



Emerging Markets:

A Review of Business and Legal Issues

VOLUME 1 | No 2 | DECEMBER 2009

Articles:

- Smart Cost-Cutting Sustainable - restructuring for small and medium sized companies by *Jan van der Oord*
- Hydrometeorological Risks: A growing market in Mexico by *Juan Pablo Mejia*
- Loss adjusting process by the insurance companies in Poland by *Tomasz Gulla*
- Advertising as an act of unfair competition by *Krystyna Fedorowicz*
- Islamic banking by *Seema Rao and Syed Burhanur Rahman*

Emerging Markets: A Review of Business and Legal Issues

WWW.KENTLAW.EDU/EMERGINGMARKETS

The purpose of the journal is to provide forum for international, interdisciplinary work on the business and legal issues confronting emerging markets.

The journal combines theoretical soundness and practical relevance. The articles guide policy makers while also advancing theoretical understanding.

Editorial Board

Richard Warner

Editor In Chief
Professor of Law
Faculty Director, Center for Law and Computers
Chicago-Kent College of Law
Visiting Foreign Professor, Director School of American Law, University of Gdańsk, Poland
Director, School of American Law, University of Wrocław, Poland
rwarn@kentlaw.edu

Agnieszka Cenzartowicz

Associate Editor
Adjunct Professor
Chicago-Kent College of Law
Program Manager
Partners for Financial Stability (PFS) Program
East-West Management Institute Representative Office in Poland
acenzartowicz@kentlaw.edu

Lukasz Grzejdziak

Associate Editor

Igor Solodovnik

Associate Editor
Adjunct Professor
Chicago-Kent College of Law

Tomasz Gulla

Associate Editor
Editor In Chief Printpol.pl (legal-insurance service)
Editor In Chief European Center for Combating Insurance Fraud (ECCIF)



Advisory Board

Edward Carter

Assistant Illinois Attorney General
Supervisor of the Financial Crimes Prosecution Unit
Adjunct Professor of Law
Chicago-Kent College of Law, Chicago

Anna Fornalczyk

Partner - Założyciel
COMPER
Fornalczyk i Wspólnicy

David Gerber

Distinguished Professor of Law
Co-Director of the Program in International and Comparative Law
Chicago-Kent College of Law

Henry Peritt, Jr.

Professor
Director of the Graduate Program in Financial Services Law
Chicago-Kent College of Law

Wojciech Rogowski

Expert, Economic Institute
National Bank of Poland
Assistant Professor
Warsaw School of Economic

Judge Dariusz Sielicki

Ministry of Justice, Warsaw
Adjunct Professor of Law
Chicago-Kent College of Law, Chicago

Disclaimer: Statements of fact and opinion in the articles in *Emerging Markets Review* are those of the respective authors and contributors and not of the *Emerging Markets Review*. *Emerging Markets Review* make any representation, express or implied, in respect of the accuracy of the material in this journal and cannot accept any legal responsibility or liability for any errors or omissions that may be made. The reader should make her or his own evaluation as to the appropriateness or otherwise of any experimental technique described. They are put forward to stimulate discussion.

Cover design & Photo: Tomasz Gulla

CONTENTS

Articles:

Smart Cost-Cutting Sustainable - restructuring for small and medium sized companies by <i>Jan van der Oord</i> (Netherlands)	4
Hydrometeorological Risks: A growing market in Mexico by <i>Juan Pablo Mejia</i> (Mexico)	14
Loss adjusting process by the insurance companies in Poland by <i>Tomasz Gulla</i> (Poland)	20
Advertising as an act of unfair competition by <i>Krystyna Fedorowicz</i> (Poland)	38
Islamic banking by <i>Seema Rao and Syed Burhanur Rahman</i> (India)	72

Jan van der Oord

Author: Mr. van der Oord worked as a consultant for more than 15 years, supporting companies throughout Europe to improve competitiveness. He mainly supports clients on topics in the field of operations excellence, sales effectiveness, cost management, restructuring and transition management, often in consumer related industries. He is working intensively with companies in EE since 1992 and happy to say that most of his current clients are served by A.T. Kearney and himself for more than 5 and even up to 15 years.

Following an earlier career as a consultant at A.T. Kearney in Amsterdam and Oslo, Mr. van der Oord gained extensive management experience as Vice President of Bertelsmann and as Sales & Marketing director Gorenje-Germany. His current position is Vice President and Shareholder of A.T. Kearney and member of the leadership of A.T. Kearney South East Europe with a specific focus on South East Europe.

“Smart Cost-Cutting Sustainable - restructuring for small and medium sized companies”

The current economic crisis, and the speed with which it gained a foothold, caught many companies by surprise. Even as long-term forecasts point to a reviving global economy within the next few years, many managers remain worried about their short- and mid-range prognoses. A sustainable restructuring plan can help reduce the uncertainty in the near future while preparing to take advantage of opportunities in the longer term. Using our approach, small- and medium-size companies can outline potential scenarios, improve cash flow quickly and implement a corporate fitness program.

The global downturn has hurt almost every sector, and the sudden drop in demand and sales has been especially menacing. As almost all companies focus on reducing costs, only a handful have done so systematically enough to make a lasting impact. Most firms are conserving capital and controlling expenses in the most obvious areas— cutting back on equipment investments, reducing marketing and IT spending, selling assets, drastically cutting inventory levels, freezing salaries, reducing administrative costs, and eliminating all unnecessary staff, travel and training.

No doubt, these are all necessary measures that clearly boost a company during a recession, but most are implemented too narrowly and will have little effect on growth or prosperity when the crisis is over. Successful change requires tackling the challenges of the current situation while creating future opportunities.

For small- and medium-sized companies to meet these challenges, we recommend a smart cost-cutting approach called sustainable restructuring. There are three pillars to this approach: know all possible scenarios, ensure a healthy cash flow, and shape corporate fitness for the crisis and beyond (*see figure 1*).

No one can say exactly how long the crisis will last, or what dangers lurk in the future, but good managers prepare for all possibilities.

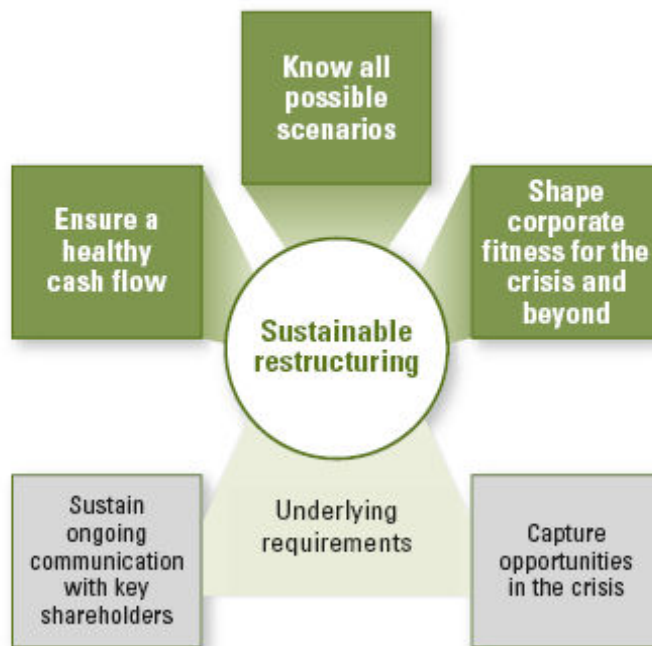
Know all Possible Scenarios

Scenario planning recognizes that the economic crisis will have a different impact on different companies, their value-chain partners and competitors. By involving all of a firm's

stakeholders in outlining possible scenarios, companies can prepare for the worst while avoiding surprises and roadblocks that can lead to hasty, unpopular decisions.

Figure 1

Three pillars of sustainable restructuring



Source: A.T. Kearney analysis

The following are steps we suggest to our clients when they engage in scenario planning. It usually takes about four weeks to complete.

Develop the scenarios.

Many of our clients are struggling in this economic crisis as banks resist loaning money, investors demand no-risk business cases, suppliers delay orders and customers hesitate to order in advance. By developing scenarios, all stakeholders have a clear, documented vision of the future and the concrete steps necessary to get there. We typically use the following three scenarios when preparing for potential problems:

Staggering loss of sales. This is characterized by a sales drop of 20 percent or more, often caused by a general decline in customer demand or a sales hit in a few markets or product segments. Lost sales mean less purchasing muscle and the need for temporary labor and cost reductions as companies struggle to break even.

Black eye. In this case a recession hits all relevant markets and product segments. Sales tumble dangerously, by as much as 40 percent, led by the departure of main customers. As the balance sheet falls into the red, the knee-jerk reaction is often to stop all innovation projects, partially halt production lines, cut salaries and bring in temporary workers.

Business inferno. Sales collapse by 60 percent or more, bottom-line losses are staggering, cash flow is problematic or nonexistent, and fixed costs can't be covered. At this point, companies often call for government help or major cash infusions on equity and debt—the recent events surrounding the U.S. automakers are a good example.

A business inferno is usually caused by a severe recession and a complete collapse of primary markets and customers. Facing such a crisis, companies are forced to sell assets and lay off large numbers of employees.

Perform a segment analysis. In all three scenarios, an analysis of market segments is used to evaluate the effect of the scenario on corporate strategy and market positioning. It serves as a stress test to help make the right choices. There are three steps to this analysis:

Assess market segments. Re-evaluate the attractiveness of major market segments. Are you protected against potential competition? Do you expect regulatory changes that would change the face of competition?

Review positioning in relevant segments. Examine the impact of the crisis on consumers, competition and the competitive landscape. How would a price change affect how customers see your company? Is consumer behavior shifting in some segments?

Test strengths and weaknesses. Amid all these changes, strengths and weaknesses will be affected. Are your current strengths sustainable in light of the crisis? Will it be necessary to develop new strengths to participate in new segments?

Gauge the impact.

A primary goal of scenario planning is to understand the impact of each scenario on innovation, purchasing, production and logistics. Determine where the crisis is hitting the company hardest and which areas you should focus on to minimize risks and capture potential opportunities. Reduce costs in non-core areas but keep crucial capabilities intact. Think beyond your company's four walls. For each major cost area, assess risks in each of the three scenarios, weigh your ability to adapt, and determine the right actions to address the risks (*see figure 2*).

Figure 2

Assess risks, costs and actions in each cost area

	Risks and costs	Actions
Innovation	<ul style="list-style-type: none"> • Less innovation could mean loss of future competitiveness • Medium cost flexibility due to innovation cooperation contracts with partners 	<ul style="list-style-type: none"> • Curtail unsuccessful innovation activities • Outsource innovation activities to increase internal flexibility
Purchasing (raw materials, components, services)	<ul style="list-style-type: none"> • Supplier bankruptcy • Less cost flexibility due to long-term supply contracts and fluctuating prices 	<ul style="list-style-type: none"> • Reduce supply complexity and renegotiate • Use supplier de-risking and collaboration • Establish flexible price adaption • Fast-track material cost reduction
Production and logistics (labor, machinery, warehouse)	<ul style="list-style-type: none"> • Overcapacity and non-competitive factor costs • Low cost flexibility due to short-term fixes such as reductions in labor 	<ul style="list-style-type: none"> • Challenge fixed costs in all areas • Flex labor costs • Increase operational and production efficiency • Sell assets and optimize footprint
Administrative (labor, marketing)	<ul style="list-style-type: none"> • Overcapacity and organizational slack • Unclear sales effect of marketing activities 	<ul style="list-style-type: none"> • Implement organizational fitness program • Outsource non-core activities • Introduce shared services • Increase effectiveness of marketing activities
Financing	<ul style="list-style-type: none"> • Loss of restricted access to bank loans • Restricted third-party funding • Restricted capital markets • Increased cost of capital 	<ul style="list-style-type: none"> • Challenge all investments • Access alternative funding sources • Assess cash position and financing needs • Free up working capital

Source: A. T. Kearney analysis

Identify new opportunities. Evaluating risk is important, but you also want to identify new opportunities that will emerge. By doing this you can escape the general downward trend that comes from decreasing demand, overcapacity, falling prices and profits. There is no better time to identify and push promising new ideas and activities than when your competitors have stopped doing any of that. With select investments, companies can establish an advantage in terms of know-how and time-to-market relative to their competitors, with the goal of capitalizing on the opportunities when the crisis passes. For example, you may consider pursuing an innovative process at the same time competitors are freezing their innovation budgets. Furthermore, if partners in innovation are under pressure brought on by the crisis, it is a good time to renegotiate cooperation contracts with new terms and new partners. This thinking also applies to labor-intense segments where the crisis can present an opportunity to get a more flexible workforce. In production, for example, a crisis is an opportunity to establish new standards, improve the logistics footprint and consolidate facilities. All procedures that fall into the “we’ve-always-done-it-this-way” category are now subject to change.

