. Its relative success in avoiding sustained periods of hyper-inflation, developing an improved policy climate for private sector growth, promoting greater competition within the banking sector, opening up opportunities for capital market formation, and the introduction of new financial instruments to mobilize domestic savings all contributed to Poland's current situation.



Other broad indicators of Poland's position relative to the three other countries contained in the sample are also instructive:

Broad Indicator	Poland	Romania	Ukraine	Kazakhstan
Population (millions) ³	38.7	22.6	51.2	16.9
Area (km ²)	312,683	237,500	603,700	2,717,300
Corruption Index ⁴	4.2	3.3	2.6	2.3
Credibility Index ⁵	68.05	52.96	>40	48.04
EBRD Legal Transition Index ⁶	4/4	3/4	2/2	2/2
Moody's Emerging Mkt. Rating	Baa3	B3	B3	Ba3

Poland's long and distinguished legal tradition is one of adaptation and survival. When Poland regained its status as an independent nation following World War I, it was faced with the challenge of harmonizing a patchwork of various laws that were inherited from occupying powers including Russia, Prussia, Austria, and France.⁷ This mélange of traditions and influences survives today - it is reported that judges give different interpretations - French, Austrian, and German - to the Commercial Code of 1934 depending on the region within Poland where they receive their training.⁸ In the area of commercial law, German and French influences are still very much in evidence in the Polish Commercial and Civil Codes respectively.

If the inter-war period can be viewed as a period of adaptation and harmonization of law, the period of Poland's Nazi occupation and Communist rule can be viewed as one of survival. Under Communist rule, the Polish legal systems were adapted to the state's needs, rather than scrapped and replaced with an entirely new socialist legal system. Key provisions of Poland's commercial law and traditions were allowed to survive, even if in dormancy.⁹ Perhaps most significantly, the private sector continued to function throughout the Communist period, thus creating "demand" for commercial law, even if contradicting the prevailing political orthodoxy.¹⁰

Considering the scope and pace of Poland's transition to a market economy, the notion that Poland's tradition of adaptation and survival played an important role seems credible. There is great pride, for example, in the Commercial Code of 1934, and a consensus that it remains

³ Population Division and Statistics Division of the United Nations Secretariat, 1998 (<http://www.un.org/Depts/unsd/social/poptn.htm>).

⁴ Transparency International Corruption Perceptions Index (CPI) 1999. Scale = 1 - 10. Higher scores indicate less corruption.

⁵ Euromoney Magazine, December 1997. Scale = 1 - 100. Higher scores indicate greater credibility of government offerings and undertakings.

⁶ European Bank for Reconstruction & Development, 1998 Transition Report. Scale = 1 - 4+, where 4+ is most advanced. 1997 and 1998 figures are included. Of those countries included in the Sample, only Romania's score changed between 1997 and 1998.

⁷ Taking The Other Road: Polish Legal Education During The Past Thirty Years, Gostynski, Z., Garfield, A., 7 Temp. Int'l & Comp. L.J. 243, Fall, 1993.

⁸ Brzezinski, C., The EC-Poland Association Agreement: Harmonization of an Aspiring Member State's Company Law, 34 Harv. Int'l L.J. 105, 108, n. 16 1993 ("Warsaw judges tend to apply a French interpretation, Krakow judges an Austrian interpretation, and Wroclaw judges a German interpretation").

⁹ Poland's Commercial Code of 1934 is a good example. Although it was not used during the Communist period, Polish law schools continued to teach the Commercial Code to law students.

¹⁰ In contrast with Ukraine, for example, collectivization of agriculture was never accomplished in Poland. Per Gostynski, et al., approximately 70% of agricultural land remained in private hands during the Communist era. In addition, a class of small entrepreneurs remained active throughout the period.

generally serviceable for contemporary needs, with some adjustment.¹¹ The current process of "approximation" of Poland's legal regime in preparation for full membership in the EU seems to represent yet another period of adaptation and harmonization in Poland's legal tradition, and provides a strong gravitational influence on the pace and direction of Poland's overall commercial law reform effort.

¹¹ Id. The Civil Code of 1964 repealed many aspects of the Commercial Code of 1934. A debate arose early during the reforms as to whether the Code had been repealed in part, or in whole. It seems that a consensus was reached that the Code did survive. As a result, the Polish government determined to update the Code, rather than replace it with an entirely new body of law.

B. Bankruptcy

1. Overview

The liberalization of state-controlled economies is a fundamentally messy process. State enterprises, who for decades produced what they were told to produce, find themselves suddenly faced with a bewildering state of affairs. Their inputs supply chain is disrupted, their market outlets disappear, and their products are typically viewed with indifference (or outright disdain) by consumers. Financial crisis, if not inherited from the former times, soon arrives with a thud.

The process of transition - while exceedingly complex - can be viewed narrowly (for the purposes of this analysis) as a process by which new participants enter the market, and others exit it. In most cases, a reformist government need only stabilize the macroeconomic environment and eliminate state controls in order to spark a flood of new entrants. The more difficult process to manage, understandably, is how under- and non-performing enterprises *exit* the market. Properly done, a well designed Bankruptcy system provides an efficient market clearing mechanism that helps assure orderly Market exit and equitable liquidation of insolvent debtors obligations.

Bankruptcy legislation is for this reason one of the more contentious areas of legal reform for transition economies. Reform implies a tradeoff between short-term economic dislocation (e.g., increased unemployment, decreased micro-economic activity, etc.) and long term economic growth - the tangible benefits of which will be felt long after the next election cycle. It is not surprising, therefore, that political pragmatism frequently wins out over visionary leadership in this area of commercial law reform.

In addition to providing a mechanism to mediate conflict between and among debtors and creditors, bankruptcy laws also provide an economically and socially beneficial systems of triage for worrying - but not necessarily terminal - cases of financial dyspepsia. Thus, Bankruptcy is distinguished from Collateral and secured transactions law, both of which address an individual creditor's interest in property and collection remedies relating to that property. The two sets of law converge in the area of priorities, where multiple, conflicting claims may be made on the same assets.

There are several different approaches to Bankruptcy that have emerged from the CEE/NIS region. These range from "straight" bankruptcy on one extreme, to insolvency proceedings geared toward rehabilitation at the other. These models also vary in the type of debtors covered. The alternative models encompass individuals and registered for profit entities. These models include a disaggregation of the classification of covered enterprises - e.g., agricultural, financial and nonprofit entities - that may be excluded from bankruptcy. Other key differences include:

- Who may initiate a bankruptcy proceeding; and,
- How large an estate needs to be prior to allowing the creditor and/or debtor access to the Bankruptcy code.

There is also considerable variation in terms of the substantive prerequisites for bankruptcy proceedings. Variations here may include the following:

- Cessation of payments;
- Inability to cover current indebtedness with current assets;
- Inability to pay all debts taking into account all prospective liabilities;
- General nonpayment of maturing debts that are not covered by legitimate disputes;
- Inability to pay on a regular basis ones' liabilities, and,
- Undertaking certain acts that clearly signal insolvency.

Among the many issues examined in these diagnostics of the current state of the region's Bankruptcy law and institutions are exempt versus non-exempt assets; title to property in Bankruptcy proceedings; preferences; and creditor priorities.

2. Diagnostic Findings

Legal Framework

Like the Commercial Code, Poland's bankruptcy law dates from 1934,¹² and retains many characteristics of the prewar period, yet it has also been significantly updated to reflect modern continental practice and emerging international norms for bankruptcy proceedings. In addition to the Bankruptcy Act, Poland has retained the Arrangement Proceedings Law¹³, which provides a mechanism for restructuring and rehabilitation of insolvent debtors. Under the existing Bankruptcy Act, a person or entity may be declared bankrupt when:

- Debt service has ceased; and,
- Where assets are not sufficient to satisfy outstanding debts.

Under Polish law, bankruptcy applies to “entrepreneurs”. Pursuant to the law of December 23, 1988 on Economic Activity (as amended), the term “entrepreneur” includes: natural persons conducting economic activity, entities regarded as “legal persons”, for example, corporations, state-owned enterprises, and registered partnerships and limited partnerships. A declaration of bankruptcy may be demanded by a debtor or by any of his creditors. Such demand may be also made by:

- Any partner of a registered or limited partnership;
- Legal representatives (e.g., directors and other members of the management board) of legal persons;
- For state-owned enterprises - the founding authority (e.g., a member of the Council of Ministers, or *voivod* - the head of province, as well as the Minister of Finance, acting on behalf of the State Treasury); and,
- For partnerships or companies being liquidated - the creditors.

12 Regulation by the President of the Republic of Poland of October 24, 1934 on Bankruptcy Law, amended Dziennik Ustaw, 1990, No. 14, item 81; 1991, No. 118; 1992, No. 1, 1995, No. 85, 1996, No. 6, et seq.

13 Ordinance of President of the Republic of Poland, October 24, 1934.

Under current law, a debtor must file for bankruptcy within fourteen (14) days of meeting either of the two conditions for insolvency. Where the debtor fails to file within the specified period, the court has the right to refuse any future reorganization plans and to impose criminal and civil penalties. Where the debtor petitions for reorganization, the fourteen day filing requirement does not apply.

The institutional framework established by the bankruptcy law is organized around specialized courts and the utilization of trustees (*syndyk*) similar to the practices of the North American and European systems. Where the court finds sufficient grounds for bankruptcy, an order will issue that identifies:

1. The name and legal residence of the debtor;
2. Notice to creditors with instruction to register claims within a specified period;
3. The bankruptcy judge or judge commissar appointed to the case;
4. The bankruptcy trustee or lawyer appointed; and,
5. The factual and legal grounds upon the order is based.

Public notice and service on interested parties is required.

The principal deficiencies of the existing Legal Framework were identified by End Users' as follows:

Order of priority of claims on debtors' assets. Under the current scheme, secured creditors effectively stand seventh in line in terms of priority. The practical effect is that there is very frequently nothing left to recover against the secured creditor's claims are addressed.

After asserted claims by government authorities. End Users' also reported that under the current law there is little incentive on the part of government authorities (e.g., tax authorities) to give notice of, or timely assert, outstanding claims against debtors. The net result is that a creditors have pursued claims against insolvent debtors assets only to have their claims superceded after bankruptcy proceedings are well underway.

Timely notice of insolvency. Creditors reported that insolvent debtors often do not comply with the fourteen day notice requirement contained in the law. It was unclear whether this can be attributed to any weakness in the existing Framework Law, or in the willingness of courts to enforce these requirements.

Implementing Institutions

Poland's Implementing Institutions for Bankruptcy are specialized commercial courts at the *voivodship* level. Since 1992, the bankruptcy courts have been processing approximately 2,400-2,700 cases each year. Although official statistics show that bankruptcy cases are pending an average of 14.5 months in 1997, the actual average pendency is reported to be between 18 and 36 months, depending on the size, complexity, and number of claims made against the bankrupt.

BANKRUPTCY CASES		
Number of cases filed		
	1996	1997
Total in Poland	2,710	2,368
In Warsaw only	611	378

Source: Statistical Data from the Ministry of Justice, Warsaw, 1998, p. 631

BANKRUPTCY CASES		
Case duration (in months)		
	1996	1997
Total in Poland	12.3	14.5
In Warsaw only	4.3	6.2

Source: Statistical Data from the Ministry of Justice, Warsaw, 1998, p. 631

Poland's bankruptcy judges received training on various aspects of bankruptcy law, practice, and case administration under USAID-funded and EU Phare technical assistance initiatives. Like other non-specialized judges in the commercial courts of general jurisdiction, bankruptcy courts are plagued by resource constraints, inadequate staffing, unevenness in the quality of court personnel, and inefficient court management systems. Despite this, from a cross-regional comparative standpoint, Poland's bankruptcy courts do appear to be fulfilling a significant portion of their organizational mandate. This conclusion is reflected in part by the Tier II diagnostic result of 80% for this Dimension.

From an operational standpoint, the courts are established and operating regularly [90%];¹⁴ their mandate is clearly defined in terms of their responsibilities in implementing the Framework Law [90%]; and a general consensus seems to exist within government about the Implementing Institution's basic functions and role [80%]. Similarly, within the bankruptcy courts themselves, and the wider legal community, there seems to be broad agreement concerning the basic role and functions of the bankruptcy courts [80%].

In terms of institutional mandate and authority, we found that the Ministry of Justice clearly has the authority to administer (if not adequately fund) the bankruptcy courts; that bankruptcy courts had received donor-funded technical or financial assistance in the previous year [100%]; and, that judicial training programs have been conducted [80%].

Poland's bankruptcy courts were found to be generally accessible to End-Users, and copies of relevant laws and regulations were relatively easy to obtain [80%]. Bankruptcy courts were found to collect data or information relevant to their operations, however these data were only available through the Ministry of Justice, and somewhat more difficult to obtain [80%]. Bankruptcy courts were viewed by End-Users interviewed during the assessment as doing a relatively good job of disseminating information (through the Ministry of Justice) on pertinent legal or operational developments.

¹⁴ Tier III results are included in brackets where relevant.

Supporting Institutions

Poland's Tier II result for Bankruptcy's Supporting Institutions Dimension is 76%. In terms of specific Tier III results, court-based enforcement mechanisms were judged reasonably accessible by End-Users [80%]. The court's enforcement agents (e.g., bailiff) authority to execute judgments against debtor estate property is perceived by End-Users as somewhat adequate [70%], however problems concerning priority of claims, obscure this metric. The supply of notaries is viewed as sufficient to meet end user demand [80%] and notarial fees are not viewed as an impediment to registering security interests [70%]. The bankruptcy fee structure does not encourage misuse of bankruptcy system for ordinary debt collection [70%] and recourse to extra-legal enforcement mechanisms (e.g., organized crime) are not generally utilized [90%]. Finally, we found that businesses (e.g., trustees, services in bankruptcy recordation and central filing, collateral instrument document filing, document retrieval, lien tracking, investigative services, law firms, consulting firms) are facilitating use of bankruptcy law system [80%].

"Market" for Bankruptcy Reform

In comparative terms, the Market for Bankruptcy reform in Poland is strong, and many of the basic macro-level reforms needed for the system function have been implemented. Large scale privatization has been carried out; a stable macroeconomic policy has been implemented; Poland has a freely convertible currency; successive Governments have adhered to a broad policy of promoting private sector development; measures have been taken to limit corruption; and EU accession remains a cornerstone objective of Poland's foreign policy agenda. In short, the general policy and economic framework for modern commercial activity are in place.

On the "supply" side of the market equation, we found that an annual legislative reform agenda was published, and that additional reforms in this area were included on it. Based on interviews with the business community, responsible government bodies, and other stakeholders, we found that they are generally afforded notice of draft laws before they are submitted to legislature for a vote. In this respect, business and professional associations, banks, consumers groups, small business advocacy groups, and academics were found to be providing input to policymakers on how Poland's bankruptcy system can be improved. In this respect, we found that in addition to notice, stakeholders were generally given a meaningful opportunity to provide comment on pending legislative changes. We did find that the lower the rulemaking authority resided, the less likely it was that those directly affected would be provided notice and an opportunity to comment. Hence, in our view, while the supply of policies for bankruptcy is quite good on a macro-level, there is clearly a good deal of work that could be done to strengthen the process by which implementing regulations are developed, interpreted and enforced. We found that copies of the Bankruptcy Law were readily available in academic bookstores in Warsaw. Copies of regulations, instructions, application forms and similar subsidiary instruments were harder to come by, but were available through the courts. However, our sample size was not large enough to provide any reliable basis for judging how widely such information was made available, particularly outside Warsaw.

