Executive Directors' Remuneration in Comparative Corporate Perspective

Edited by

Christoph Van der Elst

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CHAPTER 12

Legal Aspects of Executive Remuneration in Polish Listed Companies

Arkadiusz Radwan & Tomasz Regucki

§12.01 INTRODUCTION

The issue of remuneration of company officers – executive and non-executive members of the board of directors in one-tier systems and members of management and supervisory boards in two-tier systems – is of highest importance in modern corporate governance debate.[1] Taking into account the widespread definition, corporate governance deals with ways in which financial corporate investors assure themselves with getting a return on their investment.[2] The company itself is the nexus of contracts[3] between shareholders, managers, employees etc., that aims at supplying enterprise with equity capital provided by the shareholders, as well as debt capital by contractual creditors, in particular financial institutions and bondholders. The role of directors in the said nexus of contracts reaches beyond a mere being a part thereto. The directors not only are corporate stakeholders themselves, but also predominantly serve as agents in the contractual relationship managing wealth entrusted to them by shareholders and bearing responsibility for proper execution of duties under the contractual nexus. This

1. For the brief summary of main areas of interest of corporate governance see e.g., Stuart L. Gillan, *Recent Developments in Corporate Governance: An Overview*, 12 Journal of Corporate Finance, 381 (2006). See also: Shann Turnbull, *Corporate Governance: Its scope, concerns & theories*, 5 Corporate Governance: An International Review 4, 180 (1997).
2. Andrei Shleifer & Robert W. Vishny, *A Survey of Corporate Governance*, 52 The Journal of Finance 2, 737 (1997).
3. The nexus of contracts theory, which describes the company as a collection of explicit and implicit contracts (in both legal and economic meaning) is firmly established in legal and economic literature. See e.g., Frank Easterbrook & Daniel Fischel, *The Corporate Contract*, 89 Columbia Law Review 7, 1416 (1989), Eugene Fama, *Agency Problems and the Theory of the Firm*, 88 The Journal of Political Economy 2, 288 (1980).

dual role of corporate managers triggers certain conflicts of interest. A clear example thereof is the pay corporate officers are entitled to receive for their services rendered to the company.

The position of the company officers is associated with their privileged (more complex and less costly) access to the necessary information resulting in frequent information asymmetry between managers and shareholders, sometimes to the detriment of the latter. The scope of this asymmetry varies depending on the ownership structure and existence of large, sophisticated blockholders. As case-sensitive, and ownership-dependent, as it may be, the managers-shareholders relationship is characterized by inherent potential for conflict of interest. This conflict is known in the economic and organizational theory as the principal-agent (agency) problem and is seen as a factor incurring costs related to the oversight and monitoring of the agent by the principal.[4] Rules and standards, in both legislation and self-regulation (soft-law) regarding corporate governance, on both European and national levels, are in many ways focused on mitigating these agency problems, and therefore preventing company officers from abusing their powers and receiving benefits to the detriment of the shareholders. Remuneration is one of the obvious areas where such abuse may occur. Most of the well-known cases of financial scandals involved, *inter alia*, improprieties related to executive remuneration in public companies.[5] Enron, WorldCom[6] and Lehman Brothers (together with other big entities affected by the 2008 financial crisis) in the United States as well as Ahold and Parmalat[7] in Europe are only a few of the numerous examples of this broader phenomenon. This corresponds with increasing interest in the executive remuneration issue in both economic and legal literature, especially following the recent financial crisis.[8] Setting proper managerial incentives that would include both the basic remuneration and a bonus (either in cash, stock, stock options or other) is, therefore, considered to be one of the most important current issues, regarding the proper functioning of companies.

This chapter addresses the most important issues of executive compensation in Polish listed companies. It proceeds as follows: section §12.02 briefly presents the board structure and procedures of appointing and dismissing directors in Polish

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4. See the seminal work dedicated to defining and describing the main characteristics of the conflict of interest between managers and shareholders: Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 Journal of Financial Economics 4, 308 (1976).
5. For the analysis of corporate governance mechanisms with regard to the last financial crisis see: Ariel Mucha, *Efektywność instrumentów corporate governance z perspektywy ostatniego kryzysu finansowego*, in Grzegorz Chybicki (ed.), *Współczesne Problemy Rozwoju Gospodarczego*, 26, Politechnika Warszawska. Kolegium Nauk Ekonomicznych i Społecznych (2013).
6. On the issue of financial scandals in the United States in the beginning of 2000s, see: Joseph E. Stiglitz, *The Roaring Nineties: A New History of the World's Most Prosperous Decade* (W. W. Norton & Company, Reprint Edition, 2004).
7. Guido A. Ferrarini & Paolo Giudici, *Financial Scandals and the Role of Private Enforcement: The Parmalat Case*, ECGI – Law Working Paper No. 40/2005, <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=730403>, (2005), (accessed 12 Feb. 2015).
8. Piotr Urbanek, *Polityka wynagradzania kadry kierowniczej w sektorze bankowym w świetle wyników badań empirycznych*, 11 Zarządzanie i Finanse 2, 260, (2013). In the article it is empirically demonstrated, that a number of research papers on remuneration of executives in banks rose significantly after the outbreak of 2008 financial crisis.

company law, section §12.03 presents the Polish statutory (legislative) and self-regulatory (soft-law) regulations on remuneration of company officers, including recent trends and proposed changes, section §12.04 describes the legal basis for stock-based remuneration in the Polish legal system along with statistical analysis of such plans, and section §12.05 concludes. The chapter reflects the state of legislation and regulations as of January 2015.

§12.02 THE BOARD STRUCTURE IN POLISH COMPANY LAW

[A] The Two-Tier Board Model

The Polish company law has traditionally, in the 1920s and 1930s, as well as after 1989, adhered to the two-tier (dual) board model. Dual board structure in the joint stock company (Pol.: *spółka akcyjna*), public and non-public alike, embraces two legally and personally separated bodies: the management board and the supervisory board. By choosing the two-tier model, Polish law follows the German pattern and the board structure is among many examples of Germanic influence on Polish company law legislation. Although the one-tier model of corporate governance is more widespread worldwide, the two-tier model, which presupposes strict separation of managing and supervising corporate bodies, is heavily entrenched in Germany as well as in the countries of German legal origin. Polish company law system may generally be categorized as part of German legal family.[9]

In Poland the one-tier board is only possible as an alternative (optional) model in Polish *Societas Europaea*.[10]

Sporadically, it has been advocated in the Polish legal scholarship to introduce into the legal system the possibility for shareholders to choose between a one-tier and two-tier model in all joint stock companies governed by Polish law. Unfortunately, there has been no broader support for this idea and consequently so far there has been no legislative follow-up on this matter. However, it is well conceivable that at some point in the future the status quo will be revisited.[11]

9. A wider analysis of the of influence of German company on Polish law can be found in: Krzysztof Oplustil & Arkadiusz Radwan, *Company Law in Poland: Between Autonomous Development and Legal Transplants*, in Christa Jessel-Holst, Rainer Kulms & Alexander Trunk (eds), *Private Law in Eastern Europe. Autonomous Developments or Legal Transplants?*, 446, Mohr Siebeck Gmbh & Co. K (2011).
10. Article 27–47, Law of March 4th, 2005 on the European Economic Interest Grouping and on the European Company, Law Gazette 2005, No. 62, item. 551 as amended.
11. About the concept of introducing one-tier board model as an alternative see: Adam Opalski & Krzysztof Oplustil, *Zarządzanie i nadzór w spółkach akcyjnych – status quo i dylematy reformy*, Monitor Prawniczy 7, 5 (2014); see also: Adam Opalski & Michał Romanowski, *O potrzebie zasadniczej reformy polskiego prawa spółek*, Przegląd Prawa Handlowego 6, 4 (2008).

[1] The Management Board

Under the current regime, the management board (Pol. *zarząd*) of a joint stock company consists of one or more members (Article 368 § 2 CCC[12]) and there is no upper limit set by the law on a number of board members. Neither there is a legal requirement for the management board to be composed of at least a certain number of members. However, there is an exception: according to Article 22a of the Banking Law,[13] the management board of a bank operating as a joint stock company must consist of at least three members. Statistically, however, most of the boards of joint stock companies consist of more than one member, usually they are composed of three or more executive directors.

The management board is the main administrative organ of the company. According to Article 368 § 1 CCC management board manages the company's affairs and acts on its behalf. It covers all legal and factual actions and competences that are not assigned to other organs (supervisory board or general meeting). Thus, there is a general presumption of the management board's competence to act and manage. Powers of the management board may be divided into two groups: the right to represent the company (to act on its behalf) and the right to manage the company's affairs including the organization of all internal relations within the company.