Ensure a Healthy Cash Flow

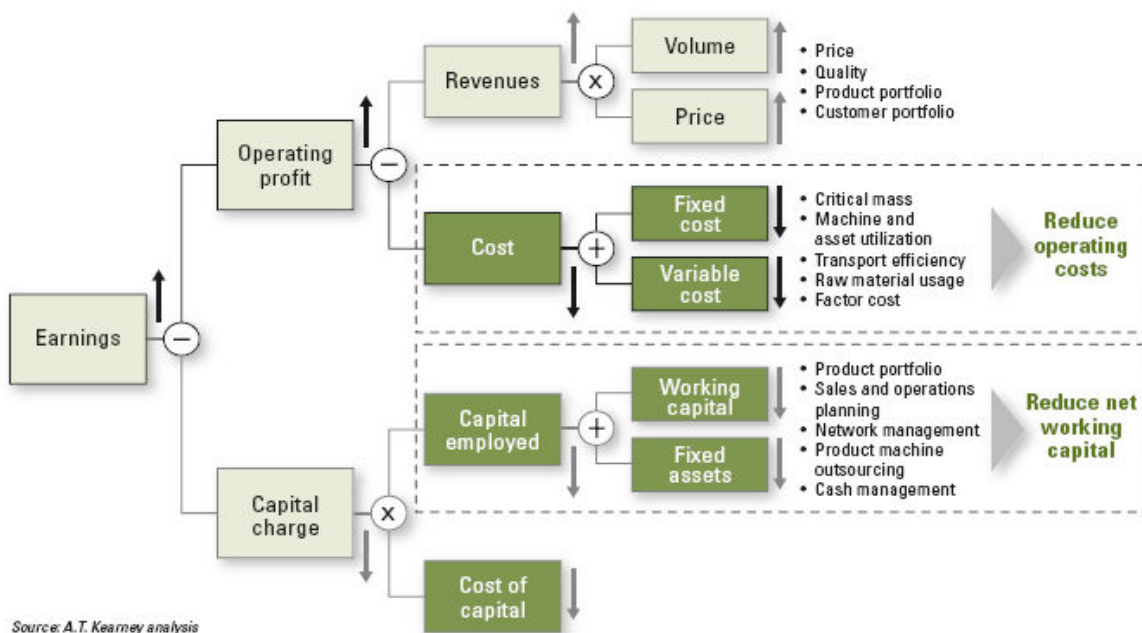
The second pillar of our sustainable restructuring approach focuses on capturing immediate savings and cash flow opportunities by reducing operating costs and net working capital and restructuring liabilities. Figure 3 shows the links between these areas and the economic earnings of a company based on a value creation model. There are seven steps to securing cash flow, a process that takes about eight weeks:

Reduce net working capital. Inventory management, decreasing accounts receivables and increasing accounts payable are proven steps toward reducing working capital. A best-practice benchmarking initiative will indicate the potential advantages of increasing working capital.

Reassess planned investments. Map investments according to their strategic and financial justification and, depending on the scenario, adapt, postpone or cut individual investments.

Figure 3

To improve cash flow quickly, reduce operating costs and net working capital



Audit cost center budget. This audit is conducted in three steps: reviewing underlying business and scenario planning, analyzing cost positions and recalibrating budgets.

Find quick wins in purchasing. Assessing sourcing will help identify costs and uncover savings potential such as reducing the cost of materials and complexity.

Reduce flex workers and freeze hiring. Beyond simple workforce reductions there are other tools to reduce surplus, such as redeploying workers to other areas and reducing work hours.

Examine IT development. When improving IT costs, the focus is on: technology architecture and lifecycle analysis, service and application processes, total infrastructure costs, and overall operations and strategic IT sourcing.

Restructure debt. In restructuring debt, the challenge lies in finding the right balance between financial engineering and obtaining a quick impact that can lead to recovery. Shortterm wins are likely to be realized by resetting covenants, exercising equity cure rights, or simply taking advantage of the existing headroom in loan documentation.

To succeed in the long term, however, it is essential to think in terms of the bigger picture. Financial modeling, for example, is crucial to understanding the company's future cash flow profile and its potential financing needs. There are several options for restructuring debt depending on the company's current financial situation (*see: Restructuring Debt for Long-Term Success*).

All of these debt measures have one thing in common: The challenge is in the execution. Creditors have to be convinced to agree on new conditions and equity owners have to reinvest in the company. That can be a hard thing to communicate in shaky conditions.

Shape Corporate Fitness for the Crisis and Beyond

Incremental improvements will not carry a company through a crisis. Planning for the worst and saving cash offer meaningful hints of what must happen over the medium term to survive the crisis.

However, sustainable, ongoing change requires high-impact actions that maximize the benefits and build momentum for change. A corporate fitness program does just that, helping you reach sustainable cost competitiveness by taking out unnecessary costs while strengthening key value-adding activities.

A corporate fitness program consists of the following steps, which can take eight weeks to perform:

Set targets. Establish a baseline view of the company's situation by identifying and analyzing the main cost drivers. We use a benchmark database that comprises data about more than 32,000 companies, combined with hands-on experience to set targets, develop hypotheses and identify improvement opportunities.

Assess opportunities. Workshops and interviews with key managers will help validate the hypotheses and identify gaps. After the managers have come to a consensus, workshops can be broadened to include other stakeholders such as department heads, experts and employees who can help outline ways to close the gaps and determine necessary actions. Hierarchy is not relevant in these workshops as everyone is encouraged to question old beliefs and make decisions based on facts and logic. The goal is to identify and prioritize potential actions and set out short-term plans to realize them (*see: In a Hurry to Capture Tangible Results?*).

Prepare for implementation. Delineate the business case for each improvement opportunity and prioritize rollouts to capture quick wins and realize the full cost-reduction potential. To secure commitment and ownership, agree on implementation plans with all responsible line managers and budget holders. All project and line managers should be clear on targets, remodeling actions within units, efficiency improvement areas and precise responsibilities. Process champions, project drivers and line managers are all responsible for implementing the measures, realizing the potential and keeping executives and the workforce up to date on their progress. Tangible results can be used as a basis for communications with vital stakeholders within and outside the company.

Implement the plan. Implementing a corporate fitness plan should take into account the financial impact and ease of each action, tracking mechanisms and monitoring tools. Appointing program managers can steer the transformation and ensure that agreed upon milestones are met and savings are captured.

A corporate fitness program is compelling because it is based on a broad master plan, designed for fact-based discussions about setting priorities and allocating resources. In this way, internal political fights and disagreements can be kept to a minimum.

One major success factor is involving all relevant managers and internal experts to perform a quick top-down assessment to identify the main performance gaps and roadblocks. Don't waste time explaining the company's unique situation—in comparing your company to peers and best practice firms, there are indisputable places to improve. There must be agreement among top and middle management about which gaps to close and how quickly to close them.

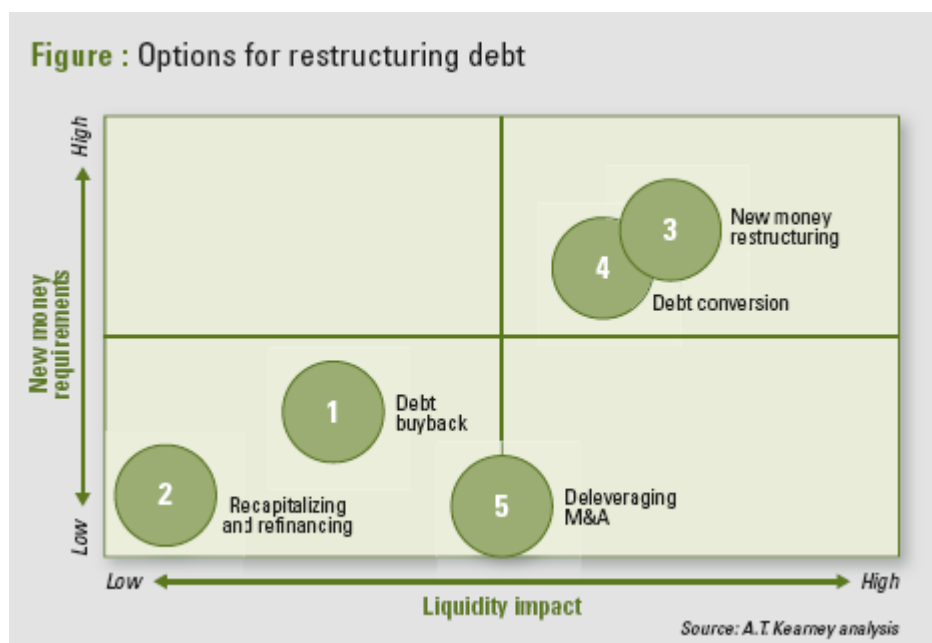
In the end, the corporate fitness program mobilizes a company for improvement. The single master plan reduces unnecessary costs and processes, assesses and prioritizes opportunities, and creates an implementation roadmap for a strong return on investment.

Building for the Future

The current crisis caught a lot of companies off guard, but the opportunity to preserve the business today and become stronger for the future has not passed. With a sustainable restructuring plan, it is possible to counteract the risks of the current crisis while preparing to exploit new opportunities when the recession ends. As the crisis “normalizes” the value of companies, there is an opportunity to strengthen business segments poised for growth, and acquire attractive targets with the funds released through smart cost-cutting.

Restructuring Debt for Long-Term Success

Companies have several options for debt restructuring, differing in liquidity impact and money requirements (*see figure*).



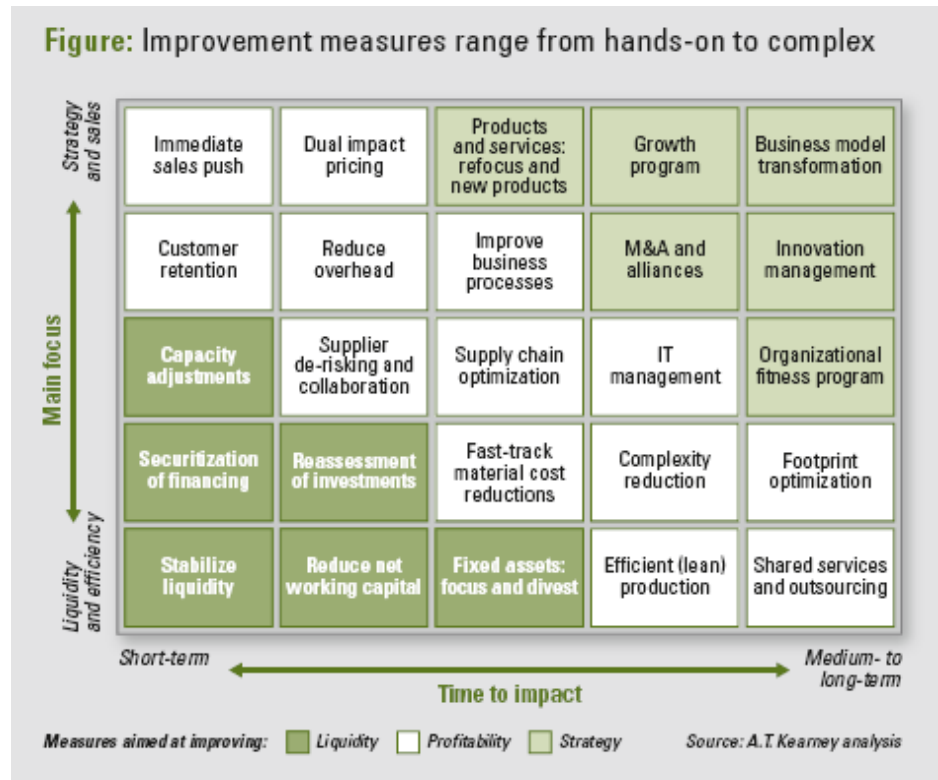
1. Debt buyback. Purchase debt at a discount to reduce cash drain by cutting interest charges and repayments. A German media company did this successfully, buying back a significant amount of its senior debt in the past several years.
2. Recapitalization and refinancing. Develop a new capital structure based on assessing the company’s business plan. This should take into account debt capacity and conditions, and cash flow profile. A leading Brazilian telecommunication firm completed a \$500 million debt recapitalization in 2006 that provided the company with greater flexibility to deal with future economic changes.
3. New money restructuring. Deleverage the business by injecting new money and amending loan documentation. Executors are often private equity firms. A leading German automotive

fast-fitting chain overcame a dramatic fall in earnings in 2008 by injecting roughly \$200 in new equity.

4. Debt conversion. Recalibrate capital structure with debt-to-equity swaps. This is often done in the case of fundamental deleveraging due to underperformance. A Spanish real estate company sold a 55 percent stake to a consortium in exchange for canceling almost \$3 billion in debt.
5. Deleveraging M&A. Dispose of or divest non-core assets, depending on the transaction type. For example, in 2006 a global automaker began the divestiture of its financial service business. The company is expected to make similar reductions due to the current crisis.

In a Hurry to Capture Tangible Results?

Considering the magnitude of the current financial crisis, companies are often in a hurry to capture tangible results. As such, the focus should be on deploying resources and optimizing current assets and investments, while also examining the overriding corporate strategy. All short-term measures are tailored to this strategy (see figure). Our approach examines various



measures, from hands-on to complex, that can improve liquidity and profitability, and reset and strengthen the company's strategy. These measures are classified based on their main focus and on their time-to-impact, and then categorized to either improve liquidity, profitability or strategy.

Juan Pablo Mejia

Author: Juan Pablo Mejia (pablitomejia@hotmail.com), is a lawyer from Universidad Panamericana, Campus Guadalajara, Jalisco, Mexico.

He has completed postgraduate studies in the area of risk management and insurance.

Also in Social Leadership, at the Institute for Business Development.

He has worked as a consultant in the program of Insurance and Risk Management at the Universidad Panamericana, Campus Guadalajara, Jalisco, Mexico.

He has participated in the International Symposium of law "Mexico and the New International Legal Order" in October 2002, ITESM Campus, Monterrey, Nuevo Leon, Mexico. And at the International Symposium entitled "The responsibility of the State" in November 2005, ITESM campus in Guadalajara, Jalisco, Mexico.

Mr. Mejia, currently pursuing post-graduate studies on *legal defense*, given by the Judiciary of the Federation.

“Hydrometeorological Risks: A growing market in Mexico”

Actual problematic issues regarding hydrometeorological Risks

World over, Insurance and Re-Insurance Companies are in trust to take on risks that could arise in certain investments and business, those risks could have important consequences on financial assets of independent investors and businessmen, that is why we have create an existing need of Insurance. We should remember, as an important recent example of catastrophe hydrometeorological phenomena, that have become transcendental risks.