As discussed in the preceding sections, we found that the order of priority established in the Framework Law creates a significant disincentive for End-Users to actually use the bankruptcy system. In this respect, the End-Users we interviewed generally did not feel that the services

provided by the state in this regard were adequate to their needs. Delays of up to thirty-two months, and the lack of certainty about the possibility for recovery, were most often cited as areas that needed reform. Additionally, the lack of clearly defined rules and procedures governing trustees was cited as a weakness in the current system. Additionally, it was reported that the threat of bankruptcy proceedings was frequently used by creditors as a means of collecting overdue obligations. The threat of liquidation is therefore being used by creditors as a means for forcing workouts.

From the perspective of End-User demand, we found that business managers, lawyers, law professors, judges, and others we interviewed during the in-country diagnostic generally felt that they had a meaningful role to play in shaping policy reform in the subject matter area. We found that End-Users are participating in the formulation of policy relating to bankruptcy, by providing direct, substantive input (e.g., draft laws, comments on regulations, suggested amendments, etc.). In this respect, End-Users actively lobby the Government for policy or institutional reforms when necessary. We also found that End-Users are represented by various non-governmental membership organizations, in particular the National Chamber of Commerce, the Supreme Bar Council, and others.

The principal complaint lodged against the bankruptcy courts by End-Users was the delay in obtaining an adjudication of claims. In particular, the role, qualifications, and financial incentives of the trustee under the current systems were identified as sore spots. The qualifications of bankruptcy judges were not called into question during our interviews, however, the general administration of courts was frequently cited as a area of End-User dissatisfaction. Supporting institutions for bankruptcy, particularly private law firms, accountancy firms, notaries, and bailiffs, were generally viewed by End-Users as satisfactory in meeting their needs with regard to the bankruptcy system.

Legal environment for Bankruptcy was viewed by End-Users as reasonably stable, and predictable, with less than one major legislative revision per year on average. We did not receive any reports of corruption or favoritism in the administration of the bankruptcy system, however it did appear that judges are generally reluctant to use the full extent of their coercive powers in implementing the Framework Law.

Our overall indicator result of 78% for this dimension of Bankruptcy clearly indicates that the basic Market mechanisms are in place and functioning. We expect that over time these patterns of behavior will strengthen, and that improvement in the areas of subsidiary regulatory instruments would be an area where progress would be both welcome and useful.

C. Collateral

1. Overview

Collateral law is intended to facilitate commerce by standardizing transactions and fostering predictability and simplicity in them. More specifically, secured transactions are intended to structure the dealings of debtor and creditor so as to preserve the rights of some creditors against the rights of others. Standardization is intended to assure familiarity and thus encourage commercial transactions.

The ability to use security interests in movable property to support the extension of credit is essential for a market economy. Commerce and industry need inexpensive capital to thrive, and lending that is secured by a pledge represents one of the most economical means of procuring financing because it significantly *reduces* the creditor's risk. Secured lending goes beyond the borrower's contractual agreement to repay since it provides a second source of payment. In fact, a legal system that assures the lender that it can maintain a secured interest is just as essential as a system of contract law.

2. Diagnostic Findings

Legal Framework

USAID support of collateral law development in Poland has been both extensive and effective. This activity, initiated in September 1992, concentrated on developing a domestic consensus in support of a draft law on Collateral. This effort was led by the Commission for Reform of the Civil Code, and supported by the Ministry of Justice, the National Bank of Poland and the Union of Polish Banks. A distinguishing feature of this effort was the extent to which Polish (as opposed to expatriate) experts were utilized in defining the scope and direction of the reform effort.

In Poland, as in other countries, there are two general types of rights used to secure credit provided to a debtor: real and personal security rights. Personal security rights are attached to the debtor as an individual and entitle the creditor to enforce his rights against the entire assets of the debtor. The disposal or loss of assets by the debtor results in impossibility of turning claims against other person. The most commonly used are personal guaranties (*poreczenie*), bank guaranties (*gwarancja bankowa*) and promissory notes.

The Polish Civil Code of 1964 provides for a third party to guarantee personally the performance of a debtor's obligation towards a creditor. In such case the guarantor enters into a written agreement with the creditor in which the guarantor obliges himself to perform the obligation of the debtor in the event that the debtor fails to do so. A guarantor may likewise agree to guarantee a future debt, in which case the agreement must specify the amount of the guarantee. Where a guarantee for a future debt is given for an indefinite period of time, it may be revoked at any time before the debt comes into existence. The scope of the obligation of a guarantor is determined by the scope of the obligation of the debtor, though a debtor may not increase the

scope of a guarantor's obligation through a legal transaction between the debtor and the creditor. Unless otherwise stipulated, a guarantor and a debtor are jointly and severally liable towards the creditor. Although a creditor must notify the guarantor in the event that the debtor fails to perform his obligation, the creditor does not have to demand payment by the debtor before demanding payment by the guarantor. If the guarantor satisfies the creditor, the guarantor then acquires the claim of the creditor against the debtor up to the amount paid.

Bank guarantees are not regulated by the Civil Code. However, bank guarantees have been defined in the Banking Law (currently - of July 21, 1997) and in the ordinance of the President of the National Bank of Poland. According to the law, a bank may undertake to perform the obligation in the event that the debtor fails to perform such obligation towards the creditor. The parties must define the duration of the guarantee and any restrictions concerning the transfer of the guarantor's obligation. The agreement establishing a bank guarantee must be in writing. A bank's obligation under a bank guarantee may only be transferred together with a transfer of the debtor's obligation being secured by the bank guarantee. The feature that distinguishes a bank guarantee from a civil law guarantee is that a bank's liability is independent from the obligation of the debtor. It is therefore not possible for the bank to raise any defense to the claim which the debtor might have.

Promissory notes may be issued by a debtor, a third person (guarantor), or both. The promissory notes used most commonly for the purpose of securing a credit are "in blanco" and bear only the signature of the debtor or guarantor. Along with a promissory note, the debtor or guarantor usually signs a so-called 'promissory note declaration' in which the promisor authorizes the creditor to fill in the amount corresponding to the amount of outstanding principal and interest. This procedure is quicker and simpler than ordinary court proceedings.

Real security rights are attached to certain objects, and the liability connected with the right is limited to the value of the object in question. Real security rights are only effective against the owner of the objects, and upon transfer of the ownership of the assets any real security rights are in principle transferred as well. The real security rights available under Polish law include real estate mortgage and various types of pledge.

Both pledges and mortgage may be employed to secure the debts of the owner of the object to be encumbered or the debts of a third person. Pledge may secure any performance of any obligation, while mortgage and registered pledge may only be established to secure possessory pecuniary obligations. The express differentiation between a pledge as a right that may be established on a movable assets or transferable rights, and a mortgage that may be established on real property is a characteristic of the Polish law. The only transferable right on which a pledge may not be established is a mortgage claim (Art.107-109 of the Act on Land and Mortgage Register and Mortgages).

A real estate mortgage may be established on real property, the right of perpetual usufruct of land (a kind of quasi-ownership, or 99-year lease), certain cooperative rights, as well as on a claim secured by a mortgage (*subintabulat*). The concept of a mortgage in the Polish law derives its roots in the Roman *hypotheca*. It does not transfer the title to the property but creates an encumbrance (real right) effective against any person. Granting a mortgage to one party does

not prevent the title holder from further encumbering the property, or to transfer ownership to a third party, provided this is not done to defraud creditors. Mortgage under Polish law is a legal interest in a particular parcel of real property used to secure payment of a debt. Therefore, in the process of establishing a mortgage there has to exist a principal monetary obligation to which the mortgage accedes. The repayment of the monetary obligation extinguishes the mortgage.

The following three steps are required to create a mortgage under Polish law:

1. Both mortgagor and the mortgagee have to enter into a bilateral contract;
2. The mortgagor has to make a motion for entry of the mortgage in the land register; and,
3. The appropriate court has to enter the mortgage in the land register.

Pursuant to the theory of the so-called “constitutive entry” mortgage is created at the moment of actual making the entry by the court in the respective mortgage book.

Land registers are open to public inquiry. As the rule of public faith of the land register, all the data in the public register are believed to be correct and true. Thus, a good faith purchaser is protected against any claims by a third party. In spite of increasing numbers of transactions in Poland, the process of mortgage creation works well. Most delays are encountered in Warsaw due to a large volume of transactions.

Enforcement (foreclosure) under the real estate mortgage involves three distinct phases and the process is rather lengthy. A mortgagee must first obtain an executory title (*tytuł egzekucyjny*), which is a civil court judgment against the mortgagor. The mortgagee then has to apply for an enforcement title (*tytuł wykonawczy*) which entails the court placing a seal, called an enforcement clause (*klauzula wykonalności*), upon the executory title and the judge signing it. The enforcement title is an official court document signed and sealed by a judge. The execution order is then forwarded to the court’s execution officer, a bailiff (*komornik*) with the instruction to make a final demand for payment and, thereafter, to execute the judgment against it.

If the mortgagor fails to pay the obligation within two weeks, the bailiff will hire a court approved expert to prepare a description and an appraisal of the real estate. Both the description and the appraisal are subject to legal challenge by the mortgagor. If the mortgagor fails in these challenges, the property is offered for sale at the public auction.

Security interest on the personal property (“movables” and rights) are commonly called pledges. Under current Polish law pledges are regulated by the provisions of the Civil Code of 1964, the Law on registered pledges and the registry of pledges of 1996, maritime code of 1962, and other laws. Despite the name, only some of pledges provide for the transfer of possession of collateral: so-called “possessory pledges”, the other form is referred to as a “non-possessory pledge” or “registered pledge” that resembles English legal concepts of fixed and floating charges that do not require actual transfer of the collateral to the creditor. Under Polish law, therefore, proper registration of a security interest is an acceptable substitute for possession.

Polish law regarding possessory pledge is contained in articles 306-335 of the Civil Code. Article 306 states that a pledge is a property right on a movable asset or transferable right which

is security on a given claim. The creditor may vindicate satisfaction of his claim from pledged asset or right irrespective of whose property it has become and with priority over other debtors' personal creditors with the exception of those who by law have a particular priority. The Civil Code describes two types of contractual pledge: the pledge on movable assets (Arts. 306-) and the pledge on rights (Arts. 328-335).

In the Civil Code we also find further distinctions relating to the pledge on movable assets. The provisions contemplate an ordinary pledge, usually called a "possessory pledge" which may be established by an agreement between the creditor and the owner of the asset and transfer of possession of the pledged asset to the creditor or a third party.

A possessory pledge may be established on movable, tangible objects. In order to establish a pledge, a creditor and an owner must enter into an agreement and the encumbered object must be delivered to the creditor or third party. This requirement renders the institution of pledge on movable objects under Polish law impractical for securing business transactions. However, an exception to the rule that the pledged object must be delivered to the creditor or third party is provided by the Civil Code in the case of banks, which are permitted to establish a non-possessory pledge. Transferable rights may also be the object of a pledge. To establish a pledge, an agreement must be concluded in written form and a certified date must be placed thereupon by a notary. The sole exception to the rule that a pledge on movables may be established only where the movables are delivered to the creditor or a third party is in connection with the securing of a bank credit. A bank may establish a lien over a movable property of a debtor without taking physical possession of the movables.

The rights of a creditor in the pledged shares are in general the same as in other objects encumbered by pledge. However, Polish company law is governed by the Commercial Code, which does contain certain modifications. The shares of either a limited liability company (*Spolka z o.o.*), or a joint stock company (*spolka akcyjna*) may be pledged. In the case of limited liability company, restrictions may be contained in the deed of association as to the shareholders' rights to pledge their shares in the company or conditioning any pledge upon the consent of the company. The Commercial Code does not contain provisions regarding the limitation of the right to pledge shares in joint stock companies. Shares in limited liability companies are registered shares which are not incorporated in any kind of document. The establishment of a pledge must be made in written form. The pledges become effective as against the company only from the moment that the company receives notice from the interested party. Joint stock companies may issue both registered and bearer shares. The parties must enter into a written agreement and shares must be handed to the creditor or a third party during the process of establishing a pledge.

The new form of security interest, adopted fairly recently and very promising to the business community in Poland is the registered pledge. The law on the Registered Pledge and the Pledge Registry was enacted in December 1996 and became effective in January 1998.

Collateral under the registered pledge law may include any transferable movable or property right, including property acquired in the future and proceeds from the disposition of the collateral. The exception is seagoing vessels. The law is neither exhaustive nor specific on this

point, so generic descriptions of collateral are possible. With regard to priority, Poland's system is based on a "first in time" order of priority determined by the date and time the secured interest is registered.

The number of changes in the Code of Civil Procedure and the Civil Code strengthen the position on a secured creditor upon a debtor's default. The new law on non-possessory pledges allows parties to a secured transaction to contractually determine the terms upon which recovery will be made against the collateral in the event of default. This is an important departure from the earlier law which required court execution proceedings and did not allow the parties to dispose of this requirement by contract. In case of non-possessory interests in movables, transfer of ownership becomes effective upon a notice to the debtor given after a fourteen-day period expires. In the case of non-possessory pledges on transferable rights and real property mortgages, the transfer becomes effective upon giving notice to the courts administrating the appropriate land or pledge registers.

In cases when the debtor cooperates with the secured party, the enforcement of the pledge or mortgage proceeds without any need for judicial intervention. The secured party, having obtained ownership and possession is entitled to keep the Collateral as the owner or to dispose of it at will. The secured party, having obtained ownership and possession, is entitled to keep the collateral as the owner.

In cases when the debtor is not cooperative and unwilling to turn over possession of the collateral to the creditor, the latter can ask for the assistance of a court execution officer (i.e., bailiff). An enforcement title is prepared by the court execution officer and signed by the judge. An agreement in the form of a notary deed qualifies as an executory title. It serves as a substitute for a civil court judgment against the debtor.

In addition to Civil Code execution procedures, the Polish law contains effective and practical choices for extra-judicial enforcement of a creditor's rights. The parties have some leeway as to how enforcement will occur based on the possibilities stated in the law, while the law specifies the exact procedures. The creditor's options are: 1) acceptance of the collateral, 2) public sale by a notary or a court pursuant to court procedures, and, 3) for banks - "the protection procedure." In the context of a pledged enterprise, satisfaction can be by collection of profits or by lease payments. The creditor may also request that the collateral be attached if the creditor has reason to believe that the debtor will default or damage the collateral.

There is no principle under Polish law which provides for classes of creditors in both the Civil Procedure Code and the Bankruptcy Act. Also, the Tax Code provides that any amounts due to the State Treasury are automatically secured by a statutory lien on all of the movable property and amounts provided in decisions of tax authorities are secured by a statutory mortgage on all of the immovable property of the taxpayer. Such mortgage and pledge are granted priority over those of all other creditors. Article 1025 of the Polish Civil Procedure Code governs the priority in which claims will be satisfied in the event of the execution of a court judgment against a debtor. For example, in the event of the enforcement of a mortgage or pledge, Article 1025 provides that claims are satisfied in the following order:

1. Costs of the executory proceedings;
2. Wages, family maintenance, indemnities;
3. Taxes;
4. Payments due to the State Treasury connected with the perpetual usufruct of parcels of state land and payments due for the use of state buildings;
5. Repayments of bank credits;
6. Secured creditors, if the security was established prior to the commencement of executory proceedings; and,
7. Other payments.