Except in the rare situation, where there is just one single person serving on the management board, the executive directors form a collective body. The principle of collectivity (collegiality) is also reflected in the way the management board handles company's affairs. According to the said principle, in respect of internal domain of a company, all board members have the right and the duty to act jointly, i.e., to collectively (collegially) manage company's affairs (Article 371 § 1 CCC). Although the articles of association may provide otherwise, the default model emphasizes collegiality, and in any case, irrespective of any customizations made by shareholders in the articles of associations (corporate charters), the board itself and not its particular members remains the organ of the company. With regard to the acting on company's behalf (representation in external relations), in cases where there is more than one member of the management board, it is required that (at least) two members or one member together with commercial proxy (Pol. *prokurent*) shall lawfully represent the company. However, articles of association may provide otherwise (Article 373 § 1 CCC), more specifically it is possible to introduce a sole representation of each board member, or differentiate powers, e.g., that the president of the board could act alone, whereas for the remaining management board members their joint representation would be required.

12. Act of September 15th, 2000 Code of Commercial Companies (Pol. *Kodeks spółek handlowych*), Law Gazette 2000, No. 97, item 1037 as amended (hereinafter: CCC).
13. Law of August 29th, 1997 on Banking (Pol. *Prawo bankowe*), Law Gazette 2002, No. 72, item 665 as amended.

[2] The Supervisory Board and Its Committees

The supervisory board (Pol. *rada nadzorcza*) is a mandatory organ responsible for comprehensive and permanent supervision over the company on every field of its activity (Article 382 § 1 CCC). It is pointed out in Polish legal doctrine, that although according to the CCC the supervisory board may act periodically whenever the need arises (still not less than three times a year – Article 389 § 3 CCC), the supervision duty should be understood in a wider sense, as a permanent activity. It includes *inter alia* inspection of company documents and company's assets, requesting various reports regarding ongoing activities from the management board or any employee of the company.[14] Moreover, the articles of association may extend its competences, for example, by adding the requirement of the supervisory board approval of specified actions undertaken by the management board. Supervisory board must consist of at least five members in listed companies and not less than three members in non-public joint stock companies (Article 385 § 1 CCC). In practice, articles of association often provide, that the board must be composed of five to nine members, or simply state that the board must be constituted of at least five members.

In European law much attention is paid to board committees,[15] i.e., corporate bodies which operate within supervisory board (in two-tier systems) or are composed of non-executive directors (in one-tier systems). The notions of audit committee, remuneration committee and nomination committee are established either in the directives or soft-law recommendations.[16] The concept of committees originally derives from Anglo-Saxon corporate governance systems. However, it was accepted throughout many systems of continental Europe, and some scholars recognize the emergence and proliferation of board committees as a manifestation of trend towards convergence of corporate governance systems.[17]

In Polish company law there are no specific rules dedicated to the formation or the organization of the supervisory board committees. The possibility of creating such

14. Mateusz Rodzynkiewicz, *Kodeks spółek handlowych. Komentarz*, Warsaw, 404 (LexisNexis, 4th edition, 2012).
15. See especially s. 5–7 of Commission Recommendation of 15 Feb. 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board (2005/162/EC), OJ 25.2.2005, *L* 52/51.
16. The audit committee is mandatory for all listed companies pursuant to Art. 39 of the Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC, OJ 9.6.2006, *L* 157/87, as amended by Directive 2014/56/EU. The nomination committee and remuneration committee remain optional in accordance to the soft law recommendations resulting from Commission Recommendation of 15 Feb. 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board (2005/162/EC), OJ 25.2.2005, *L* 52/51. Remuneration Committee is also referred to in Commission Recommendation of 14 Dec. 2004 fostering an appropriate regime for the remuneration of directors of listed companies (2004/913/EC), OJ 29.12.2004, *L* 385/55; as well as Commission Recommendation of 30 Apr. 2009 complementing Recommendations 2004/913/EC and 2005/162/EC as regards the regime for the remuneration of directors of listed companies (2009/385/EC), OJ 15.5.2009, *L* 120/28.
17. Paul Collier & Mahbub Zaman, *Convergence in European corporate governance: the audit committee concept*, 13 Corporate Governance: An International Review 6, 753 (2005).

bodies merely derives from the general provision, which states that supervisory board acts collegially, nonetheless members of supervisory board may have specific duties delegated to them for independent performance (Article 390 § 1 CCC),[18] as well as from other regulations (both statutory and soft law) that directly refer to committees. The possibility to create supervisory board committees pursuant to general provisions does not change the fact that lack of more specific legislation regarding supervisory board committees is deservedly criticized in Polish company law doctrine.[19] The obligation resulting from Article 39 of the Directive 2006/43/EC to mandate the establishment of audit committee in all listed companies has been implemented into the Polish law by the Act of 7 May 2009 r. on Auditors and Public Supervision,[20] specifically by its Article 86.

[B] The Appointment and the Removal of Directors

With regard to appointing members of the management board and the supervisory board there is a default model provided by CCC with a possibility to deviate therefrom and to lay down in company's articles firm-specific rules that govern the election of company's officers. The default rule assumes that the management board is appointed by the supervisory board, and the supervisory board is appointed by the general meeting (Article 368 § 4 CCC and Article 385 § 1 CCC respectively). Alternative models provided by the articles of association may involve *inter alia* appointing the management board directly by the general meeting, appointing the management board by the supervisory board upon request of the chairman of management board or a wide spectrum of so-called control enhancing mechanisms,[21] which include priority shares (Article 351 § 1 CCC), personal rights of specified shareholder (Article 354 § 1 CCC) etc.

According to the default model provided by the CCC, members of the management board are not only appointed but also dismissed by the supervisory board, still the articles of association may state otherwise, with regard to both appointment and dismissal. Moreover, according to Article 368 § 4, without prejudice to the power of the supervisory board to remove the management board members, they may also be recalled or suspended by the general meeting at any time. This rule is mandatory law and cannot be opted-out in the company's articles of association.

The supervisory board is both appointed and dismissed by the general meeting, unless the articles of association provide otherwise (Article 385 § 1 CCC – unlike in the case of the management board, there is no provision that the general meeting has

18. Such view is presented *inter alia* by: Krzysztof Oplustil, *Instrumenty nadzoru korporacyjnego (corporate governance) w spółce akcyjnej*, Warsaw, 481 (C.H. Beck, 2010).
19. See e.g.: Adam Opalski, *Europejskie prawo spółek*, Warsaw, 338 (LexisNexis, 2010).
20. Law of May 7th, 2009 (Pol. *Ustawa o biegłych rewidentach i ich samorządzie, podmiotach uprawnionych do badania sprawozdań finansowych oraz o nadzorze publicznym*), Law Gazette 2009, No. 77, item 649.
21. On the matter of Control Enhancing Mechanisms (CEM) see: Report on the Proportionality Principle in the European Union, European Commission, report drawn up by Institutional Shareholder Services (ISS), European Corporate Governance Institute (ECGI), and Sherman & Sterling LLP, 2007 (< http://ec.europa.eu/internal_market/company/docs/shareholders/study/final_report_en.pdf > , accessed 12 Feb. 2015).

always the right to remove a particular member of supervisory board). Moreover, the law provides for a mandatory group voting (cumulative voting procedure) to appoint the supervisory board members – according to Article 385 § 3 CCC shareholders representing at least 20% of the share capital may request that the supervisory board members election is held in separate voting groups.[22]

§12.03 REGULATIONS REGARDING THE REMUNERATION OF THE COMPANY OFFICERS IN THE POLISH LEGAL SYSTEM

[A] Introduction

Polish law, unlike European law and contrary to the approach that is becoming dominant in most western jurisdictions, remains reluctant when it comes to setting the legal framework for directors' compensation. It is rightly pointed out in Polish legal doctrine, that there are recommendations of European law regarding remuneration of company officers, which Polish law largely ignores or even contradicts.[23] However, there is a large amendment of Code of Best Practices for Polish Listed Companies (Warsaw Stock Exchange soft-law regulation) planned to be adopted soon, which includes, *inter alia*, regulations regarding the remuneration of company officers. In this part we discuss all Polish regulations regarding those issues.

CCC's interference with officers' compensation remains limited to a default rule granting powers to establish the amount of remuneration. According to Article 378 § 1 CCC the supervisory board shall determine the remuneration for members of the management board, unless the articles of association provide otherwise. This default rule applies also to cases, where the articles of association took the power to appoint the members of management board away from the supervisory board, unless the articles specifically deviate from the default rule by providing specific procedures for determining the executive compensation. Moreover, according to Article 378 § 2 CCC the general meeting may authorize the supervisory board to provide for an additional

22. The relevant provisions of Art. 385 CCC have following wording: § *3. Upon an application of the shareholders, representing at least one fifth of the share capital, the election of the supervisory board shall be made by the next general assembly by way of a vote in separate groups, even if the statutes provide for a different procedure for appointing the supervisory board. […]* § *5. The persons representing at the general assembly the portion of shares which represents the result of the division of the total number of the represented shares by the number of members of the board, may create a separate group for the purpose of electing one member of the board, and shall not participate in the election of the remaining members.* | § *6. The positions on the supervisory board not filled by the appropriate group of shareholders created in accordance with* § *5, shall be filled by way of a vote held with the participation of all shareholders whose votes were not cast in the election of the members of the supervisory board elected by a vote in separate groups.* | § *7. If at the general assembly, referred to in* § *3, not even a single group capable of electing a member of the supervisory board is created, the election shall not be held.* | § *8. Upon election of at least one member of the supervisory board in accordance with the provisions of* § *3-7, the mandates of all existing members of the supervisory board shall expire prematurely […]* | § *9. In the vote referred to in* § *3 and* § *6, each share shall carry only one vote, without privileges or limitations, subject to the provisions of Article 353* § *3.*
23. Opalski, *Europejskie prawo spółek*, 351.

remuneration based on a profit-sharing scheme – in such a case part of the remuneration of the management board members becomes linked to the profit of the company. Besides, there is generally no regulation regarding shareholders' 'say on pay' in Polish company law (the only exception are specific rules on remuneration of some state-controlled companies that are described below) – the requirement of the general meeting approval for the amount of directors' remuneration may be contractually opted-in in the articles of association based on the possibility of extending the competences of the general meeting. With regard to the members of supervisory board, the law states that the amount of remuneration is determined either by resolution of the general meeting or is stated directly in the articles of association (Article 392 § 1 CCC) and this provision cannot be modified (no possibility for the articles of association to deviate from this model).