Mexico is a growing market that recently has captured the attention of several investors, especially foreign investors wide world. For those circumstances, as equal of other developing economies, foreign investors have no certainty on their investments. The investors need to be sure that money and asset would be sure on those growing markets.

Unlike world-wide strong economics, the countries with potentially developing economies do not contemplate within their legislations protection to the sector before mentioned, staying as liberality protection of predictable phenomena with unfortunate consequences, such as the hydrometeorological ones. To not being a common practice, the Insuring Companies do not anticipate of ordinary way this protection, to not being viable for the previous ones, but they represent a high cost.

In Mexico, by their geographic circumstances, hydrometeorological risks have been appellants, having repercussions in the tourist industry, mainly in the coasts. In 2005, the Mexican coasts were whipped by Wilma, a hurricane that meant important damages to the economy, to the sector investor and coverall the permanent damage to the tourism of the south-east of our country. The risks to have been assured, the infrastructure reconstruction and economic recovery of the affected sectors could be previous. The importance of the insuring sector. In Mexico, the insuring sector, is one of the strongest and important sectors for the

economic development of the country, because this one allows to foment, to develop and until certain point to guarantee by means of the payment of compensation, the investments of the small ones, medians and great companies.

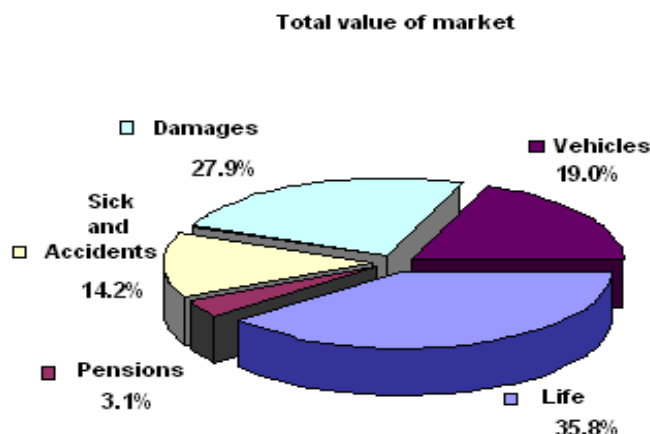
At the moment, we would not understand the commerce in its diverse modalities, without the endorsement of an Insurance Company, because this one plays a crucial role in the globalised world taking on rapidity and pressure of the businesses and investments that it faces. For this reason, the increasing necessity to delimit the possible risks in the performance of the businesses.

At the present time, the insurance contract, follows and with greater force, because it is necessary to protect the patrimony of the individuals, covering the effective risks to which they are exposed. Therefore, with the course of the time the people and still more the companies, have acquired the greater one brings back to consciousness of the importance to be properly protected.

Main insurable risks in Mexico

The sector in the matter of insurances in Mexico is conformed of the following way:

Total value of market	
Damages	27.90%
Sick and Accidents	14.20%
Pensions	3.10%
Vehicles	19.00%
Life	35.8%



The Mexican market, as it is come off the presented/displayed graph, is I divide in 46,9% stops with regard to the insurance of damages and rest 53,1% for the branch of people.

Economic endorsement of the insuring sector

According to legal dispositions, the insuring companies in Mexico are considered of “credited reliability” and they will have to guarantee the risks to which they are committed with his insured, thus, the assured public has certainty of which the Insurance agencies will respond precise of the damages, and this as well brings tranquility in the negotiations and sensations of protection and comfort to those who celebrate contracts of insurances in anyone of their meanings.

The certainty produced in the payment of the damages caused by the assured wrecks, finishes by applier the confidence in the assured public and therefore the increasing necessity to assure all the risks that could appear. The increasing being more and more the number of assured risks, the national market in the matter of insurances is seen fortified.

Regulatory authorities in Mexico

In Mexico, the responsibility to supervise to the insuring companies is entrust to the National Commission of Insurances and Guarantees, which emit obligatory resolutions and mainly; it carries out duties of inspection and monitoring; additionally, it is designed to take care of that the operations of the insuring sector are become attached to the normative frame,

preserving the solution and financial stability of the institutions, without leaving of side the guarantee of the interests of the users of the services that these companies offer, as well as to most of promote the healthy development of the sector extending the cover of their services to the population.

Being an institution whose moral authority is recognize by the assured sector, one will take care of guarding completely by the insuring and guaranteeing companies of the country. Also, considering the interests from the strengthened insured.

Imminent risks in Mexico

Nowadays, one of the obstacles to develop the culture of the insurance of damages as of people is mainly the lifted costs of the premiums and little acceptance of the risks on the part of the Insuring Companies. To exemplify, in the branch of the insurance against damages, the hydrometeorological hurricane risk or, represents nowadays, elevate costs for the insuring companies reason why to assume the risk, necessarily implies paying elevated premiums.

Nevertheless, the Insuring Companies are conscious of the Mexican panorama and, in spite of being next the season of hurricanes, these does not assume the risks, anticipating and taking like antecedents the last experiences lived in the Country caused by catastrophic phenomena, mainly meteorological, that had consequences in millionaire losses to the hotel and tourist sector.

As it is defined in previous paragraphs, the main business of the insuring sector is the risks, and on Mexico, great part of the economy is based on the market of tourist services including the hotelkeeper. Taking like departure point in the Mexican geographic context, which is defined by the two coasts, the Gulf of Mexico and the Pacific Ocean; we can infer that the meteorological phenomena appear in greater frequency than in other places of our planet, that's the reason why the imminent risk to undergo a patrimonial reduction is frequent. Nevertheless, many insuring companies abstain to assume these risks, with particularity those that could appear in beach, reason by which we concluded preliminarily that a sector of opportunity at the market of insurances exists that are responsible for those risks.

The re-insurance market will have then to take part to make against these risks and back to the national companies, not only to obtain a better handling of the risks, but to obtain that these risks are assumed of total way by the insuring companies.

Opportunities of insuring market in relation to the risks caused by hydrometeorological phenomena.

As development in the previous lines, is obviously well-known that the originating risks of the hydrometeorological phenomena is a niche of market little developed in Mexico. Nevertheless, also it is a market little developed to world-wide level, whose opportunity of development in the private sector can be pluripotenciable.

The damages caused by the risks in this matter can clearly be defined and by consequence, they can be quantified and be assured. It will be then, active role of the Insuring Companies and Re-Insuring Companies to understand the needs of the present market and to assume the risks that the tourist sector requires in these days. Reason why one mainly exhorts the Re-Insurance so that they realize the exercise of evaluation of benefit-cost that represents the tourist industry and the represented economic benefit in premiums that bring prepared assuring this type eventualities.

Tomasz Gulla

Author: Mr. Gulla (gulla.t@printpol.pl) received a MA degree in Law from the Faculty of Law and Administration, University of Gdansk, Poland in 2006. In 2008, he completed postgraduate studies on Law of Financial Services of the European Union at the same institution.

He has participated in many conferences, events and training seminars, including: IX International Conference on Insurance Offences in Szczecin, Poland (2007); Mediations and Negotiations for Lawyers (2004); and Strengthening the Protection of Intellectual and Industrial Property Rights in Poland, conducted by experts from the Danish Patent Office and the Polish Patent Office. In October 2009 he was speaker in Regional Workshop on Insurance Supervision - CEF and the PFS Program - Ljubljana, Slovenia.

Mr. Gulla is founder and editor-in-chief of Printpol.pl, a legal-insurance website. Currently involved in the development of an Internet information platform about insurance fraud in the European Union, which is planned to be released in January 2010 (www.insurancefraud.eu).

He has conducted research on insurance fraud in Poland for over eight years. He has authored the following reports:

- "*Insurance Fraud – Social Aspects*" (2007) - This report was published during the above-mentioned IX International Conference on Insurance Offences in Szczecin, Poland in 2007; in the Polish *Insurance Newspaper* and in the Polish monthly magazine *Law on Insurance and Reinsurance*.
- "*Insurance on the Internet*" (2003).

Mr. Gulla works in a law firm in Gdansk. He specializes in penal and insurance law. He is preparing his doctoral dissertation on coup d'état in the Chair of Criminal Substantive and Executive Law and Legal Psychiatry, Faculty of Law and Administration, University of Gdansk, Poland.

Mr. Gulla is a passionately keen photographer who has exhibited his work in Hamburg, Gdansk, Lodz and Vienna.

“Loss adjusting process by the insurance companies in Poland”

(reprint in Gazeta Ubezpieczeniowa 40/2009, PUR 9/2009)

I. Introduction

This report is an analysis of the survey performed via Internet, on the insurance web portal **Printpol.pl**¹, from 25th August to 10th December 2008. The sample was 504 persons. The acquired group of respondents is not representative, but the results make it possible to continue this type of research in the future. Because of the issue's complexity and the need for gradual improvement of research methods and instruments, this research is a pilot one and the interpretation of the results is possible only with having that in mind.

This report presents, within the introduction, a short characteristic of the insurance market in Poland (chapter II) and of the Polish law regulations regarding this branch of the economy. The next chapter presents a general scheme of the loss adjustments process. The fourth chapter presents the analysis of the survey results.

The results of the survey seem to confirm the widespread opinion, that the insurance companies in Poland intentionally understate the value of compensations, and some have adopted a rejection policy. The research show, that **74% of respondents think, that the insurance company failed to estimate their loss objectively**, and the entire process of loss adjustment was considered as unprofessional by over 60% of respondents.

There were accusations, that the mechanism consisting of the maximal understatement of the vehicle's market value took place with simultaneous overstatement of the repair costs (parts and labor costs).

¹ Legal and insurance web portal.

II. The insurance market in Poland.

1. History

First manifestations of the realization of the insurance idea in Poland started in 15th and 16th century and, like in other European countries, they were connected with the mining funds¹. The first mining act in Polish, on the insurance is „Ordunek Gorny”, issued by the prince Jan II Opolski in 1528².

Only in the 17th century, an institutionalized forms developed, similar to the insurance companies, in the form of so called „fire funds”, which consisted of fees paid in advance and aimed in helping the fire victims. In Poznan, since 1757, there was a „Fire Fund”, and in the 18th century, the citizens of Polish towns were insuring their buildings in foreign insurance companies, e.g. the citizens of Gdansk were insured in the London-based company – „Feniks”.

The first insurance companies developed in the 18th and 19th century during the partition of Poland and mainly under Prussian rule³. Historically it is said that the first insurance companies in Poland were, established under the decree of Frederic William in 1803 – Fire Insurance Company for towns in the South Prussia and, in 1804, Fire Insurance Company for Villages in South Prussia.

Before 1939, there were 72 private insurance companies in Poland, 38 mutual insurance companies and 16 insurance institutions. In 1947, private companies were no longer allowed to provide insurance services, and through joining and liquidation, the number of public insurance companies was decreased, as a result of change in the political-economical system. Only two insurance companies survived, Państwowy Zakład Ubezpieczeń – PZU (National Insurance Company) and Warta S.A. The first was a monopolist regarding the personal and property insurance, and Warta was a monopolist regarding the foreign exchange personal and property

¹ These organizations were supporting ill, injured miners and their families.

² W. Markiewicz, *Dzieje ubezpieczeń w Polsce*, NBP Portal, 2009.

³ Regulacje prawne w dziedzinie ubezpieczeń gospodarczych w Polsce Ludowej [in:] „185 lat ubezpieczeń gospodarczych w Polsce”, joint publication, Toruń 1988, pp. 42-70.

insurance as well as reinsurance¹. The insurance sector in Poland, during nearly the entire socialism times, was limited only to broadening the scope of obligatory insurance.

The turning point and overcoming of the monopoly started after the free market reforms, and the act on insurance operations from 1990 established the base for the modern insurance market, through the permission for commercial and private companies and mutual insurance companies operations, as long as they will be in a form of joint-stock companies.

2. Subjects of insurance market

In the end of June 2009, there were 64 insurance companies, from which: 30 life insurance companies, 34 property insurance companies.

In recent years, the number of insurance companies in Poland did not change. Poland, in comparison to Europe, has a large number of insurance companies. The number of such companies in Poland is twice as much than e.g. in Hungary and more than twice as much than in Czech Republic, Lithuania and Latvia. When it comes to the countries with a longer history of free market, like Austria or Portugal, Poland has a bigger number of registered insurance companies. The biggest number of insurance companies (over 400) is registered in Germany, which has the lowest concentration ratio among the EU countries.

One can assume, that the health insurance market in Poland will evolve in the direction of replacement (or supplementation) of subscription service providers through the insurance, which is in accordance with the European standard.

Despite the weakening of Polish economy, as a result of the global financial crisis in 2007, the insurance sector in Poland shows a better resistance to the crisis than other sectors of the financial market.

3. Costs of insurance activity

¹ Polska Izba Ubezpieczeń (www.piu.org.pl)

The main costs of insurance companies consists of costs connected with compensation payments and payments of benefits resulting from the insurance agreements. In the first quarter of 2009, the Polish insurance companies paid gross 9.54 billion PLN (\$3.18 billion) of compensations and benefits including loss adjustment costs and regress collection costs. In the first department, 6.56 billion PLN (\$2.18 billion) of benefits was paid. In the second department, gross compensations and benefits were 2.97 billion PLN (\$0.99 billion).