Implementing Institutions

Poland has developed one of the best collateral registration systems in Central and Eastern Europe. The establishment of the collateral registry is considered adequate by the practicing professionals. This success demonstrates that the system is compatible with the Polish legal tradition and the existing Civil Code. Even so, the system has its problems, complexity being one of them. Certainly the implementation arrangements can be improved and simplified.

The Collateral registry in Poland is located in specialized courts, of which there are six throughout the country, and managed by the Ministry of Justice. All six registries are linked electronically with the central registry; entries made in each are reflected in the central registry within one business day. Room for abuse is minimal and no such cases have been recorded so far.

Judges, transferred from other divisions of the courts, supervise all entries. They do not, however, have previous experience and are trained by local trainers.

Registration is not automatic. Instead, the judge in charge has three days to examine the case in closed session. The court may refuse the registration not only if the formal requirements of the application are not met, but also if the court finds that the underlying contract is contrary to the requirements of the law. This arrangement reflects several policy considerations:

1. Company and commercial registers in Poland have been traditionally located in the courts. As in most European jurisdictions, the registration process in Poland is based on the premise that the state has a role in guaranteeing the quality of the data in the registry by verifying it before registration.
2. The Ministry of Justice views the registries as a potential source of income. All registration fees are transferred to the Ministry and it is expected that in the future the fees will increase beyond the operation cost of the registry.
3. At the time the registry was established, it was assumed that most practicing attorneys would not be familiar with the system and will not be prepared to properly handle the registration documents. The system was, therefore, designed to rely on the ability of the judges in charge to correct all possible errors.

The current organization of the Collateral registry presents two significant problem: first, judges are involved in non-core activities; and, second, over - reliance on the entries in the registry.

Judges in non-core activities. The judiciary by definition is an institution designed to resolve arguments and dispense justice, not to review documents in the absence of a conflict. In the case of the commercial registry the judges are asked to review documents and to decide whether they are correct or not. At this point, there is no argument between the parties, who have already agreed to enter a particular transaction and to submit the documents for registration. Yet an argument may result between the parties and the judge if the registration court decides not to register the transaction. Such decisions may be appealed in the district court of the same level. To date, there is no body of judicial rulings in registration cases that can provide guidance to courts in implementing and enforcing the Framework Law's requirements.. In the opinion of practicing attorneys, those professionals involved in the process (bank officers, credit users and lawyers) have adjusted their practices to the requirements of the registration courts, rather than trying to resolve the disputes in the appeal process, which is costly and time consuming. As a result, judges have the power, though not the right, to amend the requirements of the law governing registration.

Over-reliance on the entries in the registry. The Collateral registry is fairly similar in functions and organization to the notarial registries, which is typical for most of the European jurisdictions. The data in the Collateral registry are deemed absolutely reliable and are covered by the revocable presumption of correctness. The registration documents are not merely a confirmation of a statement of the parties, but rather an absolute proof of the existence of certain facts. Because of the implied state guarantee for the correctness of the facts, the system of Collateral registration requires rigid examination of all facts stated by the parties. A diligent and prudent lender would have been expected to verify all the facts prior to providing a loan, and this is the situation in most cases in Poland. Yet the same re-examination of the facts, based on the same set of documents and statements, is carried one more time by the court of Collateral registration. This makes the process slower, more costly and less efficient. Ultimately, in case of defaults, it does not provide better protection for the parties.

In any case, the establishment of an operational Collateral registration system is a major achievement and an excellent example of the potential adaptability of common law concepts to the Continental legal system, especially when the local traditions and experience are taken into account.

Supporting Institutions

After the beginning of the political and economic liberalization that began in the late 1980s, the banking sector in Poland changed dramatically. Not only was the state monopoly over banks terminated, but also banks began offering a wide range of new services that had not previously been available or were very limited in the socialized economy. As a result, banks became exposed to new risks. At the same time, some of the privileges granted to banks in the former centralized economy were removed. It was not possible to maintain them for the state banks only yet the government considered the regulations to be too favorable for the banks and could not extend them to the private sector as well.

The new situation in the Market demanded that the banks form an organization protecting their interests. The banks needed a forum for exchange of information and experience. In 1990 the Union of Polish Banks was formed in accordance with the regulations of the law on Chambers of

Commerce.¹⁵ The Union plays an important role as a Supporting Institution in the areas of Contract law, particularly in Collateral transactions. The Union provides training for loan officers and exchange of information between members on related issues, including increased credit risks. It promotes the funding opportunities existing in the banking sector and is active in the development of banking infrastructure and standardized bank products and services. This helps reduce the transaction costs and makes loans more affordable for the business community. The Union was very actively involved in the preparation of the new Collateral legislation¹⁶ and provides experts in related cases before the courts. It has an important role in conciliatory procedures involving banks and may assist the courts when necessary in case of bank insolvency (no such cases have been recorded so far). The work of the Union is central in the effort to provide better access to the public to affordable credit, while increasing the guarantees provided to the banks through a well operating Collateral registration system.

The favorable investment climate and the stable macroeconomic conditions in Poland prompted the establishment of other commercial institutions with important support role. Poland has an active exchange for commercial paper, which is a clearinghouse where bonds, bills of lading and other negotiable documents can be discounted to specialized brokers.

The Union of Banks was instrumental in the establishment of the Bureau for Credit Information, a commercial agency affiliated with the Central European Center for Rating and Analysis, which is involved in the preparation of credit ratings and provides critical information on creditworthiness of potential borrowers. Such services were non – existing in centrally planned economies and their availability is vital for the core activities of the commercial banks.

Unlike most of the reforming economies Poland developed also institutions which serve to protect bank consumers. This increases the confidence of the borrowers and credibility of the banking sector. At the end this gives better business opportunities to the banks and better access to services to the clients.¹⁷

After almost ten years of economic reforms Poland has a full range of developed support institutions, including self-governing non-profit entities and commercial organizations providing services to the banking sector.

"Market" for Collateral Law Reform

The Market for Collateral is perhaps one of the most interesting of the seven subject matter areas examined in this study. In subject matter areas like Bankruptcy and International Trade, there are very often clearly identifiable "winners" and "losers" who, depending upon their interests, line up either for or against change in the status quo. For Collateral, this does not seem to be the case. Lenders and borrowers both benefit when a quick, cost-effective, and reliable means of securing debt is available. The regulatory burden, in terms of the cost of establishing a registry system and overseeing its use is, in comparative terms, relatively insignificant when compared to the cost of administering a country's trade regime. Finally, an effective system of securing debt against a variety of assets also liberates capital in the form of domestic savings. This effectively

¹⁵ Law on the Chambers of Commerce, dated May 30, 1989

¹⁶ Law on Registered Collateral and Collateral Registries, dated December 19, 1996

¹⁷ Please see the discussion in the Contracts section.

expands the amount of capital available, and implies a potential welfare gain to the economy as a whole. In such "win - win" scenarios, one would expect that reform would be easily achievable.

Supply - A specialized administrative body, the Ministry of Justice's Committee on De-bureaucratization has been established to review existing or proposed laws and regulations with the aim of reducing the regulatory burden on End-Users [80%]. Legal and regulatory environment for subject matter area is perceived by End-Users as being somewhat stable, largely because the legal and institutional regime for Collateral is new [60%]. According to those interviewed, there is a perception that conflicting laws and regulations do reduce End-Users' ability to use the Collateral system with confidence [50%].

Those within the business community that were interviewed during the in-country diagnostic generally felt that the new Collateral system was adequate to meet their needs [90%]. USAID- and Norwegian-funded technical support played a critical role in helping Poland shape its Framework Law and establish the registry system. It is not clear to what extent, therefore, that this reform can be seen as being driven by wholly "endogenous" demand, or a combination of "exogenous" (i.e., donor) and endogenous demand. In any event, the technical assistance that was provided by USAID was generally seen by those interviewed as being highly relevant and useful. In this regard, a great deal of emphasis was placed on identifying and including key stakeholders in the development process from the earliest stages [70%].

Demand - End-User participation in the design and implementation of the Collateral reform agenda appears to have been a key both to its ultimate success, and the general level of support the reform seems to enjoy from the business community [80%]. Satisfaction with the current legal and institutional regime was high within the group interviewed during the diagnostic assessment [80%]. There seemed to be no major issues concerning the stability, predictability, or transparency of the Collateral system [70% - 80%] and there seems to be a consensus among those interviewed that the system put in place was responsive to End-User needs [90%].

Poland's "Market" for Collateral is still forming. However, it is expected that within a period of a few years, the practice of securing debt against moveable property will be increasingly integrated into Poland's commercial life. The development of this reform seems to have been driven as much by endogenous as exogenous demand. Nevertheless, the importance of donor assistance in this case should not be underestimated. An overall indicator result of 75% for this Dimension suggests strong fundamentals, with room for further development as the practice of securing debt against moveable property becomes more widely understood and accepted as a routine commercial practice in Poland.

D. Company

1. Overview

Company law plays a key role in market economies as it establishes guidelines for the internal organization of private companies and for corporate governance. Along with securities legislation, company law tries to protect outside investors and the public by specifying minimum requirements for capital and for the publication of information about the company. It also aims to encourage entrepreneurship by setting limits on the liability of investors. In this sense, it is the bedrock of the commercial system.

It is well established that for-profit enterprise development (e.g., partnerships, corporations, sole proprietorships, etc.) cannot flourish without active governance mechanisms that help assure stability, predictability, and transparency in the rules that govern how firms are created and operate in the market. If for example, the rights of shareholders are not defined, or enforced, can a market-based privatization on a national scale succeed? Experience in the region with various experiments in privatization is mixed, and a debate continues on what worked and what did not. In one sense, this is a classic "chicken or the egg" argument, where the need for sound governance mechanisms arises (in theory) after privatization, yet privatization itself requires a mechanism through which to operate. Did the existence, or non-existence, of sound corporate governance mechanisms in some countries help, or hinder, the transformation to the market?

2. Diagnostic Findings

Legal Framework

Company formation in Poland is regulated by the Commercial Code¹⁸, which recognizes several company forms, common to the Continental legal tradition: the general partnership, the limited partnership, the Limited Liability Company and the Joint – Stock company.

General Partnership - The general partnership in Poland is called “registered partnership” and is defined as partnership, operating for profit in the joint name of the partners and which does not constitute any other form of a commercial company. It has several important features, which are designed to identify this kind of entity as a commercial operation. It has to be registered in the Commercial Register. The partnership deed needs to be made in writing. Alterations of the partnership deed require the agreement of all partners, independently of their share in the venture. Most importantly, the provisions of the general law on obligations do not apply to this partnership. The partnership is treated for all practical purposes as an entity separated and distinct from the partners, it can acquire rights and assume obligations, may sue and be sued. The property, brought in by the partners, as well as the property acquired during the existence of

¹⁸ The most precise reference is to the “provisions of the former Commercial Code, as maintained in force by the introductory act to the Civil Code “ The Commercial Code in Poland was repealed in 1964, and only parts of the provisions relevant to company formation remained in force. The legislator considered the integrity of the Code compromised and opted for a definition reflecting this development.

the entity, constitutes the estate of the partnership. There is no minimal capital requirement for the partnership. All partners are liable to the creditors of the partnership with their entire property, jointly and severally.

The general partnership is designed as a business entity with close relations between the partners, and with the possible minimum of formal and predetermined legal requirements as to the way the partnership is managed. While it is a flexible and simple form for small enterprises, the unlimited liability of all partners makes it somewhat inconvenient for larger undertakings.

Limited Partnership - The limited partnership is defined as a commercial entity (operated for profit), under a joint business name, where at least one partner holds unlimited liability for the operations of the business, and at least one partner has limited liability (limited to the initial contribution made by this partner and any subsequent increases, which may be agreed between the partners). The amount of such liability is expressed in cash and reflected in the registration deed for the partnership. Unless specific regulations exist for the limited partnership, all regulations for the registered (general) partnership are applicable.

The limited partners have no right or obligation to manage the affairs of the partnership, unless otherwise provided by the partnership deed, but their consent is required for all acts, exceeding the scope of ordinary activities of the business. This business form is rarely used in Poland.

Limited Liability Company - The Limited Liability Company is commercial enterprise (formed for economic purposes – to derive profits), by one or more persons, unless otherwise provided by the law and having legal personality. It resembles closely the German GmbH, the French S.A.R.L. and is roughly the equivalent of the Anglo – American closely held corporation or private company. The sole shareholder in a limited liability company cannot be another limited liability company consisting of one shareholder. The capital of the company is divided into shares of equal or different values. If a shareholder (or partner) has more than one share, all shares should be equal in value and indivisible. The minimal capital requirement for limited liability partnership is PLZ4,000 (about \$1,800 USD).

The shareholders (partners) are not liable for the obligations of the company and have no obligation to participate in the management. The capital of the company may be formed by cash and non-cash contributions. Cash contributions must be made prior to the registration. Non-cash contributions must be committed and a declaration made by the management of the company that such contributions will be transferred to the company upon registration. Prior to the registration all persons, who acted on behalf of the company, bear joint and several liability.

All shares (parts) of the capital are registered and cannot be represented by negotiable documents. While all stated contributions must be made at the time of incorporation, the deeds of the company may require the shareholders to make additional contributions to the capital, in proportion to their shares.

The shares in limited liability companies are transferable, but the transfer or pledge over the share of the company may be conditional on the agreement of the company. Unlike in some other jurisdictions, in Poland such permission is given by the management board of the

company. Even if the Board of the company refuses the permission, the court of registration may permit the transfer for important reasons. In such situation the board of the company may present a new buyer. If the proposed price, or the price, approved by the court (absent an agreement between the shareholders), is not paid within the time limit fixed by the court, the shareholder is free to dispose with the share.¹⁹

While the management provisions, related to the Limited Liability Company are more relaxed in comparison to those for the Joint Stock Company (JSC), there are several important legal requirements:

- Tenure of office for the members of the board expires at the date of the general meeting of the shareholders held to approve the annual report and balance of the company;
- Limitations upon the rights of members of the board to represent the company have no legal effect with respect to third parties;
- All correspondence of the company shall contain the name, address, registration number and court of registration of the company, the names of the board of management and the initial capital of the company; and,
- Members of the board may not be involved in competing business, unless specifically authorized by the company to do so.

Unlike other jurisdictions, the number of shareholders/partners in the Limited Liability Company in Poland is not restricted by the law, but special, more stringent provisions are applicable for companies with more than 50 shareholders or with capital larger than PLZ25,000 (approximately \$7,032 USD).

The law provides considerable autonomy for the shareholders/partners to establish the rules for company management, but in the same time has a comprehensive set of alternative provisions, applicable in cases in which the Articles of Incorporation have not provided solutions. The Limited Liability company is by far the most popular company form in Poland.