Pursuant to Article 379 § 1 CCC, in contracts between the company and a member of the management board, including employment and other service contracts, the company shall be represented by the supervisory board or a special proxy appointed by a resolution of the general meeting.

[B] Transparency

Another issue regarding the regulation on the remuneration of company officers is transparency. Polish law mandates the transparency of managers' remuneration with regard to all joint stock companies, and provides for additional requirements for listed companies. Pursuant to the Act of 29 September 2004 on Accounting[24] every joint stock company must disclose the amount of remuneration paid to persons managing or supervising the company, separately for each group of officers (but not separately with regards to each person). It seems that the information on aggregate amount of remuneration may sometimes be misleading and is not sufficiently informative. The said rules apply to both listed and non-listed joint stock companies.

With regard to listed companies, there is one specific legislation aiming at the transparency of remuneration, which is provided by the Ordinance of the Ministry of Finance on information that needs to be disclosed by the issuers.[25] According to § 91 section 6 pt. 17 of the said Ordinance, the company must disclose the amount of remuneration and bonuses paid, together with the information regarding all incentive programmes (that include stock and stock option plans, e.g., based on warrants or convertible bonds), as part of the issuer's annual report. This requirement extends to compensation paid for services rendered by the directors to the subsidiaries of the pertinent company. Moreover, the company must disclose all information regarding

24. Pol. *Ustawa o rachunkowości*, Law Gazette 1994, No. 121, item 591. Requirement to disclose information regarding remuneration of company officers is in Annex 1, Part: additional information.
25. Pol. *Rozporządzenie Ministra Finansów w sprawie informacji bieżących i okresowych przekazywanych przez emitentów papierów wartościowych oraz warunków uznawania za równoważne informacji wymaganych przepisami prawa państwa niebędącego państwem członkowskim*, Law Gazette 2014, item 133.

the agreements made between the company and its managers granting to the latter any compensation in case of their resignation or dismissal (golden parachutes).

As mentioned above, Polish law does not provide for a direct legal framework for committees within supervisory board. Still it is derived from the general CCC provisions that such auxiliary bodies may be formed. Moreover, there are some statutory provisions (other than CCC) which explicitly state the obligation of creating such committees under specified conditions. The most significant example is the requirement to establish audit committee in all listed companies pursuant to Article 86 of Act of 7 May 2009 on Auditors and Public Supervision.[26] Moreover, pursuant to § 6 section 3 of Resolution of Polish Financial Supervision Authority No. 258/2011 of 4 October 2011[27] issued on the basis of Article 9f, 9g and 128 section 6 of Banking Law, in all banks that are major in terms of size, internal organization, scope and complexity of conducted operations, the establishment of a remuneration committee is mandatory. Such committee consists of members of the supervisory board and its task is to, *inter alia*, issue opinions on policies and strategies regarding so-called variable components of remuneration – stock, stock option plans etc. Finally, a nomination committee remains optional, and is present in approximately 20% of supervisory boards.[28]

Rules described above are the only statutory provisions regarding remuneration in Polish legal system. Other standards are only soft-law recommendations, at the time of closing of this article still in the state of production, though publicly available as an official draft Best Practices Code.

[C] Self-Regulation: Best Practices for WSE Listed Companies

[1] Introduction

Warsaw Stock Exchange issued 'The Best Practices of WSE Listed Companies' – Polish soft-law recommendations for public companies. The first version of the code was adopted in 2002, and it was then revised in 2005. The first two versions (2002 and 2005) were drawn up by the Best Practices Committee, a group of company law experts as well as representatives of law firms and capital market stakeholders. The Stock Exchange adopted a new approach for its 2007 Code of Best Practices, subsequently revised in 2010 and 2012. Unlike the previous recommendations, the Practices of 2007 were drawn up not by the special Committee dedicated thereto, but solely by the Warsaw Stock Exchange. Those versions were subject to strong criticism, as they omitted some important issues such as the business judgment rule and the notion of

26. See fn. 20 supra.
27. Pol. *Uchwała KNF w sprawie szczegółowych zasad funkcjonowania systemu zarządzania ryzykiem i systemu kontroli wewnętrznej oraz szczegółowych warunków szacowania przez banki kapitału wewnętrznego i dokonywania przeglądów procesu szacowania i utrzymywania kapitału wewnętrznego oraz zasad ustalania polityki zmiennych składników wynagrodzeń osób zajmujących stanowiska kierownicze w banku*.
28. *Rady nadzorcze 2014. Skuteczność rad nadzorczych w spółkach publicznych notowanych na GPW, Suplement do raportu 'Rady Nadzorcze 2013'*, PWC, 18, (2014) (<http://www.pwc.pl/pl/publikacje/2014/rady-nadzorcze-2014.jhtml>, accessed 12 Feb. 2015).

company's interest. Furthermore, it focused rather on technical aspects of company's activities.[29] As it was indicated earlier, after much criticism, on 19 December 2014 the Warsaw Stock Exchange announced the proposal for a new Code on Best Practices and launched a public consultation of the draft. In the next part we describe the present Code on Best Practices and subsequently we present the new proposal, which is expected to come into force in 2015.

[2] Executive Compensation in View of the Present Code on Best Practices

The Warsaw Stock Exchange envisages the strengthening of the competitiveness of the market via its Corporate Governance Code. It therefore attempts to ensure that the Code addresses these issues of significant interests to the participants of the capital market.[30] However, as we will illustrate, the Code does not cover all relevant issues and in particular the issue of executive remuneration is only very partially addressed. Shortcomings of the present Code on Best Practices are apparent in the area of remuneration of company officers.[31] According to the principle I 5:

> [a] company should have a remuneration policy and rules of defining the policy. The remuneration policy should in particular determine the form, structure, and level of remuneration of members of supervisory and management bodies.

Moreover, principle I 5 directly refers to Commission Recommendations 2004/913/EC and 2009/385/EC by stating that:

> Commission Recommendation of 14 December 2004 fostering an appropriate regime for the remuneration of directors of listed companies (2004/913/EC) and Commission Recommendation of 30 April 2009 complementing that Recommendation (2009/385/EC) should apply in defining the remuneration policy for members of supervisory and management bodies of the company.

The quoted wording encountered criticism from Polish legal scholarship. It has been pointed out, that this provision, which was introduced in this form in 2010,[32] and contrary to the earlier versions of Code on Best Practices (especially those of 2002 and

29. The critique may be found *inter alia* in: Adam Opalski, *Nowe Dobre Praktyki w spółkach publicznych*, Przegląd Prawa Handlowego 3, 12 (2008); see also: Arkadiusz Radwan & Tomasz Regucki, *The Possibilities for and Barriers to Sustainable Companies in Polish Company Law*, 11 International and Comparative Corporate Law Journal 1, 99 (2015) (earlier version available at <http://ssrn.com/abstract=2159217>, accessed 12 Feb. 2015).
30. Warsaw Stock Exchange, *Code of Best Practice for WSE Listed Companies*, 21 Nov. 2012, 1.
31. Strong criticism e.g., by Jacek Dybiński, *Pojęcie i charakter prawny programu opcji menedżerskich – zagadnienia prywatnoprawne*, doctoral dissertation, Jagiellonian University Kraków (unpublished), 417 (2011).
32. Earlier regulation had only a little more specified conditions of setting the remuneration, but still it was emphasized, that including regulations regarding both members of management and supervisory board in one single provision should be considered incorrect due to vast differences between the nature of the responsibilities and the duties of a position in each of the boards. Moreover, provided criteria were criticized as inconsistent with some more postulates of economic trade. Adam Opalski, *Europejskie prawo spółek*, 354.

2005) does not include general standards of setting the managers' remuneration, but is limited to simply stating that company should have a remuneration policy, without further explication. The direct reference to the Commission Recommendations is also considered incorrect, as the soft-law code should consist of more specific standards, instead of thoughtlessly referring to all of the standards created by the European Commission, some of which are not even applicable to the Polish corporate governance system.[33]

When analysing the Recommendations on company officers remuneration that were issued by the Commission (Recommendations 2004/913/EC and 2009/385/EC), it needs to be emphasized that many of important provisions were completely omitted by the Polish legal system (except a brief reference to all provisions of mentioned Recommendations in a soft-law code). We briefly examine which provisions related to compensation known and applied in western jurisdictions remain missing in Polish law and corporate governance standards.