A large position among the expenditures of the Polish insurance companies is taken by the costs of insurance activity, which include acquisition costs and administration costs. Acquisition costs include, among others, all costs directly connected with acquiring and signing the insurance agreement, collection of the insurance fee (e.g. commissions, medical examination costs, expert opinion costs). These costs also include the reinsurance commissions and shares in profits paid to assignors. The acquisition costs in the first quarter of 2009 were 1.86 billion PLN (\$0.62 billion), with 0.89 billion PLN (\$0.30 billion) in the first department and 0.97 billion PLN (\$0.32 billion) in the second department.

The administration costs comprise of management and administration costs and general costs of insurance activity, like: office costs, other services, remunerations, energy costs, etc. The administration costs of the insurance sector were 0.86 billion PLN (\$0.28 billion), including 0.39 billion PLN (\$0.13 billion) in the first department and 0.47 billion PLN (\$0.15 billion) in the second department.

The total administration and acquisition costs in the first quarter of 2009 were 2.72 billion PLN (\$0.9 billion). The insurance companies activity costs were 21 PLN (\$7) per each 100 PLN (\$33) of fee in the deductible, while in the life insurance it is about 18 PLN (\$6), and in property insurance 26 PLN (\$9).

III. Loss adjustment process in Poland.

In Poland, the scope of actions performed by the insurance company regarding the loss adjustment proceedings depends on its size. However, since a few years, one can see a divergence from the model, where the internal network of insurer's posts performs the loss adjustment process, and the whole process is more often commissioned to the external entities. Sometimes in the loss adjustment process, one uses the evaluation system based on points to examine the loss in the scope of potential obtaining of compensations under false pretences (the most often in the OC – third party – insurance¹). Losses, determined in such way are adjusted under the manager supervision.

We can distinguish a typical loss adjustment scheme, which consists of the following stages:

- 1) Loss report;
- 2) Initial loss adjustment activities;
- 3) Determination of the compensation amount;
- 4) Payment of the compensation.

Re. 1. Loss report.

In Poland, most insurance companies require loss report to be performed in writing, however the „direct” insurance companies allow for a report via phone. It has to be noted, that the loss report via e-mail is also possible, which has started along with the Internet sales of policies in the beginning of the 21st century.

Re. 2. Initial loss adjustment activities;

At this stage, according to the art. 16 (1) of the insurance activity act on 22 may 2003, after receiving the report on the random incident under the insurance protection, the insurance company within 7 days from receiving of this report, informs the insurer or insured, if they are not the persons reporting, and starts the proceedings for determining

¹ OC – obligator third party liability insurance for the owner of a mechanical vehicle.

the factual state, legitimacy of reported claims and compensation value, and informs the person, who raised the claim in writing or other agreed way, which documents are needed for further proceedings. These activities are directed to determine, if the reported loss is within the insurance company liability.

Re. 3. Determination of the compensation amount.

The evaluation of the loss is often supported by a specialist software (often used in motor losses).

Re. 4. Compensation payment – is a final stage, where the insurer, after the evaluation of the compensation amount makes the decision on compensation payment. This decision may require the approval of a person on the higher post – which is connected with the compensation amount and employee authorization to make decisions within his own post. After making the decision, the insurer pays the compensation to the entitled person.

Appeal consideration.

These are activities performed by the insurance company only in the case, when the entitled person appealed from the insurer's decision. In such case, the insurer considers the issues stated by the insured, analyses them in order to make a decision, in which he dispels the previous decision in whole or part, or rejects the appeal.

II. Results and analysis of the research

1. Respondents characteristics.

The survey was performed between 25th August 2008 and 10th December 2008 on the Printpol.pl website and concerned the population of Poland; the sample consisted of 504 persons.

Over a half of respondents (55%) were persons between 26 and 36 years old (chart 1). Citizens of large cities were predominating (chart 2).

Chart 1: The age of respondents

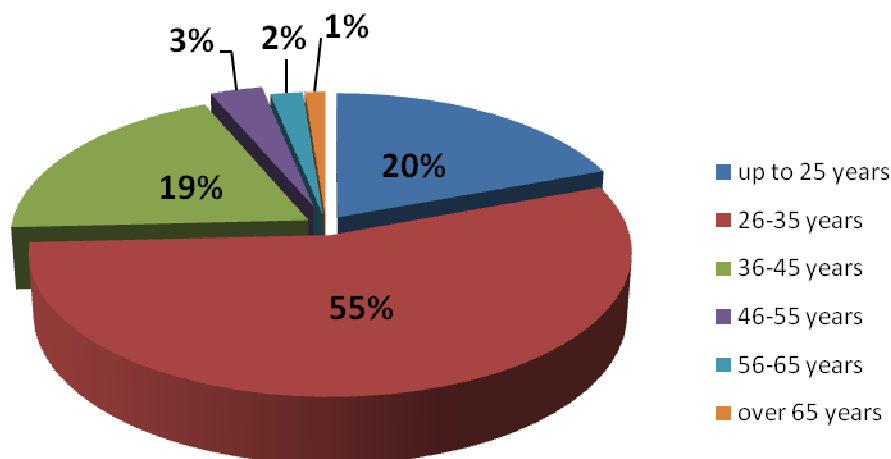
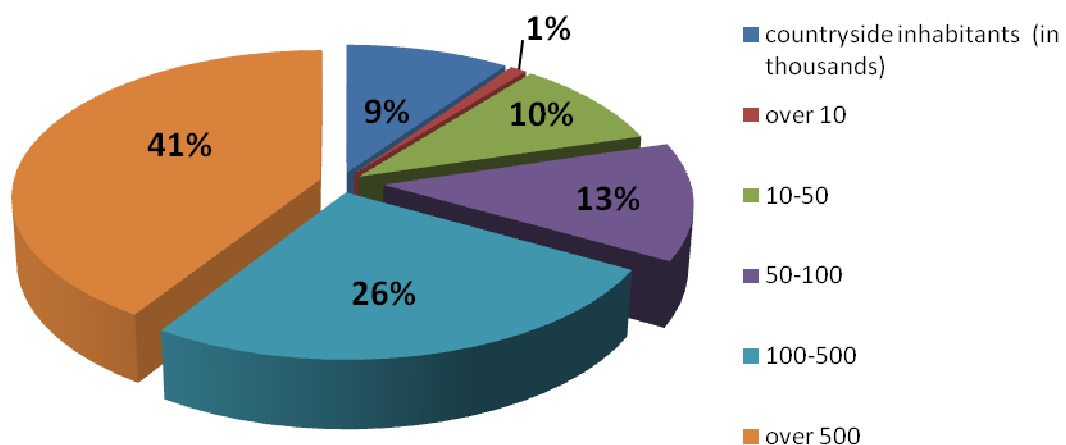


Chart 2: Respondent's place of living



2. The analysis of performed research.

The performed research show, that up to 74% of respondents is of an opinion, that the insurer did not evaluate the loss objectively (chart 3), and the loss adjustment process was considered as unprofessional for over 60% of respondents (chart 4).

Chart 3: Did the insurance company objectively evaluate the reported loss value?

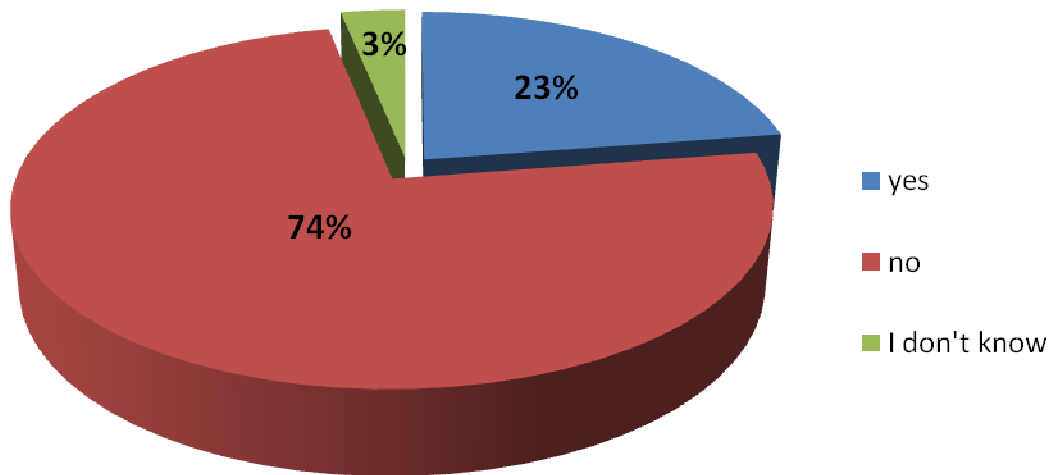


Chart 4: The evaluation of loss liquidation process by respondents.

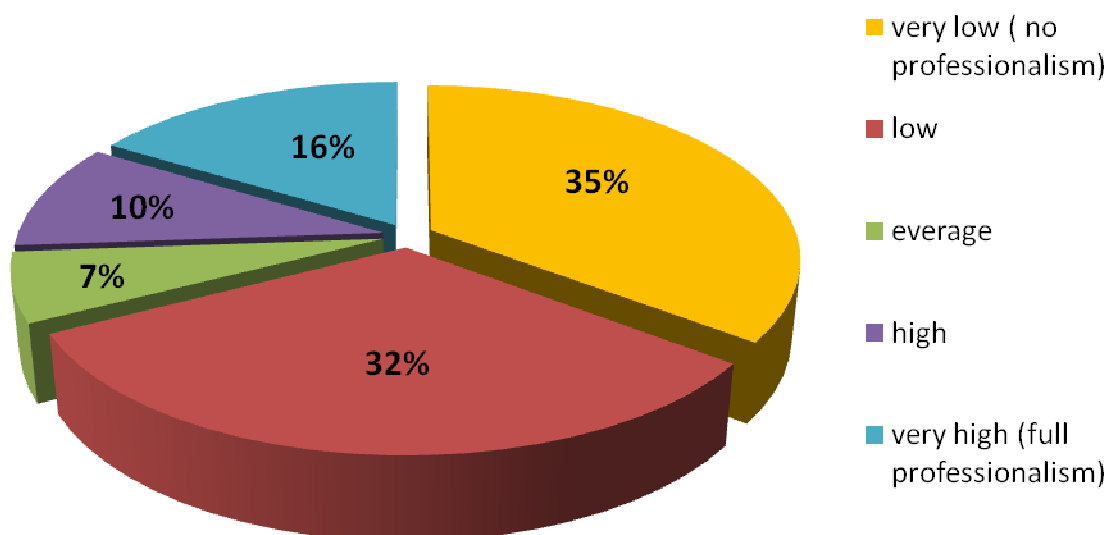
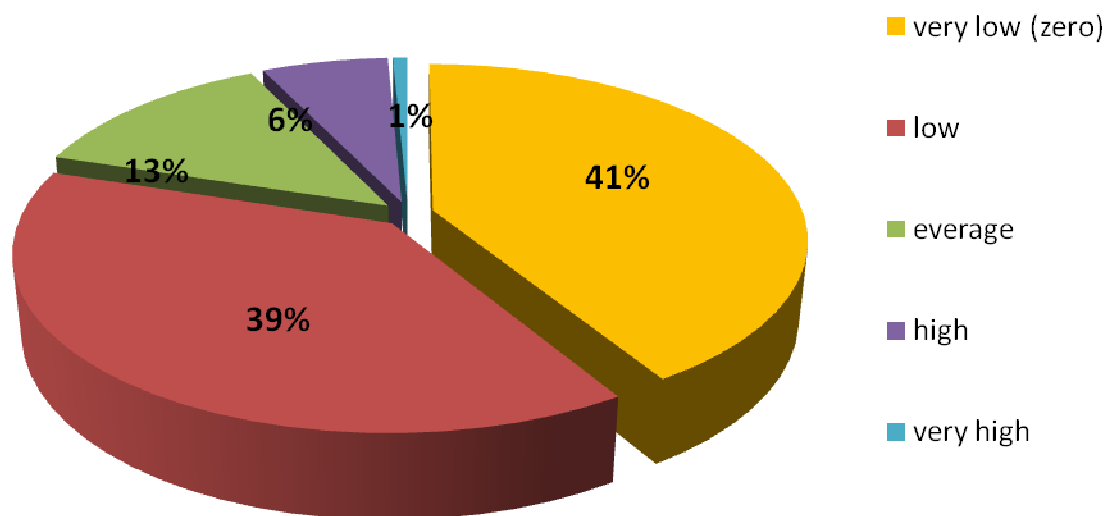


Chart 5: The respondent's evaluation of compensation value paid by the insurance company in the reported loss.

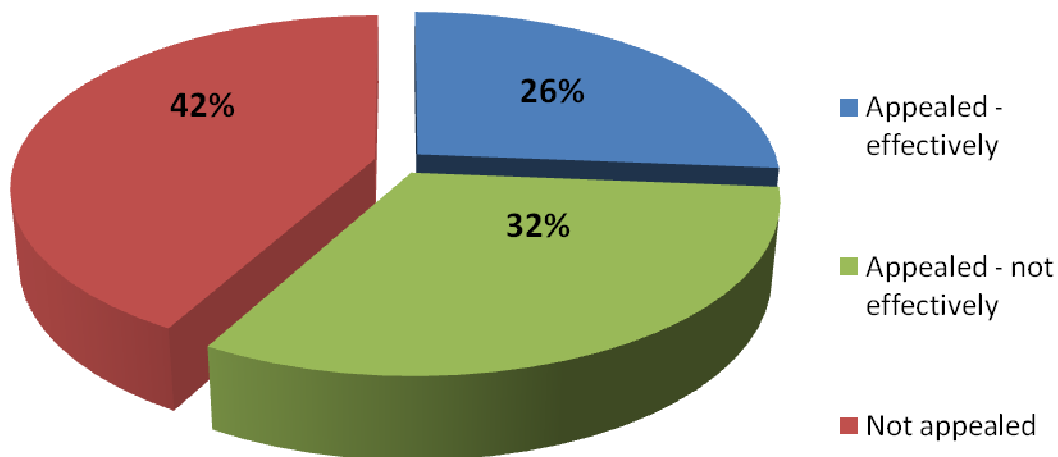


The negative opinion of respondents regarding the objectivity in loss evaluation may be connected with the victim's assumption, that the employee of the insurance company will be driven only by the interest of his employer and not by the actual evaluation of the loss value. Regarding its financial gains, the insurance company cannot allow itself for too „generous” payments of compensations and in every case, where possible, the insurer will try to pay compensation in the amount which will be appropriate for the loss size. It is understandable, that the compensation amount that is appropriate for the insurance company is usually not appropriate for the victim.