Joint Stock Company - The Joint stock company (similar to the German *Aktiengesellschaft* or the French *societe anonyme* and to the Anglo-American public corporation) is a company, the capital of which is divided into shares of equal value. In some cases (utility companies, other companies of national importance, banking enterprises), the Minister of Industry and Trade, or the Minister of Finance must approve the Articles of Association of the company. The JSC company is designed as a large corporate form, geared to attract substantive amount of capital from people with little or no interest in the day-to-day management of the company. Therefore it has some substantial differences from the Limited Liability Company. The capital of the JSC may be raised through public offer. It may consist of registered and bearer shares, and of

¹⁹ The restrictions on transfers of shares reflect the idea that the partners/ shareholders of the Limited Liability Company are selected based not only on the capital contribution, but also on some personal qualities. Thus, the Limited Liability Company is often referred as “company of persons” as opposed to the “company of capital” – the JSC.

different classes of shares. Registered shares may be exchanged for bearer's shares without restrictions (unless the law or the Articles of the company provide otherwise). The transfer of registered shares may be subject to permission by the company, but if permission is not granted, the company must name a transferee. The Articles of association shall provide the terms of fixing and paying the price and the time limits for that. In the absence of such provisions registered shares may be transferred without restrictions. Bearer's shares can be transferred without restrictions and may be issued only upon full payment. Registered shares may be issued prior to the making of full payment, the shareholder being liable for the rest to the company or to the creditors in case of liquidation. All shares, issued in exchange for non-cash contributions are registered until the general meeting of the shareholders approves the financial report for the second year of operation.

The management provisions for JSCs are much more detailed and reflect the fact that most of the shareholders are not able and willing to participate in the management. Besides, the large number of shareholders makes it difficult to secure their meaningful participation except in the election of the officers of the company and the approval of most general policy issues and financial statements.

The Polish management system permits the establishment of one- or two-tier management structures. Under the first, the company has a management board, which is responsible for the day-to-day management of the company affairs, and an auditing board, responsible for the auditing of the financial situation of the company. Alternatively, instead of an auditing board, the company may have a supervisory board, with broader authority to supervise all activities of the enterprise, including the right to suspend members of the management board. Larger companies with capital over PLZ 500,000 (\$140,647 USD) must have a supervisory board, but may also have an accounting board.

The Polish company law provides adequate protection for minorities shareholders and mandates their representation in the management. It allows cumulative voting and partial renewal of the accounting board or the supervisory board at different times, as it may be provided by the Articles of association. The law regulates the transformation of companies from Limited Liability to Joint – stock and vice versa, and provides effective protection of the rights of third parties. The basic principle in such transformations is that third parties should not be affected adversely by it.

The Polish JSC is adequately designed as a major enterprise, the shares of which are traded at a capital Market and which serves as investment vehicle for large number of shareholders.

Implementing Institutions

Polish business entities are registered by the relevant district (*voivodship*) court. The registration procedure includes review of the Articles of association or other documents, establishing the company or the partnership, in a close session of the court.

The formation and registration of the two most popular business forms - the LLC and JSC - are accomplished as follows:

1. Execution of the Deed of Formation and the Charter of the company (JSC only). Those documents are roughly the equivalents of the Articles of Association and serve the same purpose – to establish the future entity, to specify the rights and obligations of the shareholders and the way in which the company will operate. They must be executed as notarial deeds. The notarial fees and stamp duties are in proportion to the proposed capital of the company.
2. Company registration in the court. The registration takes place in the Economic Court in the place of formation of the company. The company acquires legal personality upon being entered into the commercial register. Joint – stock companies must raise their capital prior to the registration and in some cases obtain the relevant permissions from the Securities Commission (when raising the capital through initial public offering).
3. Publication of the company registration in the Court and Economic Monitor (*Monitor Sadowy i Gospodarczy*).
4. Assigning of the statistical number for the company and registration of the company with the social security establishment and the tax authorities.

In some cases licenses may be required, if the company is involved in special activities for which permits or concessions are required. The licenses are given on non-discriminatory basis and a list of the areas for which they are needed is available.

Registration cost consists of notary fees and stamp duties. For the two company forms it is usually around \$800, but may be as high as \$2,500, if the company is being registered with large capital.²⁰ The costs are high by U.S. standards. All notary fees are subject to 22% VAT. Registration of partnerships is also subject to notary fees and stamp duties, but those are not related to the amount of capital contributed to the partnerships.

The chief deficiency found in this Dimension was an overly bureaucratic and formalistic approach to regulating the corporate form. Generally speaking, the registration of a company is a relatively simple matter, however, several practicing lawyers interviewed noted that interpretations of what formalities are required can vary significantly from one court to another. A corporate charter, for example, can be rejected on highly technical grounds leading to delays of up to several months. In addition, relatively minor changes in ownership or management structure required judicial intervention. From an efficiency standpoint, this was viewed as a largely unnecessary but inevitable "cost" of doing business.

The basic administrative efficiency of Poland's commercial courts is also an issue. To a large extent, as discussed elsewhere in this study, Poland's administrative management systems - especially in the courts of first instance - do not have the capacity to meet the demand for their services. Beyond resource allocation issues, there are clearly significant administrative inefficiencies that could be addressed to improve overall operational performance. As with the proposed amendment to raise the threshold for pre-merger review by the OCCP, an easing of formal requirements for detailed judicial scrutiny of any change to the basic corporate form could help ease the administrative burden now placed on these courts. In addition to possible

²⁰ The functions of the court and the notary are absolutely the same in the course of registration of large and small companies.

cost savings, this could also help reduce the amount of judicial discretion in approval of corporate forms, thus increasing predictability and transparency of the process.

Finally, Poland's courts could substantially benefit from the modernization of record keeping and information management capabilities. As in many countries in the region, the vast majority of the administrative processes are paper-driven. The greatest challenge (and greatest drag on efficiency) ahead in this Dimension is the modernization of its information management capabilities. In addition to efficiency gains from the perspective of process, significant gains in terms of predictability and transparency could also be expected.

Supporting Institutions

Supporting Institutions for Company include the community professional service firms that play a key role in supporting and facilitating the implementation of those portions of Poland's Civil Code that comprise the Framework Law for companies. The overall Tier II result of 82% for this Dimension reflects a comparatively strong overall supporting environment for creating and operating the various forms of enterprise recognized under Polish law.

The chief deficiency in this area is the day-to-day bureaucratic burden that is placed on businesses in creating and managing enterprises, regardless of the legal form. Broadly speaking, there were no significant impediments to commercial activity found in this Dimension. The bar is well developed, and there is no apparent shortage of qualified lawyers to select from in seeking assistance in establishing and operating a commercial venture under the Civil Code. Similarly, there is an abundance of notarial firms, some operating as wholly owned subsidiaries of established law firms, that were reported to operate quite efficiently. The professional services sector was reported to be relatively well developed in all of Poland's larger urban centers, and a wide variety of accountancy, management, marketing, public relations, and similar consultancies were in evidence in Warsaw, Krakow, Radom, and elsewhere.

Supporting Institutions is also defined to include ancillary executive and regulatory arms of national, regional, and local arms of government. The chief complaints given by private firms, lawyers, and others interviewed during the diagnostic were over-aggressive interpretation and enforcement of tax, health, environmental, and safety regulations. As elsewhere throughout the region, a hyper-bureaucratic approach to regulating business prevails, with the corresponding incentives for evasion and corruption. As discussed elsewhere in this study, a lack of notice and opportunity to comment on proposed changes to implementing regulations is the norm below the national level. Reports of arbitrary, conflicting, inconsistent, and variable interpretations of regulatory requirements, especially in revenue generating areas, were common across the sample of those interviewed during the assessment. Areas of tax enforcement and customs valuation stood out as the two areas where those interviewed felt they were most commonly subject to selective and "creative" interpretation and enforcement of regulatory requirements.

Market for Company Law Reform

Our findings indicate that Poland's Market for Company is generally strong, as reflected by the Tier II result of 78% for this Dimension. Detailed regulations (beyond the requirements of the Civil Code) concerning the steps required for venture formation were generally available [70%]. Overall, those interviewed during the diagnostic felt that their basic needs were being met within the existing system [90%], and that to the extent relevant, End-Users had a meaningful role to play in shaping basic policy in this subject matter area [70%] as evidenced by their providing direct input to the policymaking process [80%] through subject-matter or professional membership organizations [80%]. This area, the American Chamber of Commerce, the Supreme Bar Council, the Polish Foundation for SME Promotion and Development, Polish Chamber of Commerce, the Federation of Consumers, numerous private companies, lawyers, and others have been active in promoting reforms that affect how businesses are registered and operate in Poland [80%].

As reflected in the preceding sections of this analysis, the legal environment governing companies is perceived by End-Users as stable [70%], predictable [70%], and transparent [70%]. Some of those interviewed felt that certain aspects of the Commercial Code governing LLCs were being misinterpreted, or inconsistently interpreted, thus explaining the relatively low Tier III result of 60% for this indicator. Despite these issues, the overall favorable rating given by End-Users interviewed was 90%.

E. Competition

1. Overview

Fair competition in the provision of goods and services is the cornerstone of the free market. Creating an environment in which such competition could flourish was one of the primary challenges facing the CEE/NIS in their programs of economic and legal reform. In the transition from the former state monopoly system, the passage of anti-monopoly laws became the focus of many legal reform efforts. In fact, foreign donors and client governments have often treated the passage of a new antimonopoly law as the chief benchmark of progress in law reform, and have commonly viewed implementation and institutional development as an afterthought. Detailed understanding of institutional constraints to implementation has been lacking. Our approach to the Competition subject matter area will examine these constraints paying particular attention to Supporting Institutions, enforcement strategy, competition advocacy programs, and the problem of over-regulation.

Supporting institutions are critical to proper development of a regulatory and enforcement regime for competition policy. To cite just a few key linkages, skilled lawyers or consumer groups may be needed to identify and bring to the attention of antimonopoly authorities various antitrust violations; academics on law, business, and economics faculties may be helpful in advancing the state of understanding of local markets and the application of law; trained judges are needed to rule on antimonopoly cases; compulsory process is necessary to obtain business records; business records must be kept in a format consistent with modern accounting methods; and so on. While development of none of these institutions is as critical to implementation as internal development of an antimonopoly agency's capabilities, their evolution is ultimately of great significance to the establishment of the rule of law and must be tracked in some detail to present an accurate picture of the complexity of a functional enforcement regime.

A phased, targeted enforcement strategy ensures that an antimonopoly agency -- especially one lacking in certain resources -- does not attempt to assume more responsibilities than it can handle. It also ensures that it attacks some of the most important, yet politically attainable, problems first, thereby boosting its credibility and gaining public trust. An enforcement portfolio needs to include both critical actions against government restraints on competition as well as a handful of politically more palatable, yet less helpful, cases (e.g., antimonopoly cases, if they fall within the agency's purview). It also needs to include voluntary compliance programs and public education efforts that lay the groundwork for an enforcement program that is perceived as fair, justified, and sensitive to business community views.

A Competition advocacy program is often overlooked in the midst of client government and donor preoccupation with high-profile enforcement actions. Yet this kind of education, publicity, and policy advocacy program is arguably the most critical type of activity that an antimonopoly agency can take in a transition economy. The reason is simple: most of the post-Soviet world suffers from excessive regulation and *government-directed restraints on trade that impede easy market entry* (e.g., *exclusive licensing arrangements*). Perhaps the highest-priority

and most effective steps that an antimonopoly agency can take are to lobby assiduously for the elimination of over-regulation generally and removal of particular restraints. Such activities will not only have a beneficial effect on competition, but will also tend to stem some of the worst corruption problems stemming from exclusive dealing arrangements brokered by ENI governments.

Finally, a trenchant inquiry into competition policy implementation must examine whether antimonopoly authorities are reflexively *exercising regulatory powers -- e.g., industrial policies that tend to affect price and output -- that are precisely contrary to the central objectives of a competition policy agency*. In many transition economies, antimonopoly agencies are often pressured by domestic business fear of foreign competition or by consumer outrage over high prices to engage in result-oriented manipulation of market structures. Often, donors are unaware of such interventions or fail to appreciate its political or cumulative economic impact. It is therefore critical to ascertain the degree to which this is occurring in order to critically assess overall implementation of competition policy.

Antimonopoly laws encompass one part of the legal framework that is an essential element in any free market economy. Competition increases market efficiency by leading to lower prices, reduced inflation, improved technology, a broader array of product offerings, and a reasonable supply of goods. Markets remain open through a combination of open International Trade, and domestic laws and international treaties that limit monopoly behavior. Domestic legislation typically includes laws that assure market information transparency, public regulation of so-called natural monopolies such as electric utilities, the deregulation of prices, and the supervision of markets by government bodies to assure competition.

2. Diagnostic Findings

Legal Framework

Poland's competition law, the Act of February 24, 1990 "*On Counteracting Monopolistic Practices*", as amended, provides the basic legislative framework for competition policy in Poland. Under Europe Agreement (EA) Competition and Approximation of Laws provisions, Poland agreed to bring its competition and consumer protection policies in line with that of the EU by February 1, 1997. This has been accomplished through a series of three principal amendments enacted between 1995 and 1997.²¹ The current law contains definitions of monopolistic practices, abuse of dominant position, and other relevant concepts outlined in Articles 85, 86 and 92 of the Treaty of Rome.. The law also defines the institutional role and powers of the Office of Competition and Consumer Protection (OCCP)²² in some detail, specifying mechanisms for pre-merger control, investigations, administrative hearings, issuance of executive orders, imposition of fines and judicial appeals to a court of special jurisdiction. In the main, Poland's legal framework for competition is judged generally consistent with EU standards, and therefore consistent with international practice.

²¹ *Journal of Laws*, No. 80, Item 405, 12 July 1995; No. 106, Item, 496, Art. 32, 30 August 1996; and, No 49, Item 318, No. 118, Item 754, and No 121, Item 770, 1997.

²² This agency, founded in April 1990, was known as the Anti-Monopoly Office until its name was changed in 1997 and its mandate expanded to include consumer protection.

It is reported that a new law on competition is being developed. A copy of the draft was not available at the time of the diagnostic, and it remains unclear when and if this might ultimately make its way to Parliament. In any event, it is reported that the proposed draft will attempt to remedy several key deficiencies that are perceived in the existing Framework Law. First, Poland has yet to adopt a law addressing state aid (i.e., subsidies) and, in this particular, is clearly lagging behind in the EU accession agenda.²³ It seems that despite a stated commitment to this reform,²⁴ the politically sensitive nature of transfers to industry and agriculture has made passage of this reform particularly difficult to complete.²⁵ Any comprehensive reform of Poland's legal framework for competition policy should seek to fill this important gap.

A second area where a degree of consensus seems to exist concerning a shortcoming of the current legal framework is the definition of conditions that trigger pre-merger review.²⁶ In particular, those interviewed felt that the minimum sales volume trigger of ECU 5m²⁷ forced the OCCP to review far too many transactions of little consequence from an economic standpoint. It has been estimated that by raising this threshold to ECU 25m, and eliminating the 10% shareholding the OCCP's pre-merger control caseload could be reduced by approximately 40%. Third, some of those interviewed felt that the agency should be insulated from direct political pressure by providing a "for cause" limitation on the power of the Prime Minister to remove the OCCP President and Vice Presidents. Second, the threshold criteria triggering mandatory pre-merger review is seen by several of those interviewed as being too low.²⁸ In this case, the OCCP has proposed an increase the minimum sales volume trigger for mandatory pre-merger review from 5m ECU to 25m ECU that would reduce case volume by an estimated 40% of the current workload. Finally, the EU has identified the extension of exclusive rights (block exemptions) in certain key sectors - particularly telecommunications - and the licensing regime for oil, alcohol and tobacco products as being inconsistent with membership requirements and requiring remediation.