First, there is no provision that would directly state, that members of the supervisory board should not receive stock-based remuneration (cf. section 4.4. of Recommendation 2009/385/EC). Such provision is of crucial importance due to the fact, that additional remuneration paid in stock or stock options may create incentives for short-termism and for undertaking some activities to overstate a fair value of shares in order to obtain private benefits in short term. Hence it is recommended that officers who are responsible for the supervision (non-executives in one-tier boards and members of supervisory board in two-tier systems) should not be paid in stock in order to avoid such evident conflict of interest. Such regulations are present in many corporate governance systems worldwide, but remain absent in Poland. The same rationale holds true with regard to the postulate according to which, a right to obtain shares of the company should not vest for at least three years after their award (cf. section 4.1. of Recommendation 2009/385/EC). This aims at reducing potential short-termism. However, there are no such provisions in Polish law.

Second, there are no clear regulations regarding the remuneration policy (cf. section 3 of Recommendation 2004/913/EC and section 3 of Recommendation 2009/385/EC). Especially, there are no criteria that would refer to or specify the determinants that should be taken into account when setting the amount of the salary paid to the company officers. There is only a transparency requirement pertaining to the remuneration paid in listed companies (cf. section 5 of Recommendation 2004/913/EC and section 5 of Recommendation 2009/385/EC).

Third, there are no rules with respect to the early termination of executive contracts – so-called golden parachutes (cf. sec. 2.2. and sec. 3.5. of Recommendation 2009/385/EC). The Recommendation states that such payments should not exceed the equivalent of two years' basic salary, and moreover such payments should not be paid regardless of the managers' performance. As Polish law does not provide any rules regarding golden parachutes, there are some voices in Polish doctrine asserting that general institutions of Polish civil law and commercial law should be applied with

33. Krzysztof Oplustil, *Instrumenty nadzoru korporacyjnego*, 324.

regard to early termination payments. Especially such payments should be examined through the lens of general clauses such as the nature of corporate legal bond (Article 304 § 4 CCC) or the so-called principles of social coexistence setting limits to the parties' freedom of contract (Article 353^1 of Polish Civil Code[34]).[35] Still it seems that these general legal principles of private law are not sufficient to adequately capture the golden parachutes problem, as they can only be applied casuistically. Therefore these principles do not create a clear-cut legal framework for the termination payments, nor provide protection against this kind of abuse.

Other institutions currently considered by the European Commission, or – being more specific – their absence in the Polish law, as it stands today, (especially the 'say on pay' principle or the remuneration committee), have been outlined in the previous section of this chapter.[36]

[3] *The Proposal of the New 2015 Code of Best Practices for WSE Listed Companies*

In December 2014, the Warsaw Stock Exchange drawn up the proposal for an entirely new version of the Code on Best Practices. The proposal is not limited to a list of amendments to the existing Code, but instead it consists of a completely redesigned new document. The recommendations contained in the new draft Code, when compared to the Code which they seek to replace, were extended and clarified, and they take into account to a much greater extent both the EU Recommendations and the findings of the international corporate governance research.[37]

A whole new chapter (Chapter VI) of the draft Code (out of a total number of six chapters) is dedicated to the problems of executive compensation, so as to give a proper account of the pivotal role, that issues of directors compensation play in current corporate governance debate. In each chapter the recommendations are divided into two groups: general provisions, which are not subject to the 'comply or explain'-principle (the company must only declare whether or not the general principle is obeyed by) and specific provisions, with regard to which to company must explain if those provisions are not respected ('comply or explain').

The first recommendation regarding executive compensation is placed in the first chapter, dedicated to the information policy and communication with the investors. According to regulation I.Z.21 in case of stock-based incentive programme, the information about the projected costs of such plan should be published on the website of the company.

34. Pol. *Kodeks cywilny* (Act of April 23rd, 1964, Law Gazette 1964, No. 16, item. 93 as amended.
35. Jacek Dybiński, *Delimitacja nadmiernie wygórowanych odpraw (tzw. złotych spadochronów) dla członków zarządów spółek publicznych w świetle natury spółki akcyjnej*, 3 Czasopismo Kwartalne Całego Prawa Handlowego, Upadłościowego oraz Rynku Kapitałowego 1, 77 (2009).
36. See §12.03[A].
37. The proposal of the Code on Best Practices is available on Warsaw Stock Exchange Website (<http://corp-gov.gpw.pl/assets/library/polish/publikacje/publikacje2014_2015/projekt_dpsn_konsultacje.pdf>).

Other recommendations regarding the executive compensation can be found in Chapter VI. General provisions of this chapter (VI.R.1 – VI.R.6) are devoted mainly to the remuneration policy. According to the draft Code the company should develop a remuneration policy (principle VI.R.1) and there should be a remuneration committee established within the supervisory board (VI.R.3). The policy should be in line with the strategy and objectives of the company, its long-term interest and results and it should take into account the solutions that would mitigate possible conflicts of interest (VI.R.2). The amount of remuneration should be adequate in light of the assigned tasks, should take into account any additional duties (VI.R.5) and should be sufficient to recruit, retain and motivate persons with competences needed for proper management of and supervision over the company (VI.R.4).

The specific provisions of the chapter on remuneration concern mostly the incentive plans. Some of the recommendations of the Commission have been taken into account in the proposal. According to principle VI.Z.2 of the draft Code, in order to tie up the executive compensation to the long term business objectives of the company, a 'vesting period' of three years needs to be observed – a minimum timeframe between granting the option or stock and the possibility of their execution or disposal (which results from provision 4.1. of Recommendation 2009/385/EC) and according to the draft Code's principle VI.Z.3 members of the supervisory board should not be granted stock-based remuneration at all (provision 4.4. of Recommendation 2009/385/EC).

The draft Code also consists of provisions regarding the transparency of executive compensation. According to the general provision VI.R.6 the remuneration policy should be presented to the general meeting of the company, and specific provision VI.Z.4 states that the report on the remuneration policy should be a part of the annual report (it also consists of some further details about information that should be disclosed).

However, there are still some regulatory instruments recommended by the Commission, which were not provided in the proposal. Especially there is 'no say on pay' principle in the new draft Code, as the provision VI.R.6 states that the remuneration policy should merely be presented to the general meeting. One may assume, that such 'presentation' is for informational purposes only, as the provision does not state that general meeting should have any powers with regard to remuneration policy. Neither does the draft Code contain provisions regarding early termination of contracts (golden parachutes), except that information about such agreements must be included in the remuneration report (principle VI.Z.4.4).

To sum up, the draft Code may be assessed as a clear step in the right direction. The provisions regarding remuneration of company officers, which in the previous versions of the Code remained at most rudimentary, are now designed to expand and many of the important recommendations of the Commission have been taken into account. However, there are still some legal institutions which have been omitted, most importantly there still is no 'say on pay' principle, neither has there been any attempt to put in place recommendations on golden parachutes.

[D] Special Provisions for State Owned Companies

In the Polish legal system there are also some regulations which concern only the companies controlled by the state or the local government agencies. A part of these regulations – more specifically the Act of 3 March 2000 on remuneration of persons managing certain legal entities[38] (hereafter: Act on remuneration SOE) – deals with compensation of directors of the said companies. The restrictions on the amount of remuneration paid to members of the management board and the supervisory board are provided with regard to companies, in which the state or local government agency (as well as other company controlled by those entities in a vertical holding structure) controls over 50% of share capital or over 50% of shares (for the sake of simplicity further referred to as the state-owned enterprises or SOE). In any company in which the above-mentioned conditions are met, a pay cap is imposed *ex lege*, whereby managers may not receive remuneration higher than sixfold of the average wage in the Polish economy (Article 8 of Act on remuneration SOE). Moreover, there is a 'say on pay'-principle introduced in SOE, whereby the general meeting shall determine the amount of executive compensation (Article 6 section 2 of Act on remuneration SOE). Since it is the state to control the company, the compensation is de facto unilaterally set by the Treasury Minister or the executive of local government agency.

The Act on remuneration SOE has been widely criticized as a manifestation of populism, which results in the deterioration of the position of companies falling under its scope of application, because those companies are less likely to be able to adequately compensate managers and are thus put in the position where they suffer from a competition handicap vis-à-vis other companies. Putting it differently, the argument goes, the SOEs are not up to successfully compete on the market for managerial talents. On the other side, however, a valid question remains, if and if so, how far the political considerations tend to prevail. Even if it may be assumed that higher compensation could positively affect the supply side of the market for managerial talents, it is far from clear if on the demand side, (i.e., on the side of SEOs) the politics does not have a gravity outweighing the merits and this tension would likely be aggravated if incentives for the prevalence of political arguments grew in line with the rise in salaries allowed by law.