One should note, that in case of personal losses, we can see large differences between the compensation granted by the insurer and compensation sentenced by the court. There is a well-known tendency of insurance companies in Poland to compensation payments of fixed amounts per percent of injury, which is against the current legal state, because the sentence by the Polish Supreme Court from the 18th November 1998 (Case No. II CKN 353/98) stated that, **„One cannot rate the compensation for damage per percent of injury.”**, as well as the sentence of the Polish Supreme Court from 28th June 2005, (case I CK 7/2005), clearly defines, that *„The scope of damage, and in consequence the amount of compensation, consist of physical and psychological suffering, which type, frequency and duration has to be individually established in the circumstances of a given case. The measure of loss, only by a percentage of*

injury would be an unacceptable simplification, not in accordance to the art. 445 § 1 of the Polish civil code.” Even so, the sentence of the Polish Supreme Court from 12 September 2002 (case no. IV CKN 1266/2001) points out, that „*During the evaluation of the compensation amount for a non-material loss, the court should take into consideration not only the situation given in the time of passing the sentence, but also the future decrease of the purchase power and to grant it in an appropriate amount*” – which unfortunately is not applicable to the insurer’s compensation amounts.

Chart 6: Percentage of persons, who appealed from the insurer’s decision (including the result)



In reference to data regarding appealing of the victims against insurance companies decisions, 42% of such people have applied. How does this data correlate with a large number of people discontent with the amount of paid compensations? This issue should be taken under further research and it should be established if such large number of people, who did not appeal against the insurer’s decision regarding the compensation may be connected with:

- a) Lack of knowledge about the possibility of appealing (despite every decision has information about such possibility);
- b) Lack of confidence, that such appealing will bring out a desirable effect;
- c) Resignation from the appealing proceedings in order to bring an action against the insurer;

Within the 58% of persons, who appealed against the insurer's decision – nearly 2/5 of them gained a desirable effect. The performed research also show, that only 11% of respondents, which appealed against the insurer's decision were using the advice of a legal professional (legal adviser, lawyer) (Chart 7). In the sample group, nobody has pointed the insurance agent as a person, who helped them in the loss adjustment proceedings.

The analysis of the effectiveness of appeals in case, when the victim is advised by a lawyer or by a specialist company it was 69%, while in the case of persons, who did not use any help – the effectiveness was only 38%. Such high effectiveness is connected with the professional legal representation by a lawyer, his knowledge, preparation, but one should also remember, that the insurers do not want to start a dispute with the victim represented by a professional attorney, taking into consideration additional costs connected with the trial in case of defeat.

Chart 7: Help used by respondents when appealing against the insurance company's decision.

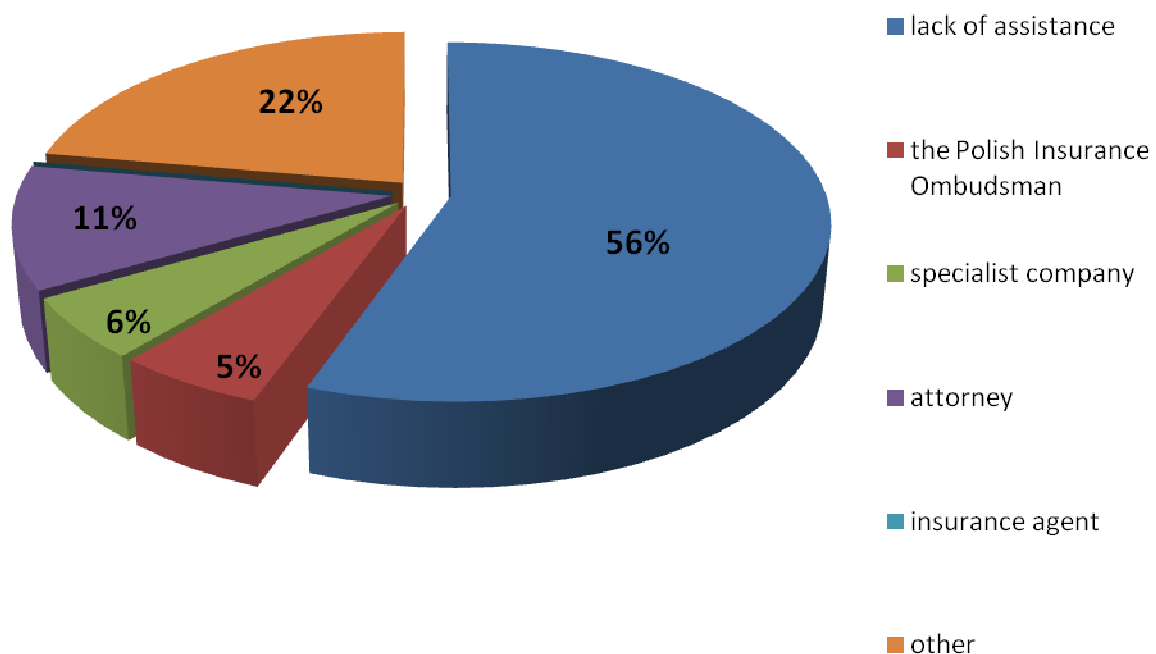
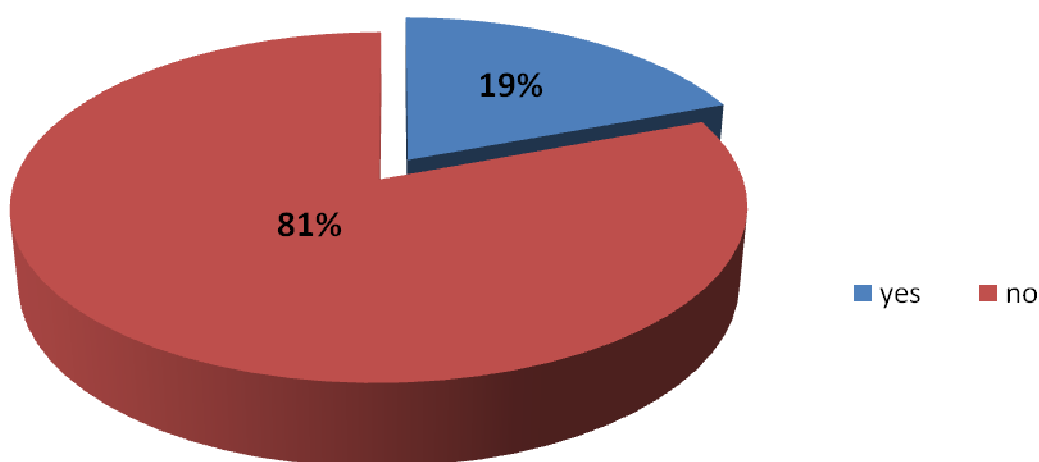


Chart 8: Percentage of people, who brought a court action against the insurance company.



Despite a critical opinion on the compensation amount and loss liquidation process – only 19% of respondents were fighting for their rights in court. Such situation may be caused by several factors, e.g.:

- a) The evaluation of the actual loss to the compensation paid;
- b) Court costs and legal representation costs;
- c) Lack of certainty about the desirable court's decision.

In case of personal losses, with the claim for sufferings in e.g. 300 000 PLN, the court fee is 15 000 PLN – of course, one can ask for court fee exemption in whole or part, which is often done by the court, but it is undoubtedly a factor limiting the actions against insurers.

The performed research, as well as my experience show, that the insurers in Poland are using some mechanisms in estimating the value of a loss, understating or overstating it, depending on which is more favorable for the insurance company. I would like to note, that nowadays it is hard to point out if this practice is frequent, but it takes place for sure.

Overstatement of the loss value takes place in case, where the insurer wants to accept a given loss as so called „total loss”. The notion of „total loss” is not defined in Polish regulations, but the art. 363 § 1 of Polish Civil Code states, that „*if the restitution of the previous condition is not possible or requires excessive problems or costs, the claim of the injured party is limited to the financial compensation*”. While, most of the general AC insurance terms and conditions, the

stage required of the „total loss” is determined at the level of 60 to 80% of the vehicle value, which means, that in case of repair exceeding the agreed vehicle value, it is considered as a total loss, which results in the usage of, so called differentiate method in establishing the compensation amount, which consist of decreasing the vehicle’s value before the damage with a vehicle’s value in the damaged stage.

In case of the obligatory OC insurance of vehicles, the insurer is required to compensate the loss up to 100% of the vehicle’s value, but the practice and the respondents opinions show, that the insurance companies incorporate the conditions from AC insurances to losses connected with the OC – which is illegal. One can only guess if this is employees’ fault – their lack of knowledge or competence or an intentional policy of the insurance company.

The respondents also pointed out, that during the loss adjustment process, the total loss was „artificially” created, through the understatement of the vehicle’s value and repair value of this vehicle.

It happens so, despite the usage of professional software like Eurotax, Audatex. In such case, we cannot talk about the software error, but about subjective evaluation of the loss value by the loss adjusters, e.g. by understating the rates for man hours.

Another alarming signal is lengthiness of the loss adjustment process. The Polish Civil Code regulates this issue in the following way *„art. 817 § 1 In the absence of an agreement to the contrary, the insurance institution shall complete performance within thirty days counting from the date of the receipt of notification of the event. § 2.If it proves impossible within the above period to clarify the circumstances necessary for determining the liability of the insurance institution or the amount of compensation, performance shall be effected within fourteen days from the clarification of those circumstances. However, the institution shall complete the uncontested part of the performance within the period in the foregoing paragraph.”* So, the parties cannot decide on the date of performance according at their discretion, because this date is bounding. Such regulation is profitable for the insurer.

In case, where the clarification of the circumstances necessary for determining the liability of the insurance institution or the amount of the compensation proves impossible, the

insurance company has 30 days to complete the indisputable part of the compensation, and the rest – in 14 days, from the clarification of this circumstances was possible. The lack of performance in a given period gives the insured the right to claim interest for late payment.

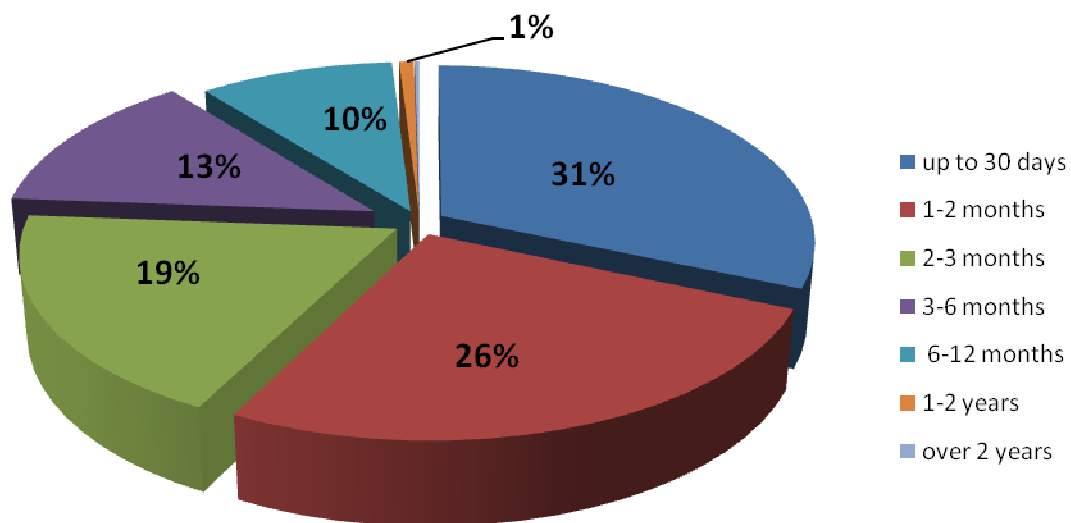
In case of losses from the third party liability insurance of the vehicle owner – art. 14 (2) of the obligatory insurance (Polish: o ubezpieczeniach obowiązkowych, Ubezpieczeniowym Funduszu Gwarancyjnym i Polskim Biurze Ubezpieczycieli Komunikacyjnych) act from 22nd May 2003, which points out, that if the clarification within the period described in the paragraph 1 (30 days from the date of the receipt of notification about the event), the circumstances necessary to determine the liability of the insurance company or the amount of the compensation proves impossible, the compensation is paid within 14 days from the day, in which the clarification of these circumstances becomes possible, however not longer than within 90 days after a date of the receipt of the notification about the event).

One should highlight, that even in case of evidence problems, the obligation of compensation payment, according to the art. 14 of the obligatory insurance act from 22nd May 2003, is established no longer than in the period of 90 days from the date of notification about the event.