²³ See, e.g., *Agenda 2000 - Commission Opinion of Poland's Application for Membership of the European Union*, No. 97/16, p. 50, July 1997. A draft law is now before Parliament, however, it is not expected to be enacted before June 1999.

²⁴ Deputy Prime Minister and Minister of Finance Leszek Balcerowicz acknowledged the government's commitment to this necessary reform in a press conference in mid-1997. While draft laws have been developed and circulated, it still remains unclear when a state aid law might be adopted. The text of his remarks can be found at <http://www.masterpage.com.pl/outlook/balceriw.html>.

²⁵ Despite the lack of the required legislative framework, a state aid monitoring capability was established in the Ministry of Economic Affairs in early 1997. It reportedly has a staff of six and is working to create a database of state aid programs extended by the Ministry of Finance as well as those of other government agencies.

²⁶ See, e.g., Ch. 3, Art. 11.1 et seq., *Act on Counteracting Monopolistic Practices*, as amended.

²⁷ Id. at Art. 11.2.1.

²⁸ In this particular, there seems to be a consensus between private and public sector representatives interviewed during the diagnostic. Generally, speaking, the prevailing view expressed during interviews was that the OCCP was far too involved in reviewing mergers that could have little real impact on competitiveness in the given market.

Implementing Institution(s)

The OCCP is a government agency subordinated to the Council of Ministers. Its president, and vice presidents for Competition and consumer protection²⁹ respectively, serve at the pleasure of the Prime Minister. The OCCP currently employs approximately 187 civil service staff distributed among is headquarters in Warsaw and nine regional branch offices.³⁰ Of these, 131 (70%) hold advanced degrees, including 51 law, 50 economic and 30 in other disciplines. Turnover at the OCCP is high, running as much as 72%. At present, 31% of the staff have worked at OCCP for less than a year; 30% have been employed for two to five years and 36% have been employed more than 5 years.

At the end of 1996, the OCCP's antimonopoly case backlog stood at 125 total, of which 55% were pending in regional offices. During 1997, 197 new cases were submitted to the OCCP for determination (90% of these were handled in the regional offices). A total of 210 cases were closed during the year, resulting in a net decline of about 13% the OCCP's backlog. The high proportion of antimonopoly cases determined in the regional offices reflects the delegation of greater authority in these matters to the regions. In total, approximately 30% of the cases investigated were negative determinations whereas an equal share did lead to OCCP action of one type or another. Of the cases pending in 1997, 16% were determined in less than 2 months, 45% were closed within 6 months, 25% between six to twelve months, and 14% more than one year. In those cases pending longer than 2 months, interested parties were informed of the cause for the delay.³¹

On the merger control side of OCCP's operations, 469 cases were submitted in 1996 and a total of 377 opinions issued. In 1997, the OCCP's case load increased significantly to 1,399 investigations and 1,225 related opinions. By law, all administrative proceedings of the OCCP are governed by relevant provisions of the Polish Code of Civil Procedure.

As with many Polish government agencies, the OCCP suffers from a lack of capacity to administer and enforce the law efficiently and consistently. Inadequate budgetary resources, a lack of modern equipment, and high turnover OCCP among talented staff were identified by the OCCP as the chief constraints to increased operational performance. Views expressed by the business community generally agreed with the OCCP's self-assessment that routine reviews took approximately two to four months to complete, whereas "complicated" cases can take upwards of two years to complete. Based on the interviews conducted in the business community, the OCCP's enforcement activities were not seen as overly aggressive or arbitrary. Instead, there seemed to be general agreement that the OCCP was involved in reviewing too many mergers and

²⁹ The OCCP was given responsibility for consumer protection matters in October 1996. The Consumer Policy Department is comprised of 9 staff and processed approximately 2,300 consumer complaints in 1997. Consumer protection law is beyond the scope of this assessment and will not be addressed in detail.

³⁰ The regional offices were located in university towns so they might take advantage of the expertise resident in their respective faculties of economics. They include: Warsaw, Bygdoszcz, Gdansk, Katowice, Krakow, Lublin, Lodz, Poznan and Wroclaw.

³¹ Including multiple parties, need for additional data and analysis, failure of a party to respond to requests for information, and verification of data supplied by the parties.

transformations and that this simply created a bureaucratic "drag" on bringing these transactions to closure.

In terms of resource allocation, approximately 50% of the OCCP's budget is spent on headquarters operations, with the remainder dedicated to supporting the nine regional offices. The Polish government co-located these regional offices with Poland's major universities in order to tap into the economics faculties in the regions by retaining academics on a part-time basis to assist the agency. This strategy worked well until, predictably, these individuals were lured to more lucrative positions. Despite this, the OCCP has reportedly been able both to attract talented economists by increasing salaries and convincing several to relocate to the main office in Warsaw.

As a whole, the OCCP seems to view itself as a somewhat passive body that reacts to cases brought before it, rather than as a proactive investigative body that determines its own enforcement agenda and priorities.³² In this vein, there appears to be a tendency by OCCP to place an institutional emphasis on vertical restraints of trade, to the possible exclusion of other matters within its jurisdictional mandate. This may be the case because there seems to be a constituency within the business community demanding "fair and just" decisions on vertical conduct (typically involving unequal Contract terms) instead of the longer-term (and more politically difficult) structural cases that (by definition) do not have a well formed constituency demanding change.

This "bias" toward vertical restraints is viewed as natural, and to some extent, appropriate in a transition setting where certain entities may, following privatization, still wield considerable Market power relative to smaller businesses. Nevertheless, there is a corresponding "cost" associated with this bias since the relatively large volume of conduct cases brought by aggrieved businesses can have a disproportionate claim on the agency's already thin resources. In the long-term, therefore, it seems that this bias may lead to a misallocation of resources where more difficult - yet economically significant - matters such as state-sanctioned barriers to entry, horizontal restraints, and mergers by new competitors are sidelined by less economically significant yet more politically palatable vertical restraints cases.

Like many aspects of the Polish government, the OCCP does not have a set of well developed internal administrative and operational guidelines and procedures beyond those afforded by the Civil and Administrative Codes. This lack of clearly defined internal processes contributes to two inefficiencies that are, by several accounts, pandemic in Poland's public sector. First, with a lack of clearly defined procedural and substantive guidelines, operational personnel are forced to operate in a partial vacuum. In an environment that does not generally reward innovation, junior staff must repeatedly seek direction from more senior staff. In addition to the duplication of

³² Although well beyond the scope of this analysis, an interesting question exists concerning the apparent reluctance of state enforcement authorities generally to utilize the coercive powers granted under the law. Intrusive search and seizure, for example, is viewed warily as those exercising these powers may be seen as using the tactics of socialist-era authorities.

effort and operational bottlenecks this creates, the lack of internal procedures and guidelines also makes staff development and training exceptionally difficult and uneven.³³

Another problem associated with a lack of well developed internal procedures and guidelines is a related lack of consistency and transparency in interpreting and enforcing the law. While this is by no means a problem unique to OCCP, it does seem to affect operational performance. Without well defined methodologies for geographic and product Market analyses in place, the individual capabilities and inclinations of investigative staff can lead to unpredictable and inconsistent findings at best, and aggressive rent seeking at worst.

Supporting Institution(s)

As noted above, the Framework Law provides for judicial appeal of the OCCP's administrative determinations. For this purpose, a court of special jurisdiction, the Antimonopoly Court, was established within the 7th Division of the Warsaw *Voivodship*³⁴ Civil Court. This court has one full-time judge and three part-time judges who share responsibility for hearing appeals from OCCP determinations.³⁵ During 1997, fifty-seven OCCP decisions were appealed to the Antimonopoly Court, resulting in forty-nine rulings. In ruling on such appeals, the Antimonopoly Court may remand the case to the OCCP for further proceedings or, under appropriate circumstances, issue a ruling of its own. In such cases, the affected party may appeal an adverse determination to Poland's Supreme Court. Given that the challenges facing the Antimonopoly Court are substantially similar to those faced by the courts of general jurisdiction in Poland, the reader is referred to Section IX F 2 (Contracts, Legal Framework, Implementing Institutions) at page 47, below, for additional discussion of the relevant diagnostic findings for this Dimension of the analysis.

Market for Competition Policy Reform

The Market for Competition policy reform is, in relative terms, one of the stronger areas of this analysis with a Tier II indicator result of 78%. An area of relative weakness was found to be the extent to which the business community was afforded an opportunity to comment on proposed implementing regulations before they are adopted [50%]. Generally speaking, when the opportunity is presented, it appears that End-Users have participated in policy dialog with policymakers [70%]. An example of this is the public-private sector dialog on the need to adjust the pre-merger control mechanism upward, thus freeing the OCCP from the need to review transactions that are unlikely to have a significant impact on the competitive structure of the market.

³³ High turnover among staff only magnifies this problem. The Market selects the "best and brightest" who seek increased wages in the private sector. With every departure, the agency loses not only qualified staff and its training investment, but the institutional memory as well.

³⁴ A *voivodship* is an intermediate unit of political organization similar to a department in France or a county in the United Kingdom. In line with EU *aquis* on administrative organization, Poland recently reduced the number of voivodships from 49 to 17.

³⁵ Judicial personnel at the Antimonopoly Court were described as knowledgeable and dedicated to their work. The relationship between the OCCP and the Court does not appear to be one-sided in favor of the OCCP. In this respect the Court was described as "demanding" as OCCP lawyers are required to cite relevant EU legal authority and precedent to support their positions.

Generally speaking, access to relevant laws and regulations seemed to be good [70%], although there is not sufficient evidence to generalize this beyond the Warsaw area. Overall, we believe that the legal and regulatory environment contains effective incentives that generally induce the intended response by the business community or (end user) [70%], in this case discouraging anti-competitive behavior [70%]. Overall, those interviewed reported that they were generally well served by the OCCP, except to the extent that a degree of over-regulation was evident due to the requirements of the existing Framework Law [90%]. As noted earlier, End-User participation in developing refinements to policy framework for Competition in Poland seemed good [70%]; while NGOs were found to be active in representing membership interests in this dialog [80%].

Overall, those interviewed reported that the overall policy and institutional framework for Competition was generally well-suited to their needs [70%], stable, predictable, and transparent [70%] in its application. Overall, those interviewed from the business community seemed to understand the basic regulatory requirements, and view them as being complete, if somewhat overly developed.

F. Contract

1. Overview

No field of law is more essential to the operation of a free market than the law of contract. A consistent, predictable set of principles binding parties to the terms of their agreements underlies all of commercial law. It is, thus, an obvious and indispensable component of this analysis of commercial law reform in the CEE/NIS.

The countries examined in this assessment are at various degrees of transition from a system of state planning where contract law played only a peripheral role. Normal contract law did not exist in the planned sector of the economy. It did exist, however, in two limited areas including foreign trade relations (conducted by a limited number of state agencies) with non-communist countries, and in non-business agreements between private citizens (e.g., sale of a house with payment in installments). With these and a few other minor exceptions, it was forbidden to make all types of business agreements.

With the end of communism, laws were passed allowing contractual agreements. The starting point in our research is the nature of this basic Contract legislation. Some elementary questions concerning these laws include:

- Whether the Framework Law embodies a market-oriented approach to contractual relations based on freedom of contract;
- Whether economically (or commercially) significant types or classes of contract, such as those for buying and selling land, prohibited or unenforceable;
- Whether imperative rules limiting the freedom of parties to set terms exist (e.g., as in Russia where some critics have claimed that the imperative rules on franchise law are so slanted toward the franchisee that they discourage the use of franchising);
- Whether parties are free to agree on customized terms relating to liquidated damages, arbitration, choice of law, and related matters; and,
- Whether adequate enforcement mechanisms are available in the event of breach (e.g. penalties, money damages, specific performance).

A major area of inquiry will concern contract enforcement. This involves four issues:

- Quality of court personnel;
- Training of court personnel;
- Independence of the courts from government intervention, and,
- Enforcement powers.

Given that the institutional capacity of the commercial courts cuts across most of the areas under study, it will be dealt with separately below.

2. Diagnostic Findings

Legal Framework

Contract law in Poland is governed by the Civil Code of 1964. Despite the fact that it was enacted during the Communist era, the Code is generally viewed as being well suited to contemporary needs. The law itself is modeled on the Poland's earlier Code of Obligations that dates to 1933. The Civil Code primarily follows the French model, yet some characteristics of German law are also said to be discernable. The Book III of 1964 covers general issues such as torts, unjust enrichment, performance of obligations, change of creditor or debtor, set off, renewal release from a debt, etc. We also find a catalogue of specific agreements which are defined and regulated in detail. One of the basic examples is a sale and purchase Contract which involves regulations from Articles 535-602, and to some degree recalls well-known Article 2 of the Uniform Commercial Code.

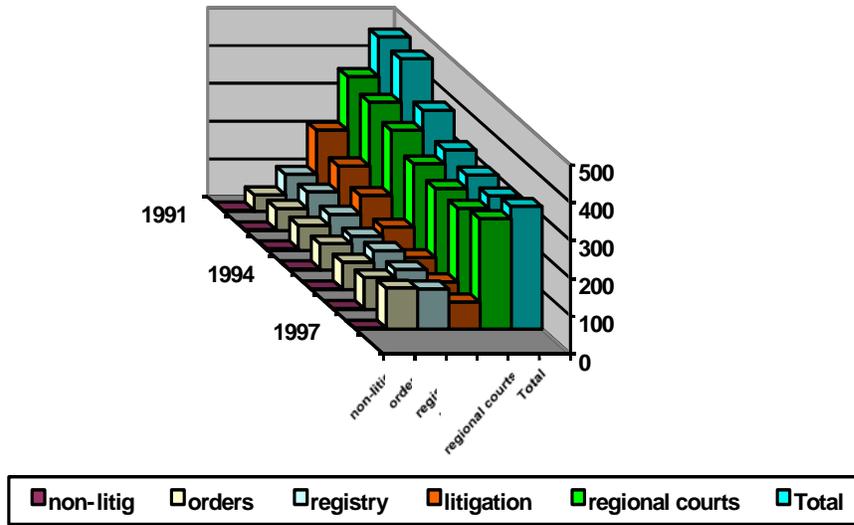
Implementing Institutions

Poland's judicial system has been transformed from an instrument of state control, to what appears to be an independent, co-equal branch of government free from direct political influence and control. While the focus of this analysis is on the operational performance of the commercial courts, there are several relevant aspects of the judiciary that should be highlighted. First among these is the mechanism for judicial appointment and promotion. In Poland, judges are appointed by the President of the Republic, on motion of the National Council for the Judiciary, a self-governing body established in 1989 that acts as a nominating committee. Under this system, the President has the right to reject an appointment, however, he may not appoint a judge without the prior nomination of the Council. In addition, the Council is responsible for judicial promotions. This mandate extends to Supreme Court appointments.

Second, administrative actions taken by the courts are governed by the "Code of Administrative Procedure". Appeals from administrative determinations may be taken in the administrative department of the intermediate and Supreme appellate courts. A third relevant feature is that of internal audit control that is carried out by the Supreme Chamber of Control. This body has responsibility for administrative and financial audit of all government financed activities at the national, regional and local levels. Poland has an Ombudsman appointed by the lower house of Parliament (*Sejm*), with the consent of the Senate, for a four-year term of office. As the name implies, the Ombudsman receives complaints of official mistreat or misconduct from citizens and may refer appropriate matters to the Constitutional Tribunal for review.