It is also worth noting that conditions in the Act on remuneration SOE are defectively constructed as they in fact mismatch the notion of control that seems to be a more accurate connecting factor than a mere ownership is.

First, the cap is imposed on companies in which state controls 50% of share capital or 50% of shares (which is the same because share capital in joint stock companies is always composed of the shares of the same value), disregarding the voting power. Consequently, multiple voting shares allow to escape this cap – the Act on remuneration SOE would not apply to companies in which the state controls over 50% of voting power, if it does not own 50% of shares.

38. Pol. *Ustawa o wynagradzaniu osób kierujących niektórymi podmiotami prawnymi*, Law Gazette 2013, item 254.

Second, and most importantly, in listed companies usually less than 50% of share ownership gives the blockholder an actual control over the company. This is due to the fact, that one of the main features of listed companies is dispersed ownership, with single shareholder being able to control a company when having less than 50% of voting power, and as it was stated above, the condition of application of Act on remuneration SOE is for the state or local government agency to have at least 50% of all shares of the company. On the Warsaw Stock Exchange the median of voting power of largest blockholder is below 40%, and this persists over the years (with the share structure getting slightly more dispersed recently) – it was 35.81% in 2014,[39] 38.43% at the end of 2011,[40] 39.5% in 2000.[41] This corresponds with the voting blocks of the state in the largest companies. Out of all 469 companies listed on Warsaw Stock Exchange, eighteen are directly or indirectly controlled by state. Out of this eighteen companies, only in seven the share of the state exceeds 50% of voting rights. Those companies are: Polskie Górnictwo Naftowe i Gazownictwo S.A. (72.4%), Polski Holding Nieruchomości S.A. (70.25%), Polska Grupa Energetyczna S.A. (58.39%), Jastrzębska Spółka Węglowa S.A. (55.17%), Lotos S.A. (53.17%), Energa S.A. (51.52%) and Enea S.A. (51.5%). Only these listed companies are subject to Act on remuneration SOE.

However, practices have been reported where the managers sought to circumvent the cap e.g., by getting appointed in supervisory boards of affiliated companies (though not direct subsidiaries). Also a kind of substitute for golden parachutes is being used in form of financially compensated non-competition clauses to extend beyond the director's term in office.

§12.04 LEGAL BASIS FOR STOCK-BASED REMUNERATION

[A] General Remarks

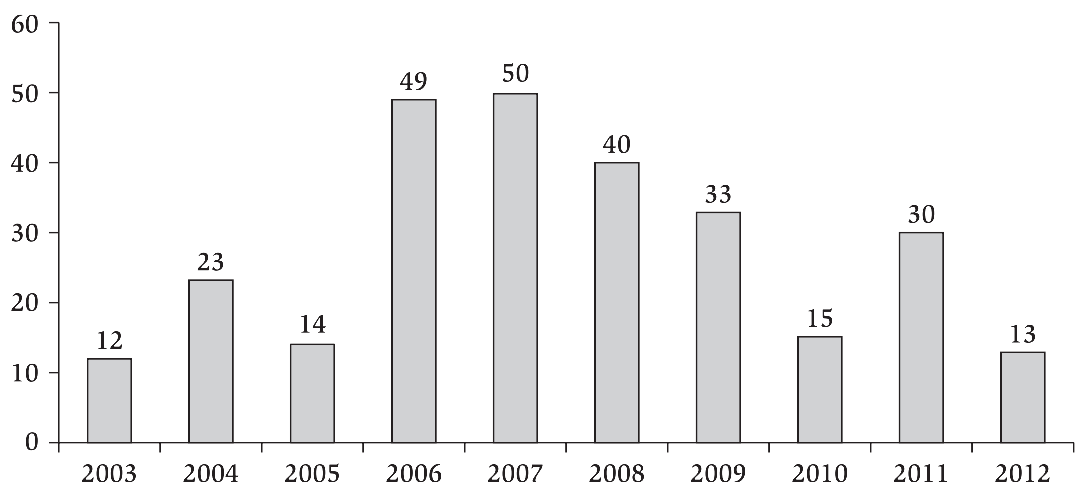
In the current corporate governance model, stock-based remuneration[42] plays an important role as a part of executive compensation. On the one hand such instruments aim at linking the interest of the company with the financial interest of managers, creating incentives to work towards positive reception of company's performance by

39. Own research.
40. Agata Adamska, *Własność i kontrola. Perspektywa akcjonariuszy spółek publicznych*, Warsaw, 102 (Oficyna Wydawnicza SGH, 2013); Another analysis of ownership structure of companies listed on the Warsaw Stock Exchange in 2011 embracing issues related to corporate control in view of the implementation of Directive 2004/25/EC on takeover bids may be found in: Tomasz Regucki, *O potrzebie zmian regulacji wezwań do zapisywania się na sprzedaż lub zamianę akcji – uwagi na podstawie analizy struktury własności polskich spółek giełdowych*, Transformacje Prawa Prywatnego 3, 81 (2012).
41. Piotr Tamowicz, Maciej Dzierżanowski, *Ownership and Control of Polish Listed Corporations*, 24 (2002) (<http://papers.ssrn.com/sol3/papers.cfm?abstract_id=386822>, accessed 12 Feb. 2015).
42. In this paper we use the term stock-based remuneration in a wide sense, regarding all payments the value of which depends on market valuation of company's (or even other companies' of the same capital group) shares, i.e., stocks and stock options as well as cash-settled contractual agreements, which refer to the value of shares (phantom stocks).

market participants (investors) which in turn should be reflected in the increase of the market value of the company (creation of shareholder value). This entails the increase in value of the managerial remuneration. On the other hand, as it was stated in the previous section of this paper, the stock-based remuneration may create some specific incentives towards short-termism, i.e., artificially increasing market value of shares in order to increase the amount of stock-based remuneration. Unfortunately, Polish law fails to adequately address these risks.

As the Polish economy and the capital market grow, many instruments and institutions known in western economies also appear in Poland. Each year more and more companies are listed on Warsaw Stock Exchange as well as in the Alternative Trading System (the so-called NewConnect). The number of available financial instruments (including derivatives) is growing. There is a rise of takeover transactions (including hostile takeovers) taking place, and most importantly with regard to the topic of this paper, the stock option plans for managers have become widespread. Figure 12.1 presents the number of stock option plans adopted in the companies listed on the WSE between 2003 and 2012. It needs to be emphasized, that this statistics demonstrates the numbers of stock option plans passed each year, not the cumulative figure of plans existing in any given year.

Figure 12.1 Number of Stock Option Plans Adopted Each Year in Companies Listed on WSE



Source: Rynek Opcji Menedżerskich w Polsce, Trio Management, 4th Edition, 2013.

As shown on the chart, the peak of the number of stock option plans was in years 2006–2007. This is due to several factors. First, Warsaw Stock Exchange indices archived their all-time high in that period, with the WIG reaching the level of 67,568.51 on 6 July 2007 and the WIG20 reaching level of 3,917.87 on 29 October 2007.[43] Second,

43. WIG – Warszawski Indeks Giełdowy (Warsaw Stock Index) is a broad index which includes all companies listed on Warsaw Stock Exchange, whereas WIG20 is a blue-chip index, taking into account the twenty largest (in terms of market capitalization and trading volume) companies on

the outbreak of financial crisis in 2008 most likely caused a decline in stock option programmes, as the situation of many companies started deteriorating due to the slowdown of the economy, and – most importantly – the stock prices tended to follow a general trend rather than to reflect upon individual company's performance.

In this section we present the legal mechanisms of Polish company law that are possible to be used with regard to granting stock, stock-options and other stock-based instruments as part of additional components of remuneration along with the results of empirical analysis regarding use of those institutions by the companies listed on Warsaw Stock Exchange.