The sentence of the Polish Supreme Court from 10th January 2000 (Case No. III CKN 1105/98) states, that *„The provisions of the art. 817 § 2 of the Polish Civil Code, do not authorize the insurance company to abandon the loss adjustment process until the legally-bounding decision of the court is made, regarding the traffic accident, in which a driver with a third party liability insurance took part.”* and the resolution of the Supreme Court from 9th June 1995 (Case No. III CZP 69/95), added, that *„The insurance company liable for the perpetrator of the traffic accident within the third-party liability insurance delays the payment if it does not pay the compensation within 30 days, from the date of receipt of the notification about the event. If the injured has previously called the perpetrator of the accident for compensation payment, and the perpetrator did not performed the compensation, the insurance company's delay starts from the day of such call.”*

While, in the sentence of the Polish Supreme Court from 6th July 1999, (case reference number: III CKN 315/98), pointed out, that „The compensations of the insurance company are prompt. The company is not delayed regarding the amounts that are not in its „*decision*”, if the injured after its receipt does not state the amount of his compensation.”

Chart 9. The duration of loss adjustment process by the insurance companies from the date of decision issue.



How does the theory relate to practice then? Unfortunately, the insurance companies are repeatedly not fulfilling its legal obligation regarding the date of compensation payment. The performed survey showed, that only 31% of respondents pointed out, that the compensation was paid within 30 days from the receipt of the notification about the event by the insurance company (chart 9). In numerous complaints to the Polish Insurance Ombudsman, the promptless loss adjustment was also pointed out. KNF has already fined several insurance companies for promptless compensation payments.

The delays in the loss adjustment processes can be caused, among others, by the large amount of losses in comparison to the number of employees, bad work organization, lack of qualified employees – especially regarding the personal injuries. The insurance companies in Poland systematically decrease the number of employees or convert their local branches into loss

adjustment centers. However, this cannot be in any way an excuse for not fulfilling the statutory dates.

Other irregularities in the loss adjustment process are, among others:

- a) No availability of the loss documentations to the injurer – (e.g. the copy of medical certificate from the medical commission established by the insurer) – which *de facto* can be against the provision of the art. 14 (4) of the insurance activity act;
- b) No reply to the letters of the injured or the lack of the factual reply – in the situation, when the insurance company is silent to the new claims of the injured, laid during the compensation proceedings or reply, using a typical „reply templates”;
- c) No ground in the decision – often, the decision dismissing part of the claims does not contain the grounds explaining the cause of dismiss;
- d) No medical commission in the required composition;
- e) Prohibition of note taking from the loss documents made available to the attorney of the injured;
- f) The requirement of stating the aim, why the entitles requires the access to the loss documents;
- g) The requirement of making the letter of attorney in order to get access to the loss documentation, in a specific form or in a way that requires the contact of the principal with the insurance company employee;
- h) Excessive costs of loss documentation copying.

III. Conclusion.

This report's aim was to establish and confirm the irregularities in the loss adjustment process by the insurance companies.

The performed research shows, that as much as 74% of respondents is of an opinion, that their insurance company did not perform the loss estimation in an objective manner, and the loss adjustment process is considered by the 60% of the respondents as unprofessional.

The current economic crisis has caused the intensification of the insurance company's methods to reduce costs – in the sphere of compensations as well. So, can we talk about the refusal policy of the insurance companies regarding the compensation payments? It is currently impossible to explicitly answer this question, we can only speculate that such informal order to understate the amount of compensations or refuse of payments exists.

At this point, I would like to refer to my previous research on the social acceptance of the obtaining of the compensation under false pretenses in Poland. In my opinion, the insurance companies in connection to the negative reception by the aggrieved party by the loss adjustment process are indirectly contributing to the process of obtaining the compensations under false pretenses.

Krystyna Fedorowicz

Author: since 2009, has the MA in Law, Academy of International Economic and Political Relations in Gdynia (specialization: criminal law).

In the first quarter of 2009, she was granted a scientific scholarship at the Faculty of Law in Università degli Studi di Firenze, Florence, Italy.

During her studies, she has been trained in various, law-connected institutions, including: Municipal Police Headquarters in Gdynia; Jerzy Lipski's Attorney Office - Gdansk, Radoslaw Rynkiewicz's Notary Office – Słupsk, District Court in Gdansk, Criminal Court; District Court in Wejherowo, Civil Court.

She has special interest in the advertising law and intellectual and industrial property law and in this field she plans to write her PhD dissertation.

In private, she has passion for horse riding and Italian culture. Contact - krystyna.fedorowicz@wp.pl.

“ADVERTISING AS AN ACT OF UNFAIR COMPETITION”

1. Advertising contrary to good practices or offending human dignity.

The art. 16.1 (1) of act on combating unfair competition (u.z.n.k) enlists the advertising contrary to good practices or offending human dignity. The expression „contrary to good practice” is extremely hard to explain. The notion itself was used by the legislator in the general clause in the art. 3.1 u.z.n.k.

According to the legislation rules, the same expressions used within one act should have an equal meaning. However, the similarity between these two articles is commonly „considered to be a legislation fault, being the result of amendments made to the government project during the legislation process. Based on the general clause on the contradiction to good practices- instead of the primarily stated contradiction to the principles of community life or later proposed, violation by the entrepreneur the obligation of honest actions, did not bring any changes in torts regarding the advertising.”¹

The proposal, to use, in the art. 16.1 (1) u.z.n.k., the clause „contrary to moral principles” instead of the phrase „contrary to good practices or offending human dignity”. „Undoubtedly, art. 16.1 (1) u.z.n.k. is not an expression of a definite, fully aware legislation assumption, which does not help in its interpretation.”²

There are different views on the relation of the „good practice” notion in the art. 16.1 (1) with the one in the art. 3.1 u.z.n.k. In the opinion of R. Skubisz³, the phrase „good practices” from the art. 16.1 (1) u.z.n.k. is a narrower notion than the one used in the art. 3.1 u.z.n.k.. „The action contrary to good practices according to the art. 3.1 (1) u.z.n.k. is both advertising offending human dignity as well as advertising enlisted in the art. 16.1 (2-5) and 16.3 u.z.n.k. So, if we assume, that the both regulations share the same notion, it is impossible to explain why the art. 16.1 (1) u.z.n.k. prohibits advertising offending human dignity, and the art. 16.1 (2-5) u.z.n.k. prohibits other forms of unfair advertising, which are already prohibited in the art. 3.1 u.z.n.k. as contrary to good practices.”⁴

¹ Ibidem, p.655

² Elżbieta Traple i inni, *Prawo reklamy i promocji*, Warszawa 2007, p.655.

³ Ryszard Skubisz – professor of Juridical Science at the UMCS.

⁴ Ibidem, p. 656

Such different understanding of „good practices” in art. 16.1 (1) u.z.n.k. does not exclude the usage of the art. 3.1 u.z.n.k. „to those cases of unfair advertising, which are not enumerated in the art.18 of this act, as well as the correcting function of this clause, in case, where a given action formally fulfills the evidence of unfair competition in advertising, but there are no evidence fulfilled of art. 3.1 u.z.n.k, e.g. the act does not threaten or infringe the interest of another entrepreneur or customer.”¹

E. Nowińska² underlined, that the good practices, mentioned in the art. 16.1 (1) u.z.n.k. should be regarded not with the economic-functional understanding of this notion, but with the social moral feelings, „decorousness of advertising medium”. Of the same opinion is F. Zoll, who showed, that „the hallmarks of good practices cannot be abstractly determined. The judge will be judging about the violation of good practices in specific cases according to his own discretion, driven by the honesty of all people, thinking justly and fairly”.

In the doctrine, one can find an opinion, that the content of „good practices” is the same within the entire act, and that this phrase is always of the same meaning. This is about the assumption, that the legislator acts rationally and uses the explicit notions, unless he states something else. One of the followers of this view is, among others, R. Stefaniecki, who is of the opinion, that „although, the advertising is a specific sphere of business activity, it is not different enough to justify a different understanding of the same expressions, therefore the repetition of the notion „good practices” in the art.3.1 (3) and art. 16.1 (1) u.z.n.k is an example of a legal tautology”.

Courts in concrete rulings state their opinion on the scope of „good practices” in the art. 16.1 (1) and art. 3.1 u.z.n.k.. In the ruling of the Court of Appeal in Gdansk on 6th November 1996, one can read, that: „An unfair advertising, and therefore – an advertising contrary to good practices – is and advertising, which by using the credulousness of the consumer, justified by the circumstances and average disability of complicated associating and concluding based on the text emphasizing the content desired by the advertiser, creates in the average consumer confidence about the existence of facts, that do not take place in reality, and this way produces the feeling of disappointment, disrespect or even misleading advertising”.

This court ruling does not clearly decide on the mutual relation between the art. 16.1 (1) and art. 3.1 u.z.n.k., because according to some (e.g. I. Wiszniewska) this proves for a broad

¹ Ibidem, p. 656

² **Ewa Nowińska, prof.** – Polish lawyer. Associate Dean of the Faculty of Management and Communication at the Jagiellonian University. Specialist in media law, competition and advertisement law. Legal adviser. On 17th August 2009, she was appointed to the Board of Directors of TVP (Polish Television) on the recommendation of the Ministry of Treasury.

construction of good practices in the art. 16.1 (1) u.z.n.k, while other academics are of opinion, that this is a narrow construction.

Another example of the interpretation of the same notion of „good practices” is the ruling of the Competition and Consumer Protection Court on 23rd February 2006: „The essence of the good practice notion is the broadly constructed respect for other person. In consumer relations, it should be expressed by proper information about entitlements, not using the privileged position of professional and diligent treatment of agreement partners. Contrary to good practices are acts intended for false information, disorientation, triggering an incorrect conviction in consumer, as well as using his lack of knowledge or naivety”

As one can see, the use of the notion „good practices” by the legislator in the art. 16.1 (1) u.z.n.k. have caused a lot of interpretation problems in practice, especially in connection to the art. 3.1 u.z.n.k..

In my opinion, this phenomena is accurately described by Z. Okoń, who states, that „the differentiation of the good practices construction really helps to get rid of the logical contradiction between art. 3.1 u.z.n.k and art. 16.1 (1) with other forms of unfair advertising described in the art. 16 u.z.n.k. However, this does not mean, that such interpretation can be accepted uncritically and that is removes all doubts”¹.

Nowadays, one diverges from explicit distinguishing of the notion of good practices in broad and narrow construction. There is a view, that only in a concrete factual state, one should use a given regulation of the unfair competition act, whether it is the art. 3. Or 16.1 (1).

The Polish Supreme Court presents the same opinion, in its ruling on 26th September 2002, „the act contrary to good practices according to the art. 16.1 (1) and art. 3.1 u.z.n.k. the Court regards as the bypass of the statutory prohibition of advertisement of specific goods, by hiding it in a form of a permitted advertising.”² In Court’s opinion „such act, easily clear to the consumer can constitute a peculiar manifestation of law disrespect. Therefore it is contrary to good practices, both according to criteria in general sphere and economic one.” The court has also mentioned the relation between the „good practices” from the art. 3.1 and art. 16.1(1) u.z.n.k., stating, that „in the analysis of a concrete case, it turns out, that the differentiation of broad and narrow construction of the good practices notion, although it inspires the theoretical discussions, it does not necessary bring to different evaluation of acts in the practices, according to each of the regulations. In this case, this statement is reflected in the conclusion that the

¹ Ibidem, p.658

² Ibidem, p.658

advertising acts of the defendant were contrary to good practices in each of the presented ways of this notion's construction".

As you can see, the differentiation of good practices in narrow and broad construction is not of importance for deciding upon a given case, because the evaluation if there is a contradiction was left to the judge.

Another problem shows up with the interpretation of the phrase from the art. 16.1 (1) u.z.n.k „contrary to good practices or offending human dignity”. The legislator does not state if the regulation uses the alternation or are the both parts of the phrase to be treated in conjunction.

Also in this matter, the opinions in literature are divided. Many of the authors understand these notions as separate, because of the liberal outcome of the act, others contradict with such view.

I agree with R. Stefanicki's opinion, that „it is not totally impossible to separate the contradiction to good practices from offence of human dignity”¹.

The notion of „offending human dignity” regards mainly the so called „personal advertising” or „base advertising”. Such advertising is prohibited, because instead of focusing on characteristics of the good or service, it focuses on personal characteristics like: sex or religion views of the future customer or tenderer. According to some authors, the advertising offending human dignity is also the advertising that contradicts Polish moral value. It is mainly about pictures, phrases, symbols that are commonly considered offending or the advertising emphasizing poverty or suffering.

It is accepted, that the advertising that fills with disgust does not offend human dignity. Because „based on the art. 16.1 (1) u.z.n.k, the good taste or artistic sensitivity of the advertisement authors is not placed under evaluation, but only the possible contradiction to the community dignity sense”².

Similar to the „base advertising” is so called „shockvertising”. It uses the motives which cause mixed feelings, it often uses scandal. Its aim is to cause a consumer's reaction, not to build a brand. Such advertising is risky, its aim is to surprise the consumer, usually arouses negative emotions like disgust or fear. The induce of emotions make consumer to better remember the advertisement. One of the examples can be the cellular network company Play, which used in its advertisement the motif of hand with cut off fingers.

¹ See: R. Stefanicki, *Prawo reklamy w świetle przepisów ustawy o zwalczaniu nieuczciwej konkurencji na tle prawnoporównawczym*, Poznań 2003, p. 71

² E. Nowińska, M. du Vall, *Komentarz 2005*, p. 194; R. Skubisz, in: *Komentarz 2006*, red. J. Szwaja, p.679

Other examples are the „United Colors of Benetton” advertising campaigns, which often contain photographs on important social problems connected with the company’s logo. And in different countries, some of them were banned. In Germany, an ad with a duck covered in oil after the tank ship catastrophe was banned, and in Brazil a picture of a priest kissing a nun.

I agree with Z. Okoń, who states, that one cannot treat the shockvertising and advertising offending human dignity equally.