As discussed in greater detail below, Poland's commercial courts have a basic lack of

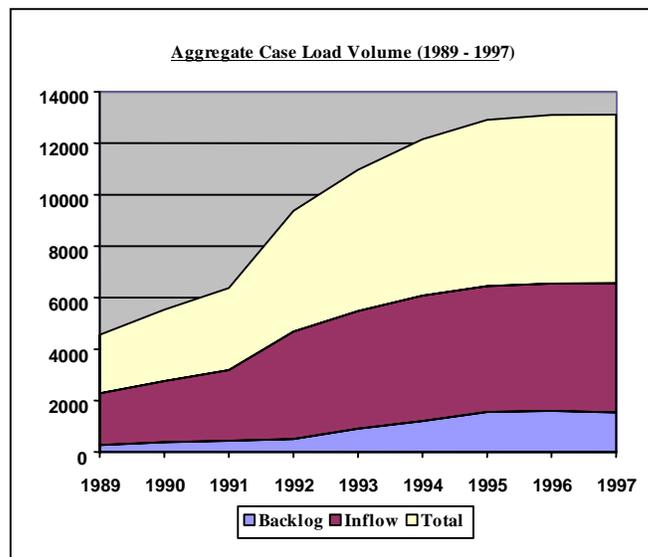
'Commercial' Cases by Type (thousands)



Source: Ministry of Justice Statistical Annual, 1997.

administrative and management capacity that is translating into significant case backlogs. A relatively recent reform, adopted in August 1997, introduced the office of judicial clerk (*referendarz*) to help alleviate the burden of purely administrative duties that have been traditionally performed by judges themselves. While the reform is much needed, there was no evidence in the commercial courts visited during the diagnostic that this reform has been effectively implemented yet.

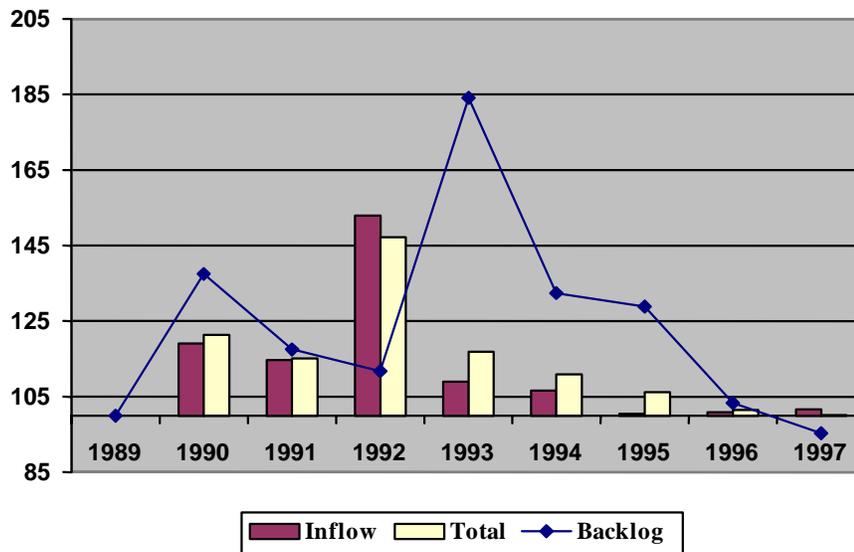
A significant constraint to commercial activity identified during the diagnostic was a lack of



judicial capacity to quickly consider and dispose of routine commercial matters. While the causes for this phenomenon are many and complex, a few trends are worth highlighting here. First, as in many developed and transition countries, the volume of matters brought before the courts is increasing annually. Official Ministry of Justice statistics show that between 1991 and 1995, the total case volume for Poland's ordinary courts more than doubled.

Several factors may have contributed to this general increase in volume. First, Poland's Market reforms sparked a rapid expansion of entrepreneurial and private sector activity.³⁶ The reallocation of ownership rights and liberalization of Markets created both opportunity and uncertainty for new Market entrants. Second, during this period, Poland's economy grew in real terms at an annual average rate of 3.2%, representing an aggregate increase in the volume of commercial activity. Third, the jurisdiction of Polish commercial courts has been expanded and newly introduced substantive legal matters including insurance, leasing, and franchise are now being considered. Simultaneously, the technical and administrative complexity of other matters - particularly real estate transactions - is also increasing. Third, the courts' scope of involvement in otherwise routine commercial matters including company registrations, amendment of corporate statutory articles, recording secured interests and similar matters is relatively high. Fourth, during this period, a number of commercial laws were either enacted or significantly amended. It is also expected that these reforms would create a degree of uncertainty early in the reform process that could lead to an increase in commercial disputes.

Percent Change in Case Volume on Previous Year



In 1997, the courts handled 5,058,000 cases or 44,000 more cases (0.9 %) than during 1996. Civil cases represent the single largest element of the courts' overall case load (55.4%). The remainder of the case load is comprised of domestic, criminal, commercial, and other cases. Of

³⁶ e.g., The massive influx of micro- and small-scale traders following demonopolization of Poland's foreign trade sector.

the commercial matters brought before the courts in 1997, approximately 107,000, or 66.8% were land- and mortgage-related matters. At the appellate level, 631 appeals from *voivodship* commercial courts were taken in 1997, of which 393 were disposed of, leaving a backlog of 248 cases of approximately 39%.

Cases closed during the period exceeded cases docketed by 41,000, thus representing a reduction in backlog for the year by 2.3 % to 1,499,000. Of this backlog, 49.3% consisted of real estate matters (738,000). The figure above illustrates a sharp increase in total backlog between 1992 and 1996. While the national trend seems to show a leveling off both in terms of total case load and backlog as a percentage of the total, this picture is somewhat misleading. According to official statistics, the national average in 1997 for resolution of commercial cases of all types is 4.6 months, the average in Warsaw was 13.2 months, representing an increase of approximately 28% over 1996,³⁷ even though the Warsaw region reported a drop in case volume of approximately 3% for the period.

Whilst official data regarding the length of procedures indicate an average of 5 months for a case to be terminated, the reality suggests that procedures can take several years. As a result of the heavy workload of courts and tribunals and the general lack of infrastructure and technical means, the treatment of cases suffers considerable delays which increase every year to reach a record of 6 years in Warsaw.

Supporting Institutions

Poland maintains a notary system, which follows closely the European legal tradition. It is based on the same principles as the systems in most European jurisdictions. The legislation on notaries and notarial services was substantially modernized in 1991³⁸. The new Law on Notarial Services liberalized access to the profession and provided for the establishment of a self-governing, self-regulated professional institution which is in charge of the organization of notarial work – the *Chamber of Public Notaries*.

The most important and progressive change in the law of 1991 is that Poland completely privatized the profession. Under the present system, qualified lawyers are admitted to the profession and licensed to practice in designated notarial districts, without being directly subordinated to the Ministry of Justice. The notaries in Poland are similar in their position to attorneys in private practice. The state does not employ notaries, but sets the requirements for their licensing and confers on them the right to carry out some important quasi-administrative functions (registration of transactions with real estate for instance). The maximum amount of all notarial fees is fixed by the Ministry of Justice (most recently in 1997).

Polish notaries have important rights and obligations in all transactions for which the law requires to be notarized. The notaries prepare the respective documents (designated by the law as notarial deeds), and are responsible for the contents. The notaries are also responsible for the

³⁷ By comparison, Katowice's case load, reported at 12,060 for 1997, has an average rate of pendency of 3.3 months, significantly lower than that of Warsaw.

³⁸ Law on Notarial Services, dated February 14, 1991 (Official Gazette - Dziennik Ustaw Nr 22, 1991, as amended most recently, Dz.U/1997 r. Nr 28, pos. 153).

preparation of affidavits, depositions, preservation of documents for safekeeping, preparation of official copies of documents, presented to them, and a number of other activities, required by law, and related to the need to obtain an official certification for certain acts. The notaries are obliged to refuse the preparation of deeds, contrary to the law, or to refuse the certification of such deeds. This provision of the law permits the notaries to refuse the certification of certain documents, because in the understanding of the notary they are not in accordance with the law, even if prepared by the attorneys of the parties. In that respect the problems of the Polish system are the same as the problems in most other European jurisdictions.

Another problem of the system exhibited not only in Poland is the high fees, assessed based on the value of the transaction and not on the services provided. Such fees represent in fact taxes, collected by the notaries on behalf of the State.³⁹ In some cases they may discourage the parties from notarizing certain transactions (e.g. loan agreements). Notarial fees in Poland are established by the Ministry of Justice, but notaries are also allowed to provide consultations on issues related to their practice (which is in fact a way to allow some additional charges).

Polish notaries have some important corporate functions. They are in charge of the preparation of the minutes of general meetings of different corporate bodies, primarily the general assembly of shareholders in joint – stock companies, in the cases when this is provided by law.

Another important Supporting Institution is the Polish Bar Association. The Bar Association was founded in 1918 and remained self governing and relatively independent from the authorities during the Communist period. Because of this it was in fact the first self-governing professional organization, which started operating effectively in the transition period. All practicing attorneys must be members of the Bar Association in order to appear in front of the courts. The Association maintains rigid standards for professional admission and ethics, and organizes continuing legal training for the members. An important aspect of the Association is the existence of specialized sections, which provide the members with the opportunity to discuss problems of major interest according to their area of specialty.

Market for Contract Reform

We found the Market for Contract reform somewhat difficult to assess given the degree of consensus among all of those interviewed that it was quite sufficient to meet most existing needs. In areas where gaps have existed in the Framework Law (e.g., leasing, franchising) these seem to have been addressed fairly efficiently. In these specific cases, automobile dealers, equipment leasing firms, chain restaurants, and others similarly situated seem to have successfully raised these issues (either directly or through representative organizations) within existing mechanisms for public-private sector dialog (e.g., parliamentary commissions and the Ministry of Justice). The overall Tier II result for this Dimension was 75%, which is lower than the foregoing discussion might suggest, reflects a general level of dissatisfaction that we observed among End-Users concerning the efficiency of the commercial courts in adjudicating contractual claims and enforcing judgments. The process is viewed by End-Users as lengthy, costly, and unpredictable. Because judges are reported to be very reluctant to use the coercive powers afforded them by law, litigants are generally able to deploy a variety of tactics to delay proceedings, and thus wear

³⁹ Please also see the Company section – registration fees for companies are in proportion to the registered capital.

down the party claiming compensation. As was the case in Bankruptcy, there clear preference among parties to a dispute was to avoid formal judicial intervention in all but the most stubborn cases.

F. Foreign Direct Investment

1. Overview

Our analysis is based on the premise that the more an FDI regime resembles internationally accepted norms, the more attractive it will be to potential investors. As in the other substantive legal areas, our FDI indicators are intended to inquire beyond the formal legal guarantees. This includes an examination of whether government agencies and the courts afford equal treatment in practice to foreign corporations. Our Team also met with private business executives both local and foreign to obtain their insight into the investment climate. It will be important to distinguish between those bureaucratic hurdles that restrict investment generally and those that are aimed at foreign investors. A regulation that is investor neutral on its face, if selectively enforced, may become a de facto restriction on foreign investment. We will also investigate whether there are unwritten agreements to exclude foreign corporations from certain Markets, or whether the "cost of doing business" is significantly higher for those companies. Finally, we will compare the results of FDI research with the results of our analyses of trade laws and company law.

The challenge of developing meaningful comparative indicators for FDI lies in the diversity, breadth and complexity of the subject area. The indicators developed for this purpose place heavy emphasis on compliance with international obligations and norms, rather than the details of specific national legislation. This emphasis reflects the broad trend toward international harmonization of law and practice governing cross-border direct investment. It is also based on the assumption that a correlation exists – all other things being equal – between the degree that a country's FDI regime reflects international standards and its ability to compete for and retain FDI.

The emphasis placed on international obligations, rather than on a detailed analysis of national legislation is useful for several important practical reasons. First, the data required can be obtained relatively easily and cost-effectively via widely published sources. This reduces the cost of assessment significantly and makes monitoring development and updating the analysis simpler. Second, for comparative purposes, the quality of the data is relatively uniform since in many cases a single source (e.g., WTO Secretariat; MIGA, OECD) can be used. Third, focusing on consistency with international norms provides a useful means of limiting the subjectivity inherent in comparative analysis of national legislation. This approach therefore creates an opportunity to emphasize the quantitative element to the analysis by distilling development indicators into performance measures that can be stated in relatively simple yes/no propositions for comparative purposes.

The expediency of focusing on adoption of international conventions and norms as a basis for drawing cross-country comparisons has significant limitations, however. First, a gulf generally exists between formal accession to treaty obligations and compliance with those obligations. In a practical sense, therefore, it is misleading to consider treaty accession without explicit reference to treaty compliance. In developing these indicators, an effort has been made to control

for this shortcoming in two ways: 1) by attempting to capture the extent to which obligations have been limited or reserved by the acceding country during negotiations (e.g., the number of conditions placed on right to national treatment); and, 2) by focusing on regulatory barriers to entry as a basis for characterizing the climate for foreign investment.

A second difficulty arises in the selection of international norms to be included in the analysis. Poland has made full membership in the EU a central foreign policy objective. EU membership is likely to have a significant impact in terms of Poland's future FDI flows.⁴⁰ Nevertheless, including EU membership as an indicator of commercial law development is problematic from the standpoint of cross-regional comparisons given that access to membership is not universal.

Eliminating EU (and OECD) accession from the analysis, however, poses the risk that an artificially narrow and potentially distorted view of commercial law development in Poland will be presented.⁴¹ There is no doubt that Poland's accession to both the OECD and the EU offer significant benefits in terms of credibility, consistency, predictability and durability of the reforms.⁴² Because membership in these organizations is conditioned upon meeting certain legal and administrative conditions precedent (i.e., "reforms"), membership confirms, rather than necessarily determines, Poland's emergence from "transitional" to "developed" status in terms of its legal regime for FDI.

2. Diagnostic Findings

Legal Framework

The Act on Companies with Foreign Shareholdings⁴³ provides the basic domestic legal framework for FDI in Poland. From an international perspective the EA, governs Poland's treatment of capital flows and commits it to liberalization in advance of full EU membership. Poland's membership in the OECD,⁴⁴ MIGA, ICISD and WTO all further bind Poland to the international norms for FDI. Finally, Poland is signatory to over 50 bilateral investment treaties (BITs) (notably with the United States and the EU) that provide an additional reinforcing framework of legal norms governing FDI.

⁴⁰ To date, EU countries have invested \$12.2b in Poland, representing 54.1% of total FDI in Poland as of June 1998. By comparison, U.S. investments – currently the largest in terms of volume – comprise 20.8% (\$4.7b) of the total FDI in Poland; and Asian investments, led by South Korea, stand at \$1.5b, or 6.6% of the total. Polish Market Review, No. 5 (21), October 1998, Polish Agency for Foreign Investment.

⁴¹ Put differently, the level of abstraction required to developing cross-regional comparative measures for FDI that permit "apples with apples" comparisons may yield insights of limited analytical value (e.g., "apples are fruit").