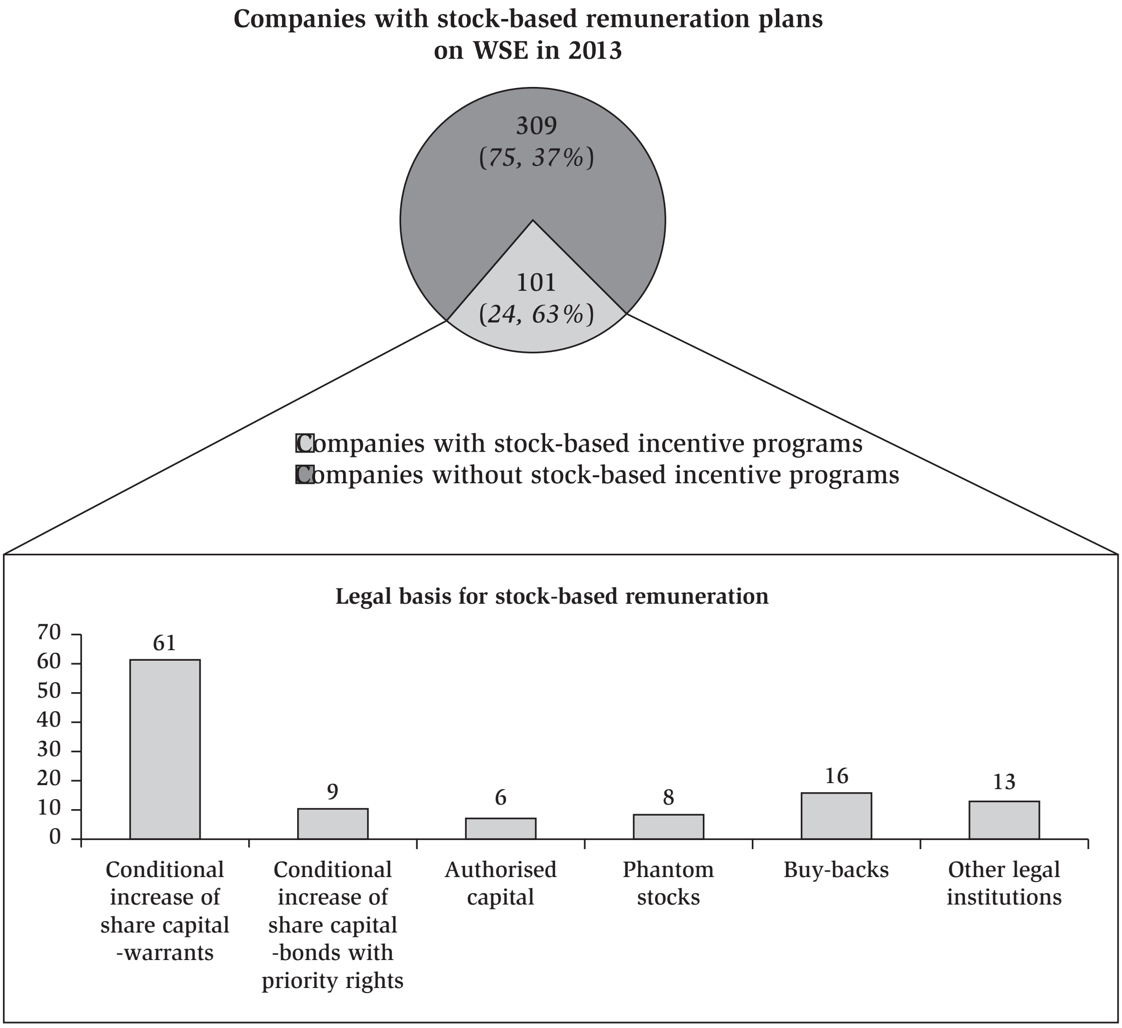
There are a few legal mechanisms that are suitable for the purpose of establishing a stock-based remuneration plan for executives in listed companies. First, stock options may be granted as part of the so-called conditional increase of share capital (Pol. *kapitał warunkowy*). Second, the authorized capital (Pol. *kapitał docelowy*) may be used for granting executives stocks. Third, due to CCC provisions a company may acquire its own shares in order to sell them to the managers (most frequently at discount price). Fourth, contractual agreements may be used in order to create cash-settled financial instruments (phantom stocks). There are also some other legal institutions which are used less frequently.

Next chart represents the number of companies which had stock-based remuneration plans in 2013 indicating also the legal basis of those plans (only companies registered in Poland and therefore operating under CCC were taken into account, foreign companies listed on WSE were omitted). For the purposes of this paper the annual reports regarding the year 2013 (reports released in 2014) of all companies listed on WSE were analysed with regard to stock-based programmes. Each company was examined with the context of having such incentive plans and the exact legal basis for those plans. It needs to be emphasized that only stock-based plans were taken into account – cash bonuses and other awards which were not directly linked to company share capital or the market price of shares were not the subject of analysis.

The number of companies with stock option plans is lower than the one shown on the previous chart because this statistic takes into account only the plans that were declared by the companies in 2014 (regardless of whether those plans were actually used by entitled managers or whether conditions of their application were actually met). Furthermore, the statistic does not take into account plans that have ended before 2013. Some of the companies that adopted such plans in previous years (which are covered by Figure 12.1 above) have been delisted, which caused further difference between the numbers in Figure 12.1 and 12.2.

WSE. For comparison, on 12 Dec. 2014 the value of WIG was 52,265.24 and WIG20 2,360.00. It needs to be pointed out, that due to the growth of WSE currently there is new blue-chip index WIG30 which composes of thirty biggest companies, nonetheless WIG20 will still be quoted until the end of 2015.

Figure 12.2 Number of Companies with Stock-based Remuneration Plans and Legal Basis of those Plans



Source: Own research.

As the chart above shows, a large number of companies (101 out of 410 = 24.63% of the Polish companies listed on WSE in July 2014) do have stock-based remuneration for company officers. The most common legal basis for those programmes is a conditional increase of share capital, which may involve issuing of warrants (sixty-one companies) or bonds with priority subscription rights (nine companies). Authorized capital is also used with regard to stock options (six companies), which may involve emission of warrants (four companies) or options as purely contractual agreements (two companies). Other solutions regarding stock-based incentive plans may involve phantom stocks (eight companies), repurchase of company's own shares and granting them to the managers (sixteen companies), stock options or phantom stocks pertaining to the parent of the issuing company (usually in international holdings) and rarely some other institutions such as investment certificates, options or the free granting of shares of the parent company, purely contractual agreements between managers and the company by which the company commits to issue the new stock for the entitled managers, or a stipulation of the provision of a specified number of stock by the majority shareholder. It also needs to be pointed out, that in some companies the stock incentive plan is based on more than one legal instruments – for example in some cases the company establishes stock-based plan through buying-back shares and offering them to managers and moreover adopts a conditional increase of share capital plan, in case all of the shares bought back are granted to managers and there are still some outstanding entitlements resulting from the incentive plan. Also in some companies the managers do have various entitlements, e.g., they are given the stock options regarding both the parent and subsidiary company. This is the reason why the aggregate number of the legal basis of stock-based plans on the chart above exceeds the number of companies with such plans.

Finally, one more remark needs to be made. Generally there is no universal legal definition of an option in the Polish legal system. In this paper we use this term in a wide sense,[44] i.e., we regard option as a right to obtain shares of a company, i.e., both newly issued shares as well as the existing ones, i.e., purchased in the secondary market (in the context of managerial stock-based remuneration such stock is usually purchased from the company, but other solutions such as buying shares from a dominant shareholder are also possible), as well as cash-settled contractual agreements that directly refer to the value of company's shares (phantom stock).

[B] Specific Modes of Increasing the Share Capital with Regard to Stock-Based Remuneration

The current Code of Commercial Companies was adopted in 2000, entered into force in 2001 and replaced the former Commercial Code of 1934.[45] The enactment of CCC marked an important step of the Polish transformation – after a period of nearly fifty years of centrally-planned economy resulting in lack of case-law, stagnation of legal doctrine and, generally speaking, erosion of the legal framework for commercial trade. The CCC was designed to remedy this situation. Among the new institutions regarding joint stock companies introduced by the CCC there were new specific modes of increasing share capital – the conditional increase of share capital (Pol. *kapitał warunkowy* – Articles 448–453 CCC) and the authorized capital (Pol. *kapitał docelowy* – Articles 444–447[1] CCC).

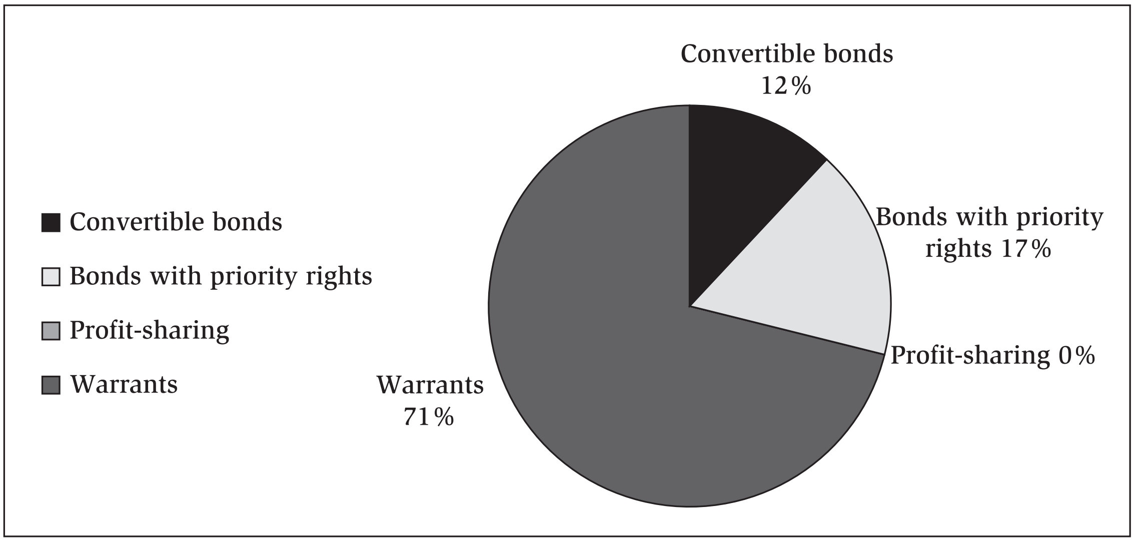
The conditional increase of share capital is an institution designed to enable gaining capital by use of certain financial instruments, i.e., convertible bonds, bonds with priority rights and warrants, as well as facilitating the issuance of shares needed to meet obligations resulting from the creation of profit-sharing entitlements.[46] The conditional increase of share capital is, therefore, based on issuing certain financial instrument granting to its holders the right to obtain a specified number of shares (option). If such holders decide to make use of their entitlement, new shares are issued automatically, with no consent needed from general meeting (which is obligatory in