It is not known, how to treat advertisement, where marketing is strictly connected with the message on important social issues. There is a problem, if the freedom of economic speech allows for creating the image of a given entrepreneur through supporting by him given social or political views, or does it allow only for advertising of specific products.

According to Z. Okoń, there is no possibility to assume, that there is no place for political or social matter in advertising. „Offending human dignity does not consist of triggering disgust or intense emotions in advertisement’s consumers, but on offending this way the basic moral values. In concrete cases, the ratios of „social layer” and „pro-supply layer” may seem important. If the advertiser only „preys” on important social issues, and the drastic content are only used for better exposure of product’s advantages or bringing attention to the advertisement, such advertising should be considered as base.”¹

The problem of interpretation of the art. 16 u.z.n.k was outlined by the Court of Appeal in Gdansk, in the ruling on 6th November 1996. It was stated that, „based on the art. 16.1 of the act, which disallows the use of unfair advertising, there are no rules developed, both in the judicature and doctrine, which would give the unambiguous meaning to the phrases: „unfair”, „contrary to good practices” or „offending human dignity”. It does not seem, that it is possible to precise or even catalogue these evaluation criteria, which – like every criterion based on moral principles – have many non-legal conditions, among which the material status of the society, manners and ethic of the citizens, as well as the awareness of threats in the personal goods sphere, coming from, among others, experience in public life, are not conditions concerning everybody equally. To the extent that, these differences in non-equal understanding of decent and honest acts boundaries, as well as acts coming from specific tastes or aesthetic acts, are of course slipping from exclusion, in so far as in case of a concrete dispute, it is necessary to verify a given act in terms of honesty, morals or decency. Despite that the notion of good practices may include acts not harming anyone’s dignity, the essence of good practice is a broadly constructed in respect for other person, so the same moral value, which is a base for the provisions of art. 230-244 of

¹ Elzbieta Traple i inni Prawo reklamy i promocji, Warszawa 2007, p.664

Polish civil code, and every lack of respect to the other person, every, e.g. non-serious treatment of other person, should be evaluated in terms of offending good practices. The contradiction of good custom of being respectful and seriously treat other persons is a disrespectful treatment, humiliation, mockery, causing disappointment, as well as using someone's naivety, inciting expectations that cannot be fulfilled; the methods used in such cases include: specific graphical design of leaflets, usage of inadequate words for the actual situation, which ignite imagination, specific word balancing, size and location of individual phrases and type fonts, multiple exposure of specific phrases, etc. Such attitude of the defendant towards the addressees of the leaflets, calculated for false information or disorientation or even in order to cause a false impression of the customer, cannot be justified in the categories of good practices in advertising by inattentively read leaflets by customers, even if these leaflets contain all information, which – after the analysis – allowed for a completely different conclusion that at first glance seemed to be opposite. Advertising, by definition is used in order to bring attention to the company or its products, can use the psychological phenomena of an average human susceptibility for delusion and in such sense may use e.g. exaggerated evaluation, but it cannot deprive from choice or force thinking leading to such choice, association or conclusion crossing the possibilities of an average consumer. Under the notion of unfair advertising, including the advertising contrary to good practices, one should also construct advertising, which – by using emotions, naivety of the consumer or average disability of complicated associations and conclusions on the base of text exposing the content required by the advertiser, causes the average consumer to believe in facts, that do not exist in the real life and therefore it causes disappointment, a feeling of disrespect or even deception” (63, p. 139)

2 Misleading advertising

2.2. Evidence of misleading advertising.

According to the art. 16.1 (2) u.z.n.k the advertising misleading the customer and therefore influencing his decision on purchasing the product or service is prohibited. As we can see, the definition comprises from two evidence, which shall be fulfilled simultaneously. The first one is the misleading advertising through the advertisement, the second one is the influence on customer's decision¹. Therefore, not every advertisement, that uses false information fulfils the preconditions in of the above mentioned provision. The essence is if the content of the

¹ The supporters of such division are, among others : R.Skubisz, I. Wiszniewska,

advertising is important enough – from the customer's point of view – to influence on his decision. And one should take into consideration the feelings and expectations of the advertising consumers, not the feelings and expectations of the advertising agencies or advertisers. The „importance” of the misleading advertising is also important, as well as its weight. Such misleading advertising is important if it can potentially influence the economic decision of the addressee. So, in case of small misleads, concerning non-important, from the customer's point of view, elements of the product or service, one cannot say it constitutes the evidence of influencing the decision of the addressee, so the art. 16.1 (2) u.z.n.k. cannot be used in such case.

The evidence of „importance of the misleading advertising” from the art. 16.1 (2) u.z.n.k. is not fully harmonized with the 84/450/ EEC. The art. 2 (2), of this directive states, „that the protection against misleading advertising should be given not only in case of the misleading advertising's influence on the purchase decision of consumer, but also in case, where the misleading advertising can harm the competitor. Therefore, the literature on this matter underlines, that the art. 16.1 (2) u.z.n.k. should be supplemented with the art. 14 u.z.n.k, which protects against spreading false information, which can harm other entrepreneurs”¹

This solution does not guarantee the full concordance of the Polish act with the directive 84/450/EEC, because the art. 14 u.z.n.k. makes the responsibility conditional of willful misconduct, which in advertising delicts is hard to prove, while the 84/450/EEC directive and the art. 16.1(2) u.z.n.k. does not require such responsibility.

There are also the opponents of distinguishing two preconditions from the art. 16.1 (2) u.z.n.k. According to E. Łętowska², distinguishing the precondition of „possibility of influencing the consumers purchasing decisions” is pointless, because every advertisement is from definition made for inducing the purchase of a given good.” So, every information, which is an advertisement has a feature of „abstract possibility to induce a decision”. And the induce for making a purchase decision itself has a lot of evidence, even when we deliberate on abstract issues. Therefore it is hard to analyze the question on the extend of the advertising as a causative factor, especially if we have to make the analysis in abstracto”³

According to the art. 2 (2) of the EEC directive 84/450 'misleading advertising' means any advertising which in any way deceives or is likely to deceive, by reason of its deceptive nature, affect the economic behavior of the consumers.

¹ Elżbieta Traple and others, *Prawo reklamy i promocji*, Warszawa 2007, p.670

See. R. Skubisz, in: *Komentarz* 2006, red. J. Szwaja, p.703, 710

² **Ewa Łętowska**– Polish lawyer, professor of Juridical Science; judge of the Polish Constitutional Tribunal, first Polish Ombudsman.

³ E. Łętkowska, *Prawo umów konsumenckich*, Warszawa 2002, p. 158

„Misleading advertising takes place, when the notion created on the base of the advertising is not in accordance to the actual state”¹

One should not mistake the misleading advertising with the so called unobjective advertising.” Misleading advertising is only in situation, where the customer, on the base of the information provided in the advertisement creates a concrete, rational image of the good or service, which does not correspond with the reality. All such elements of an advertisement, which aim is only to create positive feelings towards the product in customer’s mind, and which cannot be treated in the true or false category, are not under evaluation from the misleading advertising point of view. In consequence, an advertisement, which is unobjective, suggestive or undesirable from the consumer’s policy point of view cannot be treated as misleading advertising.”²

2.4. Awareness of falseness, acceptable exaggeration, superlative advertisement (exaggerated), presentation in a misleading way, incomplete advertising, imitative advertising.

The misleading advertising prohibition concerns mainly disinformation, not the prohibition of presenting untrue information. It is so, because the essence of the misleading information is the way it is perceived by the addressees, while presenting false information in the advertising does not necessarily connect with a false notion of the reality by the consumers. It is about the situation, when the consumers will be aware of the fact, that the advertisement is false, or about the, so called, „acceptable exaggeration”.

When it comes to the awareness of the falseness of the advertisement by the consumers, one take into consideration the knowledge of an average consumer. This is perfectly illustrated by the ruling in case Verein gegen Unwesen in Handel Und Gewerbe Koln e V v. Adolf Darbo AG³. The European Court of Justice precluded, that the ‘naturally pure’ description on the jam, which contains traces or residues of heavy metals or pesticides does not misleading advertising the customer, because an average customer, should have the knowledge, that nowadays there are no food products, which do not contain traces of pesticides, because of the environment pollution.

¹ I. Wiszniewska, w : Komentarz 2000, red. J. Szwaja, p. 458

² G. Schricker, Law and Practice Relating to Misleading Advertising in the Member States of the EC, IIC 1990, no. 5, p. 622

³ Case C-465/98, on the base of the 79/112/ EEC directive on the labelling, presentation and advertising of foodstuffs and its subsequent amendments.

While the expression „acceptable exaggeration” is characteristic for marketing actions, which are strictly connected with „exaggeration”, highlighting the advantages of given products. Of such opinion was also the Court of Appeal in Warsaw, in the ruling on 31st October 2006¹. Factual state: the defendant was advertising a washing powder stating, that it contains „active stain removers ingredients”. This expression was created by the defendant himself, because such compounds do not exist, so the expression used in the advertising was undoubtedly and objectively false. The plaintiff, and a competitor of the defendant, stated, that the usage of the false expression was aimed to create the false notion in the consumer’s perceivment, and therefore to create his advantage over competitors. The Court of Appeal has dismissed the complaint and precluded, that the expressions used in the advertisement are within the scope of „acceptable exaggeration”. Another example of acceptable exaggeration is the usage of and expression „always sunshine” in advertisement for travels to South countries.

Similar is the way, the superlative advertisements work, using the words like the best, unique, exceptional, the most beautiful, so called, hype advertising. In general, such advertising will not be treated as misleading, because, as I mentioned above, the essence of the advertising is exaggeration in order to focus attention on the entrepreneur or product, and the consumer should not treat the advertisements literally, but with distance. Unfortunately it is hard to determine the boundary between a misleading advertising and an advertising using superlative. For example, the usage of expressions in advertising like „exceptional”, „one of the kind” – regarding one product will be treated by an average consumer as an incentive for purchase. While the expression, e.g. that the yoghurt is „the only fully natural yoghurt”, might be perceived as if the other yoghurts are not real, therefore such advertisement would be considered as misleading.

Incomplete advertisements could also be misleading. They omit certain information, that are important from the consumer’s point of view.” Such information takes place, e.g. when there are enlisted all the extras of a car, but the advertisement lacks information that each extra is paid additionally. The incomplete advertising is most often used in promotional actions of the car manufacturers: in short spots, usually in the radio, there are free services offered, but no one mentions that only those only a few auto salons are participating. Others propose, instead of a free service e.g. a purchase of a part in discounted price. However, the advertisement does not mention this”²

Misleading advertising in advertising can also consist of presenting information, which – although true, are presented in a misleading way. An example of such advertising can be an

¹ IACa 526/06

² K. G.rzybczyk, Prawo reklamy, Warszawa 2008, p.66.

advertisement for medical supplements, or diet supplement, which is presented by „marketing professor, but the way of presentation and the visual layer of the ad suggest, that such person has a medical education”¹. This is caused by the pharmaceutical law regulations, which prohibits the participation of persons with medical education in pharmaceuticals’ advertising.

Imitative advertising is also among those, which can mislead advertising the customer. It consists of the emission of an advertisement, which is very similar to the one that is already on the market. For such advertisement to be an act of unfair competition, the imitated enterprise should already have its market position and brand.

The threat of misleading advertising is also the limitation of presenting information on „awards or specialist ratings received, which is in accordance with the reality, but the method of presentation exceeds the actual importance. An example can be the exposure of the fact of being awarded by an unimportant award, which has been received abroad (e.g. „Gold medal in Liverpool”), where the consumer of the advertisement cannot verify the actual prestige of an award. Obviously misleading is informing about an award received in an event especially organized by the advertiser or awarded to anyone, who pays a certain fee”²

A misleading advertising also takes place, when the advertisement touts certain features of the product, which are present in every product of a kind.

To sum up, the false information presented in the advertisement should always be examined from the point of view of the art. 16.1 (2) u.z.n.k. If it does not comply to the evidence, one can appeal to the prohibition of disseminating untrue information according to the art. 14.1 u.z.n.k, which requires an additional evidence: disseminating untrue information in order to yield benefits or bring detriment to a third person.

2.5. The object of misleading advertising.

Apart from the example catalogue of advertising elements, which may be subjected to misleading advertising, stated in the art. 16.1 (2) u.z.n.k. and discussed above, there are also other circumstances or features, which may be an object of misleading advertising, as far as they can influence customer’s decision on purchase. One should enlist here the elements presented in the art. 3 of the EEC 84/450:

1) the characteristics of goods or services, such as their availability, nature, execution, composition, method and date of manufacture or provision, fitness for purpose, uses, quantity,

¹ Elżbieta Trąpiało i inni *Prawo reklamy i promocji*, Warszawa 2007, p.676.

² Ibidem, p.676

specification, geographical or commercial origin or the results to be expected from their use, or the results and material features of tests or checks carried out on the goods or services;

2) the price or the manner in which the price is calculated, and the conditions on which the goods are supplied or the services provided;

3) the nature, attributes and rights of the advertiser, such as his identity and assets, his qualifications and ownership of industrial, commercial or intellectual property rights or his awards and distinctions.

The art. 16.2 u.z.n.k. enlists also „customer’s behavior”. According to R. Skubisz, this criterion is unnecessary, because it was not enlisted in the EEC directive 84/450. Of such opinion was also the European Tribunal of Justice in case *Lloyd Schuhfabrik Meyer*¹, where the tribunal precluded the necessity of modification of the average consumer model because of the type of advertised good.