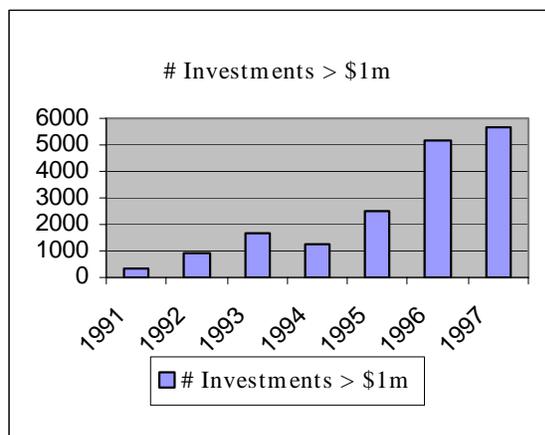
⁴² Institutional Investor Credibility Index.

⁴³ Dziennik Ustaw 1991, No. 60, item 253, as amended, Dziennik Ustaw 1991, No. 80, item 350 and No. 111, item 480; 1993, No. 134, item 646; 1996, No. 45, item 199, January 1, 1997. Other relevant acts, not treated in detail in this analysis, include: *Act on the Acquisition of Real Estate by Foreigners*, Dziennik Ustaw 1996, No. 54 item 245, January 1, 1997; *Act of the Foreign Exchange Law in Poland*, Dziennik Ustaw 1994, No. 136, item 703, as amended, Dziennik Ustaw 1995, No. 132, item 641; *Order of the Minister of Finance*, 16 January, 1996, *Concerning General Foreign Exchange Permits*, Monitor Polski No. 6, item 73, as amended, Monitor Polski No. 21, item 244, No. 27 item 290.

⁴⁴ Poland acceded to the OECD in November 1996.

As illustrated in Figure 4 below, Poland's has been quite successful in attracting FDI to date. A series of reform measures adopted by Poland in 1996 (and effective January 1, 1997) liberalized, or at least partially liberalized, restrictions on foreign participation in the Polish economy with respect to direct investment, commercial credits, long-term financial credits and loans and personal capital movements. Partial reforms were also introduced in the areas of foreign ownership of real estate, and securities trading. Foreign ownership of real estate, however, remains an area where further reform is necessary.

Fig.4 FDI 1990 -1997



Source: Ministry of Economy, 1998.

registration of any business in Poland, therefore, the regime for admission of FDI is consistent with European standards.

As concerns *treatment* of FDI, national treatment is accorded to all FDI and no limitations are placed on shareholdings (e.g., local participation requirement) and foreign investors may operate in Poland in one of four ways:

1. Through a representative office;
2. By establishing a wholly owned LLC or JSC ;
3. By forming an LLC or JSC with local partners; or
4. By acquiring shares in an existing Polish company.

As discussed in Section IV, C, 2(a) above, Polish law does specify minimum capital contributions for foreign-owned companies. It should be noted, however, these are essentially the same in form as those required for domestic companies and generally consistent with continental practice. No restrictions are placed on employment of foreign employees beyond normal immigration requirements. As a general matter, there are no formalized "profile" or workforce retention requirements for FDI, however, in a given transaction, these might be negotiated as a condition of sale. No limitations are placed on the conversion and expatriation of

Concerning *admission* of FDI, most approvals have been removed. As in many countries, foreign direct investment in certain areas (e.g., subsurface materials extraction, explosives manufacture and sales, pharmaceuticals, alcohol, tobacco, public conveyance, etc.) require special permission from a designated regulatory body. At present, there are 26 activities designated under the Economic Activity Act that require a special permit (concession).⁴⁵ It should be noted, however, that national treatment is accorded to FDI in these sectors.

The number of legally mandated approvals or steps required for FDI is the same required for

⁴⁵ At present, there is a draft bill, *On Economic Activity*, before Parliament. It is reported that under the proposed bill, only six activities would required special approval.

after-tax profits, wages, dividends or proceeds. Under the Law on Companies with Foreign Participation, payment of compensation for nationalized assets is guaranteed.

Implementing Institutions

The Polish Agency for Foreign Investment (PAIZ) is an exceptionally well-organized, technically sophisticated and effective organization. PAIZ is a government-funded investment promotion agency that has received significant financial and technical advisory support from the EU's Phare program under a joint project known as "Investprom".

PAIZ operates with a staff of approximately 50 who are organized in 10 departments that have both sector specific and region specific foci. PAIZ is a full service investment promotion agency that provides information on the investment climate in Poland through its *Monthly Economic Data Sheet* series, a bimonthly newsletter *Polish Market Review* and various other publications including its web site (www.paiz.gov.pl/), a CD ROM *Thinking Investment, Think Poland!*

As a quasi-government agency, PAIZ utilizes its direct relationships with members of Parliament and national and local government officials to help facilitate FDI. By all accounts, PAIZ is operating very effectively in this role.

PAIZ provides a wide range of investment promotion services. In addition to the information dissemination activities described above, PAIZ actively Markets Polish investment opportunities in Europe, North America and Japan. PAIZ staff also provides direct support to potential foreign investors by helping identify and qualify active investment opportunities in various regions around Poland. PAIZ also sponsors foreign trade missions and provides an investor matching service. Finally, PAIZ has established and maintains close working relationships with sister organizations throughout Europe, North America and elsewhere.

Overall, PAIZ' institutional capacity to promote and facilitate FDI in Poland is impressive. The EU Phare program of assistance to the organization is clearly a key factor in this impressive success, however, this support is now ramping down. The proof of sustainability, therefore, will be the extent to which PAIZ is able to transition into a fee-for-service mode to help support its operational capacity. As discussed below, Competition from a variety of non-profit and for-profit business promotion organizations are providing competing services that will almost certainly impact on PAIZ' future activities and performance.

Supporting Institutions

The Polish business community has been successful in establishing a number of viable Supporting Institutions in a relatively short time. This success is due to several factors— familiarity with Market business practices, cooperation with the government, general independence from political considerations, a large Polish Diaspora (which provided financial support and experience), general public agreement on the policy towards foreign investors, and ability to absorb the available technical assistance. As a result, a number of non-government organizations function in Poland and are valuable partners of the government in policy formulation and identification of the problems of the investment community.

After more than 40 years of restrictions and subordination to the needs of the centralized economy, the Polish Chamber of Commerce was quickly reborn as the principal self-governing institution of corporate Poland. It has 160 members, most of which are local chambers of commerce. The Chamber is not directly involved in promotion of foreign investment, yet it provides important services for the entire investment community and contributes significantly to the improvement of the investment climate in Poland.

The most important institution, supported by the Chamber, is the Court of Arbitration. This court is the designated standing court of conciliation under the Civil Code. It provides arbitration services for the parties to international commercial disputes under two different procedures. Conflicts may be resolved under the “in house” Rules of the Court Of Arbitration (the 1970 procedure) or under the rules selected by the parties to the dispute (the UN recommended 1976 UNCITRAL Arbitration rules serve as a default if no rules have been specified by the parties). The Court has separate procedure for disputes by Polish parties only. Poland is a party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

The Chamber of Commerce maintains a separate legal office – the Legal Services and Information Center -- which provides assistance in establishment of joint venture companies and representative offices, preparation and negotiation of Contracts and agreements, analytical work with respect to foreign investment and International Trade, and representation of parties in business cases.

Several bilateral and multilateral international Chambers are also members of the Chamber of Commerce, representing the business interests of most of the neighboring countries and of the principal trade and investment partners of Poland. There bilateral chambers with Germany, Russia, and Ukraine, as well as regional chambers with Belgian and Luxembourg, and the Balkans, to name but a few. The American and British Chambers of Commerce in Poland are particularly active and provide valuable services to members and even non-members. Unlike in other countries, however, they are not the only source of information about the problems of the Western business community.

The Foreign Investors Chamber of Industry and Commerce was established in 1989 as a response to the need for association in the emerging foreign investment community. The Chamber concentrates on protection of the specific interests of the foreign investment community. It achieved some prominence with the successful support of a case before the Constitutional Tribunal already in 1991. Since that time the Chamber has concentrated on the formulation of policy proposals related specifically to foreign investors, and on the provision of specialized information and services to the members. It is also active in organizing specialized training in the areas of tax law, custom regulations and accounting for the members and the general public.

All big accounting firms and several of the major international law firms have established successful practices in Warsaw. They provide the full range of services, similar to those in other major business centers in Europe. The major consulting companies are also present and are gradually moving from predominantly donor- financed projects to work with major corporate

clients on their core activities. The level of professional and organizational support for foreign business in Poland is similar to that in most developed Market economies.

Market for FDI Reform

Our findings for this Dimension should not be surprising based on Poland's well-publicized success in attracting large volumes of foreign direct investment (per capita) as compared to other countries in the region. The 75% Tier II result suggests that a comparatively healthy Market for FDI exists, however, significant progress still must be made in "debureaucratizing" government regulation of foreign investment. The foreign investment community in Poland is well organized and represented by various embassies, commercial attaches, representative offices, chambers of commerce, and industry groups. The consensus view reflected among those interviewed seemed to be that the national Government continues to be very supportive of foreign investment generally, even though a good deal of unnecessary bureaucratic overlay remains. As in other areas, discretionary interpretation and enforcement of ancillary regulatory requirements were a point where most agreed there was progress to be made. Tax, customs, and standards certification were most frequently identified as key areas where an unstable regulatory environment constrained day-to-day commercial activity. This is not to suggest that problems of this genera are unique to the foreign investment community. In fact, representatives of several multination corporations with operations in Poland expressed the view that their firms have greater leverage in advocating for specific reforms than domestic firms of a similar size. Whether this is the case or not, the problems faced by foreign investors in this regard were generally accepted as part of the "cost of doing business" in Poland. Among those interviewed relative to FDI, there seemed to be a general consensus that the situation had been improving and that future improvements could be expected over time.

G. International Trade

1. Overview

The sweeping political changes that began in 1989 were to have a profound impact on virtually every aspect of commercial life throughout the CEE and NIS regions. In particular, 1991 was a year of profound change throughout the region. By early 1991, Market prices, hard currency payments, and international commercial practices began to replace Soviet-era mechanisms of trade throughout most of the region. In July, the Council for Mutual Economic Assistance (CMEA) was formally dissolved. In late August, Ukraine declared itself a sovereign state. Three months later, Romania adopted a new constitution. Finally, Kazakhstan declared itself an independent nation in early December 1991.

This is particularly true in the foreign trade sector, which was both highly centralized and tightly controlled by specialized state trading organizations. With the collapse of the Soviet Union, individual firms found themselves cut off from at both ends - input supply on one hand, and Marketing outlets on another. Further, due to the segmentation and specialization common under the state trading system, firms were faced with a debilitating lack of information or experience upon which to draw in establishing their own foreign trade relations. Added to this, many state trading monopolies seized the opportunity spontaneously privatize under *perestroika*, and utilize special hard currency and commodity trading licenses to perpetuate their monopolistic position in the sector.

It is widely stated that a country's openness to foreign trade and investment is a major determinant in its overall rate of economic growth and the stability and vitality of its Markets. Empirical evidence tends to support this view,⁴⁶ however, the recent Asia Crisis has caused some to challenge this orthodoxy.⁴⁷ Despite this, a central organizing assumption upon which this analysis proceeds is that a legal regime consistent with international norms and practices is a fundamental requirement for a modern, market-oriented economy.

Trade law and the institutional framework for its implementation is an extremely broad and complex subject. As a result, it has been necessary to define the parameters of this analysis somewhat narrowly. One principal theme, however, will be the extent to which the country has embarked upon the process of accession to the World Trade Organization (WTO). The progress which a country has made in negotiating and enacting implementing legislation to accede to WTO agreements is a good preliminary indicator of the overall development of a country's International Trade law. Among the many areas addressed by these agreements are market access, subsidies, health standards, trade in services, intellectual property, and government procurement. Customs laws and procedures, especially the tariff levels, classification system,

46 See, e.g., Trade Liberalization in IMF-Supported Programs, Sharer, R. et al., International Monetary Fund World Economic & Financial Surveys, Washington 1998; Open Markets Matter - The Benefits of Trade & Investment Liberalization, OECD, Paris, France 1998.

47 Saving Asia, Krugman, P., Fortune Magazine. 9/7/98, www.pathfinder.com/fortune/investor/.

and whether Most Favored Nation (MFN) status is afforded to trading partners are also considered as a basis for comparison.

It is important to note the impact of many ancillary laws on the overall trade environment. Among those which could represent substantial non-tariff barriers are tax laws, currency convertibility restrictions, and immigration and banking laws. Obviously, a detailed investigation of each of these areas is well beyond the scope of this diagnostic assessment. It should, however, be possible to include specific examples of discriminatory treatment in an overall analysis of the country's receptivity to foreign trade.

From an institutional perspective, we have focused on the major trade regulatory bodies from the Ministry level to the customs point of entry. We will assess the degree of detail, consistency and transparency in agency procedures and compare statistics regarding enforcement. We will also attempt to gauge the degree of political support for open trade policies as expressed in public statements by government spokesmen, opposition leaders, legal academics and the popular media. Finally, we have attempted to assess the degree of satisfaction among those most affected by the trade laws and policies (e.g., import/export firms, foreign chambers of commerce) with the current regime

2. Diagnostic Findings

Legal Framework

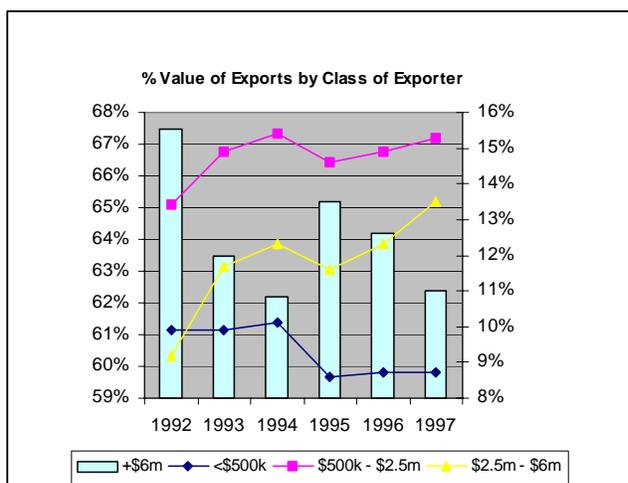
Poland has made significant strides in liberalizing its trade regime since transition began in the early 1980s. Today, with relatively minor exceptions, it can be fairly characterized as an "open" economy. Since the early 1990's, Poland's primary foreign policy objective - EU accession - has provided a particularly strong gravitational pull in the area of trade policy reform. Upon accession to the EU, Poland's trade regime will be, for all practical purposes, harmonized with most relevant international norms.

Poland is signatory to various International Trade regimes that provide a comprehensive legal and institutional framework for regulation of trade and trade-related disputes. Principal Among these are the Europe Agreement, GATT/WTO, the Central European Free Trade Agreement (CEFTA), and the European Free Trade Association (EFTA). In addition to various bilateral trade and investment agreements, Poland is also actively pursuing free trade agreements with Estonia, Israel, Morocco, Turkey and the Faeroe Islands.