44. Same as the term stock-based remuneration, see n. 42.
45. Pol. *Kodeks handlowy*, Law Gazette 1934, No 57, item 502.
46. See the legislative motives for the Code of Commercial Companies, available in Polish on Parliament of Poland website: Uzasadnienie projektu ustawy – Kodeks spółek handlowych, Kancelaria Sejmu RP, s. 50–51, www.sejm.gov.pl .

most other modes of increasing share capital). The institution of conditional increase of share capital has been widely used by joint stock companies since its introduction back in 2001. Interestingly, in most cases, it was used for a purpose of stock-based incentive plans for company officers. As it is pointed out in Polish legal doctrine, the institution of conditional increase of share capital is legally and economically best suited for facilitating stock-based remuneration. This is due to its structural features, such as: (i) the possibility of flexible determination of the group of entitled individuals, (ii) the ability to exercise the rights to obtain shares over a specified, long period of time, (iii) the possibly to allot shares in several tranches (it does not need to occur at once), (iv) no need for further consent of any organ after granting options – the shares are issued automatically as soon as any given holder of the option decides to make use of her entitlement.[47]

There are four legal mechanisms allowed for a conditional increase of share capital: (i) convertible bonds, (ii) bonds with priority rights, (iii) profit-sharing entitlements and (iv) subscription warrants. Figure 12.3 presents the statistics regarding use of conditional increase of share capital by listed companies.[48]

Figure 12.3 Legal Basis for Conditional Increase of Share Capital in Listed Companies

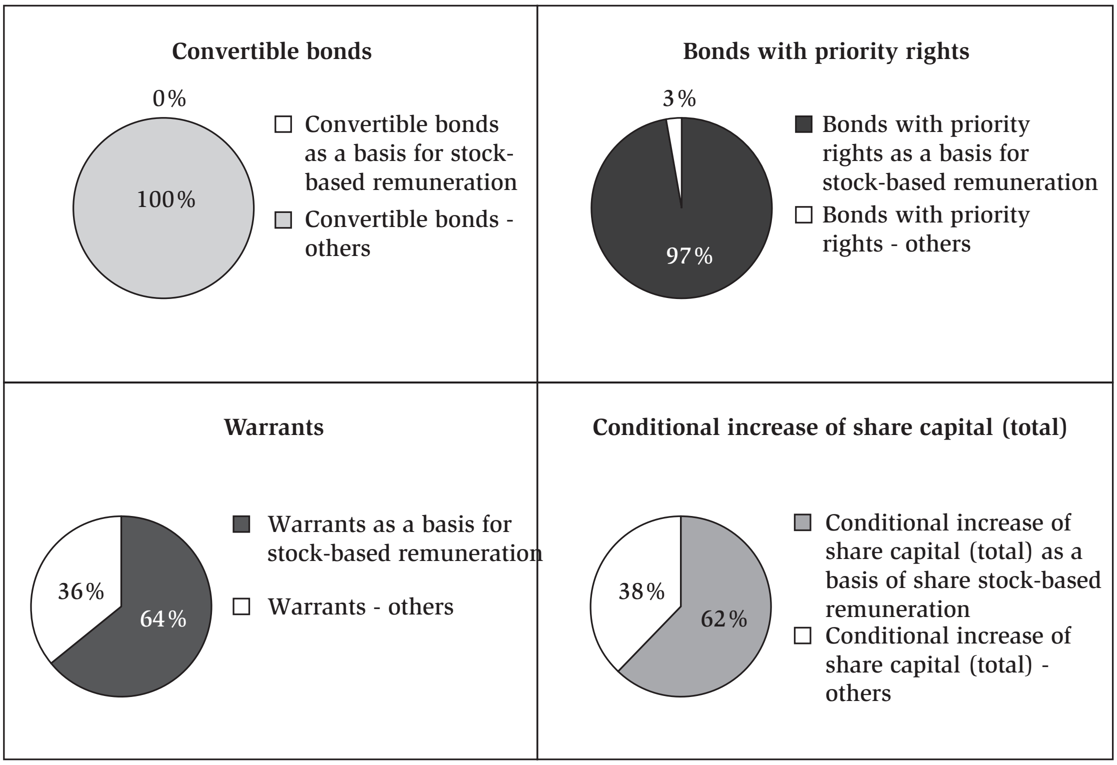


Source: Tomasz Regucki, Maria Stępniewska-Janowska & Jakub Zygucki, *Warunkowe podwyższenie kapitału zakładowego w spółkach giełdowych. Analiza empiryczna*, Allerhand Working Paper 10/2014, 14, <http://www.allerhand.pl/images/WP102014.pdf> (accessed 12 February 2015).[49]

47. Jacek Dybiński, *Pojęcie i charakter prawny programu opcji menedżerskich*, 335.
48. Analysis regarding the use of conditional increase of share capital were made as a part of research project 'Specific modes of increasing share capital in joint stock companies' which was carried out in Allerhand Institute in 2013 and was led by Tomasz Regucki. See: Tomasz Regucki, Maria Stępniewska-Janowska & Jakub Zygucki, *Warunkowe podwyższenie kapitału zakładowego w spółkach giełdowych. Analiza empiryczna*, Allerhand Working Paper 10/2014, (<www.allerhand.pl>, accessed 12 Feb. 2015).
49. All of the companies listed on Warsaw Stock Exchange in July 2013 were analysed with regard to the use of a conditional increase of the share capital. The articles of association together with

As shown in the above chart, the most common legal basis for conditional increase of share capital is the issue of warrants, although bonds (both convertible bonds and bonds with priority rights) do play an important role. There is no profit-sharing used with regard to conditional increase of share capital (reasons for this are explained below in this section of the chapter). Figure 12.4 represents the proportion of each instrument within the conditional increase of share capital used for establishing stock-based plans as part of remuneration of company officers.

Figure 12.4 Conditional Increase of the Share Capital Used for Incentive Plans



Source: Tomasz Regucki, Maria Stępniewska-Janowska & Jakub Zygucki, *Warunkowe podwyższenie kapitału zakładowego*, 15.

The conditional increase of the share capital has become a common legal instrument among the joint stock companies. It is used for several reasons, including raising capital, restructuring, finding strategic investor etc. However, most (62%) of the cases of conditional increase of share capital in listed companies were related to granting

current reports of companies were examined, the total of 213 resolutions of general meetings which provided a conditional increase of share capital were taken into account. In some companies (especially those which introduced a conditional increase of share capital earlier – in 2001–2005) there could have been no information regarding the increase remaining, moreover some companies were delisted prior to 2013. Because of that, the analysis did not take into account all of the conditional increases of share capital, but very large, representative sample (approx. 70%–80% of all resolutions which took place) and the results are therefore entirely representative.

options to the managers. Subsequently, we analyse the four legal mechanisms of conditional increase of share capital with regard to stock-based remuneration.

The use of warrants is an easy technique useful for the conditional increase of share capital. A warrant is a security, which incorporates an option to obtain shares of new issue. If the entitled person decides to use this right, the stocks are issued automatically, without the need of any further consent by any organ of the company. *De lege lata* warrants may be issued free of charge or for a fee. Nonetheless in the vast majority of cases where warrants were employed, they were allocated free of charge.[50]

Another important matter regarding warrants is the procedure to establish the price of the newly issued shares. There are a few possible solutions regarding the determination of the price of the shares to be granted to the managers. First, the price may be set by the general meeting along with the resolution adopting the conditional increase of the share capital – this is the most common model found in 51% of all cases. Second, the resolution may provide a mathematical model that sets the price of shares (usually with a discount relative to market price of the stock) – this method was used in 14% of the cases. Lastly, the stock price may be set by the supervisory board (in 23%) or directly by the management board (in 12% of all cases).[51] However, the latter modus is questionable in view of the general corporate governance principles, as it triggers obvious conflicts of interests. It seems that the management board or even supervisory board (as Polish law does not prohibit granting stock options to members of supervisory board) should be barred from setting the stock price relevant for the determination of their bonuses. However, it may be argued that this problem is not that serious due to two factors – first, the general meeting may set the price of the stock on the minimum level anyway (which is the nominal value of shares) and second, the procedure is fully transparent, so managers could bear personal liability for setting the price at unjustifiably low level (see Article 481, Article 483 CCC). Still, however, it seems to be a case for having in place regulations prohibiting managers to set the price of the stock they obtain in order to avoid the said conflict of interest.

The second technique for the conditional increase of the share capital is the issue of bonds with priority (subscription) rights (Pol. *obligacje z prawem pierwszeństwa*). Such bonds are composed of the standard bond entitlement (which is to receive the nominal value of the bond, sometimes with interest) and the right to obtain shares, which is identical with the right associated with warrants (right of preferential subscription).

Interestingly, in practice bonds with priority rights virtually are not used for anything but facilitating the issuance of stock options – in thirty-five out of thirty-six (97.2%) cases where bonds with priority rights were used, they were used as a stock option mechanism. The standard procedure involves the following: (i) setting the nominal value of a bond at a very low level, (ii) payment by managers of the price, as

50. There was only one example of warrants issued for a fee, still in that case the fee was offset against payments for obtaining the stock, so it may be established that in all cases warrants for company officers are free of charge.
51. Tomasz Regucki, Maria Stępniewska-Janowska & Jakub Zygucki, *Warunkowe podwyższenie kapitału zakładowego*, 23.

set for the bonds (the bonds are always zero-coupon) and subsequently, subject to specific conditions of any given bond issuance, (iii) subscription by the managers for the new shares, and (iv) allocation of shares subscribed for by the bond-holders (i.e., managers). In most cases the bond is redeemed immediately after it entitled the manager to make use of the right to the preferential subscription, which definitively confirms that – economically speaking – the bonds with priority (subscription) rights constitute just another type of warrants.

Also there is a CCC provision regarding profit-sharing schemes within the conditional increase of share capital. According to Article 448 § 2 (2) the conditional increase of share capital (Pol. *kapitał warunkowy*) may be adopted in order that the right for the shares to be taken up by employees, members of the management board or the supervisory board in exchange for contributions in kind can be granted, such contributions representing their claims under vested rights to a share in the profits of the company or those of the dependent company (subsidiary). Even though this provision would be suitable for establishing stock-based remuneration, due to serious legislative flaws, this technique has not been used at all. These legislative shortcoming include *inter alia* the qualification of profit-sharing rights as non-cash contributions, the obligation for such contributions to be examined by the auditor (with further uncertainties regarding the scope and exact procedure of such examination) and the fact, that profit-sharing plan in this case may include the rights to participate in the profit of the company itself or of its subsidiary company, but not the parent company.

Convertible bonds were not used by the companies as basis for conditional increase of share capital with regard to stock-based remuneration plans.

Another company law technique that was used with regard to granting stock options for company officers is the use of authorized capital (Pol. *kapitał docelowy*). The authorized capital is the procedure, provided *inter alia* by Article 29 § 2 of the capital directive,[52] whereby the increase of the share capital may be executed by the management board based on a prior authorization by the general meeting. In the Polish legal practice the authorized capital is widely used and it has also been used to provide a stock based executive remuneration. Empirical research reveals six cases where stock-based compensation involved authorized capital. Besides authorization to issue the shares directly, Polish law allows for the board authorization to issue warrants incorporating subscription rights (Article 444 § 7 CCC). Hence warrants used in connection with the authorized capital are different than those used as a basis for conditional increase of share capital. Whereas warrants associated with a conditional increase of share capital grant the right to obtain a certain number of shares (at a sole demand of an entitled person), warrants linked with the authorized capital grant the right to obtain a specified number of newly issued shares, i.e., without legal guaranties similar to those under the conditional capital. Consequently, this kind of warrants

52. Directive 2012/30/EU of the European Parliament and of the Council of 25 Oct. 2012 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Art. 54 of the Treaty on the Functioning of the European Union, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent, OJ 14.11.2012, *L* 315/74.

structurally resemble pre-emptive rights to newly issued shares. Warrants are granted to the officers and subsequently, upon decision of the management board acting within their authorization to issue shares (Article 444 § 1 CCC) formally required by law to meet the rights of the warrant-holders, newly issued shares may be obtained by the entitled individuals.

[C] Other Techniques

Besides specific modes of increasing share capital as described in the previous part of this paper (see § 12.04[B] *supra*), there are several other institutions that may be used with regard to stock options for company officers.

According to Article 362 § 1 (2) CCC a company may acquire its own shares in order to offer them to employees or persons who were employed in the company or its affiliated company for a period of no less than three years. In such a case, a company carries out a buy-back programme, and the repurchased shares are then offered to the members of the management or supervisory board. Unlike the previously discussed cases of stock-based remuneration, share buy-backs do not involve the issuance of new shares, but instead the employees may buy the existing stock. Since there is no new share issue, rules requiring payment of at least the nominal value of shares do not apply. Technically, the shares can be obtained by the company officers free of charge, but it is not clear in Polish legal doctrine whether this should be regarded as permissible given the existing wording of Article 362 § 1 (2) CCC ('offer for members').[53] Either way, there are many legal solutions to facilitate the acquisition of the shares by the managers, such as providing large discounts, instalment payments, deferred payment etc.[54] It should be noted that in some cases share buy-backs occur together with or supplementary to other stock-based remuneration programmes, e.g., the incentive plan provides, that if all of the warrant or bond-based options are used, the company may employ the buy-back reserve in order to complete the programme by granting company officers more shares, as the need may be. Incentive plans based on buy-backs have been implemented in eight companies (which is 12.5% of all companies with stock-based remuneration in 2013).[55]

Another important mechanism for providing the management with long-term variable pay are the so-called phantom stocks (Pol. *akcje fantomowe*). These are contractual arrangements that provide additional remuneration for the company officers, which are based on the price of listed shares. Managers receive payment based on the increase of price of shares as if the manager himself was holding the shares. Still, such arrangement between a manager and a company is of purely contractual nature. This kind of arrangement may be considered as a cash-settled derivative, and it may be

53. Stanisław Sołtysiński & Tomasz Sójka in Stanisław Sołtysiński, Andrzej Szajkowski, Andrzej Szumański & Janusz Szwaja, *Kodeks spółek handlowych. Komentarz. Tom III. Komentarz do art. 301 – 458 KSH*, Warsaw, 538 (C. H. Beck, 2nd edition, 2008) states that such action should be allowed, whereas Rodzynkiewicz, *Kodeks spółek handlowych*, 725 advocates that obtaining shares free of charge should be limited only to some exceptional cases.
54. Rodzynkiewicz, *Kodeks spółek handlowych*, 724.
55. Own research.

written as an additional clause within the managerial contract (or other form of contract such as contract of employment) or may constitute a separate arrangement. In 2013, phantom stocks were used in seven companies, which is 10.94% of all (sixty-four) companies that provided stock-based incentive plan for members of management or supervisory board.[56]

There is also a wide spectrum of other possible solutions with regard to stock-based remuneration. For example, a company may establish a closed investment fund, which invests in the shares of the company, and grants investment certificates to the members of management or supervisory board.[57] Moreover, it is common to grant stocks or stock options (mainly as contractual agreements) of the parent company, which is often a foreign controlling investor or international holding corporation.

§12.05 CONCLUSION

In this chapter we presented the main features regarding the remuneration of company officers in the Polish legal system. As was shown, even though the issues regarding executive compensation are among the most important ones in the contemporary corporate governance debate, Polish regulations are still rudimentary, and remain behind the current developments at the EU and international level.

Having said that, the Polish legal system does not provide many detailed regulations concerning the remuneration of company officers, frequently ignoring the recommendations of the European Commission. Still, there is a basic framework of executive compensations stated in the CCC and other legal acts. Following legal institutions in this field have been introduced in Poland:

– By default, the organ competent to set the amount of remuneration for members of the management board is the supervisory board, whereas generally there is no ‘say on pay’ for shareholders in Poland. The articles of association may state otherwise (Article 378 § 1 CCC).
– The general meeting may authorize the supervisory board to establish an additional remuneration for members of the management board, that is based on a profit-sharing scheme (Article 378 § 2 CCC).
– With regard to companies in which the state or a local government agency directly or indirectly controls over 50% of share capital or over 50% of the shares, there are certain restrictions (cap) regarding the amount of remuneration paid to the company officers, as well as the ‘say on pay’-rule (Article 6 section 2 and Article 8 of Act on remuneration SOE).
– Listed companies must disclose the amount of remuneration and bonuses, together with other information in the annual report (§ 91 section 6 pt. 17 of the Ordinance of Ministry of Finance on information that needs to be disclosed by issuers).

56. Own research.
57. Such solution was implemented in Polish company Agora S.A.

- The remuneration committee is mandatory in banks that are large in terms of size, internal organization, scope and complexity of conducted operations (Resolution of Polish Financial Supervision Authority 258/2011 of 4 October 2011).
- The new draft Code of Best Practices for WSE Listed Companies introduces a number of recommendations on directors' remuneration, in particular pertaining to the remuneration policy, fostering long-term orientation of the corporate performance, the avoidance of conflicts of interests as well as transparency of compensation.

Stock-based remuneration plans can be found in a significant number of companies listed on the Warsaw Stock Exchange, but as yet they are not commonplace in Poland – approximately one fourth of WSE listed companies had some form of stock-based remuneration plans as of 2013. There is no single scheme used by the companies, instead there is a variety of legal instruments enabling the implementation of such incentive plans. The most frequently used among them is the conditional increase of share capital supporting the issuance of warrants that grant to their holders i.e., the beneficiary officers, subscription rights for new shares.