Diplomatic relations between the EC and Poland were first established in September 1988. A Trade and Cooperation Agreement (TCA) was signed in September 1989. This agreement provided for reciprocal MFN treatment, and the elimination of quantitative restrictions applied by the EU⁴⁸ on imports from Poland by 1994. Thereafter, in December 1991, Poland signed a bilateral agreement with the EC known as the *Europe Agreement* (EA). While the EA as a whole came into force on into force on February 1, 1994, the trade related aspects contained in

48 Under the terms of the Maastricht Treaty, the European Community (EC) became known as the European Union (EU) on November 1, 1993.

Chapter III became effective two years earlier (February 1992) under an Interim Agreement.⁴⁹ This agreement provided a mechanism for consolidating earlier trade concessions made under the (TCA) and establishing a timetable for gradual, asymmetric trade concessions in favor of Poland over a ten year period. In April 1994, Poland submitted its application for associate EU membership. This application was granted by the EU Intergovernmental Conference in June 1997.



Source: *Market Structure and Foreign Trade Performance in Poland*, Anna Wziątek-Kubiak, Institute of Economics, Polish Academy of Sciences, July 1998.

Within the context of Poland's progress toward full EU membership, a variety of trade reforms and concessions have been made by Poland that will bring it into compliance with both EU and WTO requirements. EU specific-concessions include tariff rate quota (TRQ) reductions and binding tariff concessions on a broad range of products.⁵⁰ For example, on accession Poland will be required to apply the EU's Common Customs Tariff, and the external trade provisions of the Common Agricultural Policy (CAP) that will require it bring the average MFN rate on industrial products down from 9.9% to 3.6%.

The *Central European Free Trade Agreement* (CEFTA) was signed by Poland, Hungary, the Czech Republic and the Slovak Republic in December 1992 and entered into force in 1993.⁵¹ CEFTA was created to replace CEMA and the COMECON trading bloc under which members have agreed to the phased elimination of all customs duties on all industrial and agricultural

⁴⁹ The EA is not a trade agreement per se, but instead seeks to promote broader political and social agenda that is consistent with the requirement of EU membership. For example, Poland's EA includes chapters on political dialogue, general regulations, movement of workers, services, payments, capital, Competition, approximation of laws, economic and cultural cooperation and other subjects.

⁵⁰ For GSP products, tariff rate quotas (TRQ) were increased by 10% per year over the 5 year period, accompanied by 50% duty reductions over the first 2 years. Duties on products with no TRQs, were reduced by between 30% and 100%. For non-GSP products, concessions average a 10% per year increase in TRQ accompanied by a 20% decrease in duty over each of the first 3 years. Polish concessions to the EU also include an average tariff reduction of 10% on 247 agricultural products.

⁵¹ Membership has since expanded to include Slovenia (1995), Romania (1997) and Bulgaria (1998). Likely prospective members include Latvia, Lithuania, FYR Macedonia and Croatia.

products within the FTA. Thus far, tariffs among CEFTA members have been eliminated on 80% of industrial goods and on approximately 50% of agricultural products. In 1994, CEFTA members agreed to accelerate tariff reductions by one year, so that tariffs on all non-agricultural goods would be eliminated by January 1, 2000.

In addition to the above, Poland entered into a bilateral free trade agreement with Lithuania that became effective in January 1997. Approximately half of all agricultural products included in the agreement are tax free for both countries. Some sensitive products for each of the countries (e.g. sugar, products containing sugar, mutton and some fruits and vegetables) are excluded.

Poland became a signatory of the *General Agreement on Tariffs & Trade* (GATT) on October 18, 1968 and a member of its successor organization, the *World Trade Organization*, on July 1, 1995. New Polish anti-dumping legislation entered into force on 1 January 1998. Other relevant multilateral organizations to which Poland has become a member include the *Organization for Economic Cooperation & Development* (OECD), the *International Monetary Fund* (IMF), the *European Bank for Reconstruction & Development* (EBRD) and various relevant United Nations organizations including the *Conference on Trade & Development* (UNCTAD).

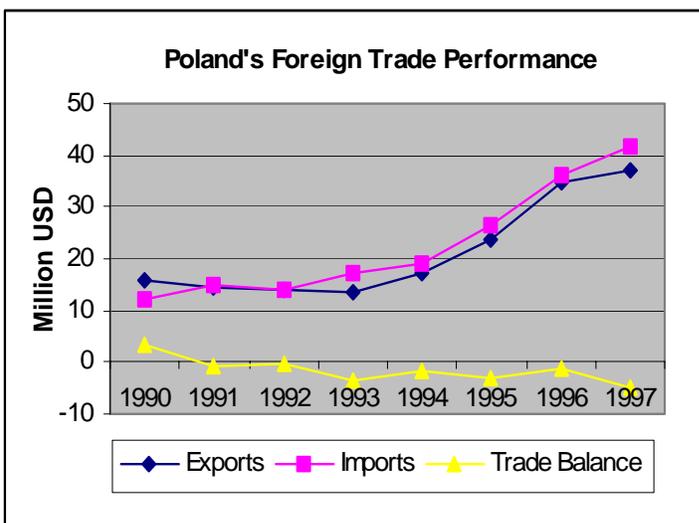
A principle advantage enjoyed by Poland in this area of commercial law development - as in others - was that it started the reform process earlier than the other nations included in this study. Starting in the early 1980's, Poland began to dismantle its system of state control over foreign trade. Prior to 1982, Poland's foreign trade sector was organized on the principles for central planning and state control.⁵² Under this system, foreign trade was restricted to specially licensed Foreign Trade Organizations (FTO). Accordingly, domestic producers had no direct access to foreign buyers, nor did they have access to current information on foreign trade opportunities.⁵³ By 1989, private firms and individuals were allowed to engage in import and export transactions without direct state control. Thereafter, in 1990, a majority of Poland's tariff and non-tariff barriers were eliminated. Since then significant progress has been made toward increasing transparency of remaining barriers to trade.

Demonopolization of Poland's export sector promoted a surge of new entrants in the foreign trade sector as illustrated in the accompanying charts. In the first instance, a period of sharp growth in new entrants, particularly in micro- and small-scale exporters, took place between 1992 and 1994. In absolute terms, the annual number of new entrants increased from slightly under 60,000 in 1992 to approximately 100,000 in 1997. In economic terms, the impact of this surge in micro- and small-scale exporters is somewhat less dramatic. As a percentage of total value of exports, the micro- and small-scale exporters combined share of exports increased from approximately 23% in 1992 to 24% in 1997. The value of total export volume attributable to large exporters (+\$6m) declined from approximately 67.5% in 1992 to 11% in 1997. Despite increases in export volume during the relevant period, Poland's terms of trade eroded from \$3.6m in 1990 at the time tariff liberalization was initiated to -\$3.2m in 1995.

⁵² This system was characterized by a small number of firms specialized by function (e.g., IMPEX banks) or product (e.g., metals and minerals).

⁵³ By contrast, vestiges of this system can still be found in many of the former Soviet republics.

Poland's progress in liberalizing its trade regime has been impressive. Restrictions on agricultural imports, for example, were converted into tariffs in May 1995. Most licenses, and all quantitative restrictions, have been eliminated. This is not to suggest, however, that liberalization has been easy—or smooth. In December 1992, for example, Poland instituted import surcharges to address a rapidly declining balance of payments situation. These were later



Source: World Bank, IMF.

reduced to 5% in 1995, 3% in 1996, and phased out completely in January 1997 in accordance with Poland's undertakings with the WTO. As with many other transition economies, Poland's government continues to face strong domestic pressure for protection, particularly in the agricultural, steel and petrochemicals sectors. Today, Poland has a variety of non-tariff trade restrictions⁵⁴ of imports in the form of licenses,⁵⁵ preferential tariff quotas,⁵⁶ and import prohibitions.⁵⁷ Non-tariff trade restrictions for exports include licenses⁵⁸, quotas,⁵⁹ and prohibitions.⁶⁰ Generally

speaking, however, Poland's WTO membership and closer association with the EU are likely to be powerful forces weighing against the impulse to backslide on trade liberalization due to short-term trade and payments imbalances.

The EA provides for the establishment of a free trade area between Poland and the EU accomplished through the progressive elimination of customs duties on a wide range of products. In line with this process, Poland is aligning its national goods nomenclature to the EU Combined Nomenclature and is in the process of preparing an integrated tariff that will facilitate comparison between Poland's tariffs and those applicable in the EU. Finally, Poland has moved forward to integrate its customs regime into the larger international framework by becoming a

⁵⁴ See, *Trade Barriers & Opportunities in Poland*, Michael, J., Central & Eastern European Economic Research Center, University of Warsaw, 1997.

⁵⁵ License requirements apply to alcoholic beverages, military equipment, radioactive materials, petroleum oils, tobacco products, natural gas and goods for assembly of automobiles.

⁵⁶ Including, inter alia, wheat, barley, oats, vehicles, paper, computers, paper containers for juice and milk, among other items.

⁵⁷ Including two-stroke engines, tractors, special purpose motor vehicles and other items.

⁵⁸ Including radioactive materials, military equipment, coal, petroleum products, natural gas and goods subject to quotas.

⁵⁹ Textiles to the EU, Canada and Norway, ferrous waste scrap, raw hides, and other products.

⁶⁰ Including geese eggs, non-food trade with Iraq, and trade with Libya on certain industrial items.

signatory to the EC/EFTA Common Transit and Simplification of Formalities Conventions in July 1997.⁶¹

Implementing Institution(s)

The lead Implementing Institution for International Trade is Poland's Ministry of Economy. Until recently, the key units within the Ministry responsible for International Trade-related matters included:

- ***Economic Strategy Department*** - Develops socio-economic policy with general, sectoral and regional impact;. Also collects data and prepares reports to the EU and WTO on state aid programs;
- ***Department for European Integration*** - Deals with trade policy issues as they relate to Poland's application for full EU membership;
- ***Multilateral Economic Relations Department*** - Responsible for implementation of treaty policy requirements and maintaining working relations with the WTO, OECD and other multilateral organisations;
- ***Bilateral Economic Relations Department*** - Primarily dealing with EFTA and CEFTA relations concerning cross-border and regional cooperation; and,
- ***Economic Policy Instruments Department*** - Entity within the Ministry responsible for interpretation and enforcement of defensive instruments (i.e., antidumping, countervailing, safeguards) and implementation and coordination of customs policy and administration.

As of January 1, 1999, however, the Ministry implemented a restructuring plan that reorganised functional departments along subject matter divisions. In effect, this reorganisation decentralises responsibility for trade policy and enforcement. A newly created administrative unit, the Trade Defence Department, will be responsible for enforcing Poland's antidumping, countervailing, safeguards provisions. This new unit is currently staffed by 12 experts and future growth is anticipated.

Supporting Institution(s)

For the purposes of this analysis, Poland's Customs Service will be evaluated as the primary "Supporting Institution" for the International Trade component of the analysis. The Tier II indicator result of 49% for this Dimension (the lowest of any Dimension evaluated in the assessment) reflects to a large extent our findings with regard to End-User perceptions concerning the Customs Service's effectiveness.

Poland's Customs Service is comprised of a Central Board of Customs, 19 regional customs offices and 400 frontier stations. The customs service currently employs approximately 14,000

⁶¹ See, e.g., Agenda 2000 - Commission Opinion of Poland's Application for Membership of the European Union, No. 97/16, p. 39-40, July 1997.

staff. Despite advances in the areas of customs law reform noted above, the Customs Service is generally viewed as being significantly challenged in terms of institutional capacity to interpret and enforce the laws.

Generally speaking, the business community representatives interviewed during the diagnostic viewed customs administration in Poland as inefficient, unpredictable, and prone to petty corruption. The principal complaints registered concerned lengthy processing delays, inconsistent interpretation and application of regulations (especially relating to tariff classification), a general lack of transparency due to poor communication of policy changes, and petty corruption. While these difficulties are by no means unique to Poland, they do represent a significant challenge - and potential obstacle - as Poland lays the policy and institutional groundwork necessary for full membership in the EU.

As noted above, a series of legal and policy reforms have already been initiated in order to bring Poland closer to compliance with EU standards. The Customs Services' capacity to internalise and implement these policy changes seem to be overwhelmed. In this respect, additional capacity in the areas of information dissemination and staff development are certainly inadequate. The lack of adequate information technology infrastructure, however, appears to be the largest and most critical capacity constraint faced by the Customs Service. Without the needed information management capabilities, the Customs Service appears unable to coordinate and manage the operations of its regional offices and frontier stations at the level required for membership in the European Customs Union. Similarly, Customs Service management has not been able to develop an integrated strategy to remedy these deficiencies. So short-term prospects for rapid capacity improvement are not promising without significant outside financial, technical, and strategic planning support.

The Market for International Trade Liberalization

Poland's international trade sector offers a unique opportunity to examine the related concepts of "gravitational pull" and "exogenous demand" that we have used to help illustrate certain aspects of C-LIR. The concept of gravitational pull refers to a situation, like that found in Poland, where due to physical proximity (or other linkages such as complementary markets, shared cultural heritage, shared language, shared political orthodoxy, etc.), one country is "pulled" into the orbit of another, adopting norms and standards that approximate those in place in the dominant sphere. In addition to Poland's approximation of laws in anticipation of future EU membership, legislative changes in Mexico to clear the way for the North American Free Trade Agreement (NAFTA) could be viewed as an example of gravitational pull as that concept is used in this analysis. Countries of Eastern and Central Europe experienced a similar gravitational pull (push) when, following World War II, they were forced to conform their laws in varying degrees to the Soviet model. This could be viewed as ideological or political gravitational pull. Another possible example is the gravitational pull that multilateral regimes defined by subject matter or function exert on countries including the WTO, the World Intellectual Property Organization (WIPO), the International Standards Organization (ISO), and others. Within the context of the WTO, for example, an individual country's "weight" is determined (formally or informally) by its share of world trade volume based on purchasing power parity.

Exogenous demand is a related, but different concept. Exogenous demand for reform can come from a trading partner (e.g., current bilateral negotiations with China on WTO membership), a multilateral development agency (e.g., World Bank and IMF conditionalities), from regional groupings (e.g., EU, MERCIFUL, etc.) or potentially from a variety of other sources (e.g., industry and product standards, technical protocols, religious doctrine, etc.). Based on our findings, we feel that Poland's experience in the subject matter area of international trade illustrates both phenomena rather well.

Poland's membership in the WTO and prospective membership in the EU are two powerful gravitational forces that certainly are contributing to the relatively rapid and progressive agenda of trade liberalization that Poland has committed itself to. Interestingly, however, it is in the trade arena that some of Poland's greatest obstacles to EU membership exist. Within the framework of legislative approximation, we found that End-Users are generally given advance notice and an opportunity to provide input on major legislative initiatives relating to trade regulation [80%]. Although it was difficult to gauge based on the sample interviewed, the Government does appear to actively solicit and accept stakeholder input in the trade policy formulation process [70%].

As noted in the preceding section, specialized administrative bodies have been established within Government to review proposed legislative reforms to assess the regulatory burden placed on End-Users, as well as conformity with relevant EU legislation [80%]. With the exception of the Supporting Institutions discussed above, End-Users interviewed during the diagnostic did not feel that the existing trade regime was stable, and generally took a dim view of the trade regime's responsiveness to their needs [40%]. Similarly, End-Users reported that they did not feel that they had a meaningful opportunity to participate in setting the trade policy agenda [50%], however, they continue to actively lobby for reforms, particularly in the area of customs administration.

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