The interpretation of the „customer’s behavior” is also difficult. Different authors present different definition of this expression. So, according to I. Wiszniewska, it is about the shopping behavior of the consumer, while she highlights, that when it comes to the FMCG products, the risk of misleading is lower, because the customers make the purchase decision without much thinking. While, the articles which are more durable are purchased with bigger deliberation and thought. According to E. Nowińska „it is about the decision process of a customer, so about the imperative of constructing the advertising consumer model regarding the sex, age or professional experience of the advertisement addressees”².

„Shopping behaviors of the customers should be therefore taken into consideration during the evaluation of the misleading advertising, but not – as Polish act suggest – in scope of the misleading advertising object, but using a model of an average advertisement consumer”³

2.6. The addressee of the misleading advertising (the model of the consumer).

An important element of acknowledging an advertising as misleading is its receipt by the addressee, customer. With time and advertising development, the model of „an average customer” has changed. „In older statements in this matter, usually the addressee was inattentive, without good orientation”⁴, a person with low level of skepticism. Nowadays, when the advertisement are a big part of the surrounding world, when we are used to them on the

¹ Case no. C-342/97

² E. Nowińska, *Zwalczanie nieuczciwej reklamy, zagadnienia cywilnoprawne*, Kraków 2002, p.109.

³ Elżbieta Traple and others, *Prawo reklamy i promocji*, Warszawa 2007, p.673

⁴ K. G.rzybczyk, *Prawo reklamy*, Warszawa 2008, p.67

streets, on the radio or TV, it would seem, as if the „average addressee” should be a person, who is „rather critical, but still susceptible to suggestions”¹. Also, the model used in the European Union is „a consumer, who is critical, resolute, enlighten and not careless and uneducated”². So, it is a person, who through using general knowledge is able to analyze advertisement of which he/she is and addressee.

Regarding such perceivment of the consumer model, the Supreme Court made a statement in the ruling on the 3rd December 2003: „The criteria, which influence the model of an average customer and the evidence in the art. 16.1(2) of combating unfair competition act of 16th April 1993, cannot omit the possibility of independent analysis of the information and notions about the advertisement of a good by its addressee, including the conditions in the certain market segment, as well as needs which drive the market member in making the decision on purchasing an advertised product”³.

The consumer model of an attentive and resolute consumer was also accepted by the European Tribunal of Justice, while the Court of the Competition and Consumer Protection in the ruling on the 23rd February 2006 suggested, that one should decrease the requirements for the average customer. The ruling states, that „plaintiffs assumption on the level of an average national customer is incorrect, and the presented argumentation, despite being taken from the EU regulations is misleading. One should remember about the specificity and customs of internal markets of each country and such argument can be brought up for the protection of native consumer in the international arena. In the court’s opinion, who are not influenced for several dozen years by the advertising methods, which were used on the Western consumers, are not educated on the level, the plaintiff presents in the grounds of his position, so the criteria of promotional actions evaluation in the national market should be more restrictive. In consequence, also the internal regulations on the protection of consumers and combating the unfair competition, are more strict in our country, and their interpretation is adjusted to the market”.

To sum up, in each concrete case, the model of an average consumer will be modified, after taking into consideration „the social, cultural or linguistic factors”⁴

An exception from such perceivment of the consumer are advertisement directed to specific groups, to naive or sensitive persons, e.g. children, ill. Such advertisements should comply with higher requirements. While the criteria of an misleading advertisement would be

¹ Ibidem, p.67

² E. Łętkowska, Ustawa o ochronie niektórych praw konsumenckich. Komentarz, Warszawa 2000, p. 8

³ Supreme Court ruling on 3rd December 2003.

⁴ European Court of Justice ruling on 13th January 2000

evaluated more liberally to the consumers more oriented, e.g. professionals from different branches and all other groups of persons, whose experience is bigger for any reason.

Therefore, the target group, for which the advertisement is directed, should be identified, and then the model of an average consumer should be established for this specific group.

2.7. The risk of misleading and its evaluation.

There are two way in establishing the risk of misleading advertisement. The first one is a normative method, which consists of hypothetical establishment of mode behavior of an average advertisement consumer. In general, it is not based on any data and research, it just establishes the model of an average buyer in abstracto.¹

The second one is the empirical method, which uses all available cognitive means, like: demoscopic research, interviews with buyers, surveys and expert witness opinions, by which one determines the notions, buyers opinions, triggered by a given advertisement. This method is often used by German courts, „where it is assumed, that the advertisement was misleading, when it causes an incorrect notion at „not small” group of consumers. The percent ratio, from which the number of consumers is considered „not small” (so called intervention threshold) is usually set at 10-15% level, but it can be modified depending on the advertisement topic, target consumer or method of presentation”²

None of these method is considered as prevailing, nor by the art. 16.1 (2) u.z.n.k, nor by the 84/450 EEC directive.

In Polish law, as a rule, it is assumed, that the risk of misleading should be estimated in abstracto, according to the experience of the judge”³. Very often, as an influence of German practice and theory, one can come across the requirements of a minimal percentage threshold, which decides whether the advertisement is misleading or not.”⁴

According to R. Skubisz, such reasoning is incorrect, because „the determination of a percentage intervention threshold is only possible in case, where there are opinion polls presenting the actual addressees reaction on the advertisement”⁵. It is hard to determine, without any research, the hypothetical percentage of viewers, who have been misleading advertising.

¹ See: J. Dudzik, Reklama wprowadzająca w błąd w prawie wspólnotowym, PPH 2002, nr 9, p. 10.

² Elżbieta Traple i inni Prawo reklamy i promocji, Warszawa 2007, p.677-678

³ I. Wiszniewska, w: Komentarz 2000, red. J. Szwaja, p. 458

⁴ See: E. Nowińska, Zwalczenie nieuczciwej reklamy. Zagadnienia cywilnoprawne, Kraków 2002, p. 107

⁵ R. Skubisz, w : Komentarz 2006, red. J. Szwaja, p. 700

The European Court of Justice ruling on 16th June 1998 in the case *Gut Springenheide*¹ is essential, regarding the determination of the risk of the misleading advertising in the European Union law. The German Administration Court asked the European Court of Justice „does the law of EU requires the determination of actual expectations of the advertisement addressees or can the misleading advertising be determined according to the objective model of an average buyer, established only in the legal interpretation. The tribunal precluded, that the national court should base its ruling on the supposed expectations of an experienced consumer, who is properly informed, observant and prudent”². This ruling of the European Court of Justice, decided that the basic method of determining the misleading risk of an advertisement will be the normative method. However, the tribunal has also pointed out, that the EU law allows the usage of the empirical method by the national courts, in cases, where the usage of normative method is difficult. It is about the situation where, e.g. the establishment of the average consumer’s notions is difficult. So, in the opinion of the European Court of Justice, the empirical method is supportive to the normative method.

2.8. Burden of proof.

According to the general rule in the art. 6 of the Polish Civil Code („The burden of proof relating to a fact shall rest on the person, who attributes legal effects to that fact”³) in cases concerning advertising, the burden of proof would rest on the plaintiff, for whom it would be extremely difficult to reveal irregularities of the expressions in the advertisement. Because of that, the directive 84/450 EEC regulates this topic differentially. The art. 6 of this directive states, that: „require the advertiser to furnish evidence as to the accuracy of factual claims in advertising if, taking into account the legitimate interests of the advertiser and any other party to the proceedings, such a requirement appears appropriate on the basis of the circumstances of the particular case (...)”

The art. 18a u.z.n.k., introduced with the amendment on 16th March 2000 helps in the implementation of the above discussed directive: „The burden of proof of the veracity of

¹ Case no. C- 210/96, ruling based on the 1907/90/EC order

² Elżbieta Traple i inni Prawo reklamy i promocji, Warszawa 2007, p.678

³ Dz.U.64.16.93

marking or information placed on products or their packing or of statements contained in the advertising shall fall upon the person accused of the act of unfair competition connected with misleading.” As one can see, the Polish act does not contain the possibility of accepting the justified interest of the advertiser or of other participants¹.

The Polish legislator did not acquire the amendment of the art. 6 of the 84/450/EEC directive, which contained the requirement for advertiser, that in the comparative advertisement, he shall furnish evidence of as to the accuracy of factual claims in advertising in short time.

Art. 18a u.z.n.k cannot be interpreted broadly, because it is an exception of the burden of proof rule.” Therefore, the burden of proof as to the accuracy of factual claims in the advertising can regard only these expressions, which are verifiable, it is not possible to prove the accuracy of claims, which are of an evaluation character, a metaphor or within the limits of accepted exaggeration². The art. 18a u.z.n.k will be used only in cases, where the plaintiff states, that a given advertisement contains objectively untrue elements.

3. Advertising appealing to emotions of customers by provoking fear, exploiting superstitions or credulity of children.

One of the advertising instruments is to appeal to customers emotions and feelings. There is nothing wrong about it, because these are the rules and way in which advertising functions. We are already used to slogans like: „you’re worth it”, „only for real man”, etc. Such slogans cause an image of a product or a person that buys the product in the mind of consumers. The problem starts, when the advertising appealing to emotions of customers, influences him in such a strong way, that he is not able to make objective comparisons and choices. Such advertising complies with the art. 16.1 (3) u.z.n.k. According to this regulation, the advertising appealing to emotions of customers by provoking fear, exploiting superstitions or credulity of children is forbidden. Another name used for this act of unfair competition is „irrelevant advertising”. According to R. Skubisz, this expression better gives the essence of this type of advertising,

¹ See more:: R. Skubisz, w: Komentarz 2006, red. J. Szwaja, p. 704

² Elżbieta Traple i inni Prawo reklamy i promocji, Warszawa 2007, p.682

because the name „advertising appealing to emotions” is misleading, because causing such reactions is the essence of every advertisement.¹

The advertising is irrelevant, when „the non-substantive elements, not connected with the good, producer and irrelevant for making an opinion on a product prevail”². It is highlighted, that in such cases, the advertisement is full of persuasive elements, which put pressure on the consumer’s psyche. An example would be the advertisement causing the fear of illness, old age, etc.

In theory there is a dispute, whether the art. 16.1 (3) u.z.n.k. enlists only examples of the forbidden appeals to emotions, or it is a closed catalogue. The winning opinion is that it is just a sample enumeration and this regulation can be used to every other cases of advertising excessively appealing to emotions of the customer³. The opponents of such view say, that while assuming an aware consumer, it is hard to consider him as a person, at whom a pressure is made by a single appeal to emotions in order to make him purchase something. There is also an argument, that the sufficient protection of the consumer’s interests in this matter is granted by the art. 16.1 (1) u.z.n.k.

The advertising appealing to emotions of the customers by exploiting superstitions is also considered to be unfair. One should underline, that the superstitions does not refer to any racial or social prejudice. Such superstition are defines as „a credulous belief or notion, not based on reason, knowledge, or experience. The word is often used pejoratively to refer to folk beliefs deemed irrational.”⁴.

The unfair act consists of using the superstition in the advertising in such way, that they influence customers’ decisions, „steer” their choice. Since, the advertising of the services of fortune-tellers, prophets or esoteric products is not forbidden. An example of such illegal advertising would be the advertising of an amulet, which is suppose to heal a terminally ill person, etc.

One of the most dangerous forms of advertising is the one using the credulity of children. This group of consumers is extremely susceptible for suggestions, has an uninvolved mechanism of combating persuasion and has a tendency to imitate other people behavior. Therefore, the children are under protection of the art. 16.1 (3) u.z.n.k.

¹ Doubts regarding the correctness of this expression are made by, amon others, E. Nowińska

See: Zwalczanie nieuczciwej reklamy. Zagadnienia cywilnoprawne, Kraków 2002 p.111

² K. Grzybczyk, Prawo reklamy, Warszawa 2008, p.70.

³ The opponents of such view are, among others. E. Nowińska, Zbigniew Okoń

See: E. Nowińska, Zwalczanie nieuczciwej reklamy. Zagadnienia cywilnoprawne, Kraków 2002, p. 112.

⁴ WWW.wikipedia.pl

„The research on the behavior of children-consumers has led to distinguishing a few typical characteristics:

- children have a lower ability to process the information about the product,
- they treat the advertisements as true and real
- they have a lower level of criticism towards advertisements,
- they do not understand the intentions of persuasion and incentive,
- they are very susceptible for influence of models and patterns,
- they are unable to protect themselves against persuasion”¹

The art. 16.1 (3) u.z.n.k. does not determine the age of the person, which is under its protection. The term „children”, used in this regulation should be interpreted differently from other legal acts, like civil or penal code. It is not about a concrete age boundaries. „The aim of the regulation in question is not the protection of children against the advertising itself, but only against a dishonest exploitation of a credulous view of the world, which is completely natural for them.”² In theory, the view that the limit-age is 18 years old, prevails. It is due to a judge to evaluate if the given advertisement is using credulity of children or not. The same advertisement can be understood differently by a four year old and a nine year old, despite they are both being children. „It is accepted, that the properly created children advertising:

- should use concrete information, regarding the looks and action of the product,
- should avoid fantasy,
- should not suggest, that the owning of a given product makes you better than others,
- should not use models for imitation,
- should not be a source of conflict between a child and its parents”³

4. Statement encouraging the purchase of products or services, creating the impression of a neutral information (hidden advertising).

4.1. Notion, legal regulation.

The art. 16.1 (4) forbids statements encouraging the purchase of products or services, creating the impression of a neutral information. This act of unfair competition is considered in the theory, nearly unanimously¹, as hidden advertising.

¹ A. Jachnis, J.F. Terelak, Psychologia konsumenta i reklamy, Bydgoszcz 1998 r., p.350.

² Elżbieta Traple i inni Prawo reklamy i promocji, Warszawa 2007, p.693

³ A. Jachnis, J.F. Terelak, Psychologia konsumenta i reklamy, Bydgoszcz 1998 r., p.353.

The prohibition of the hidden advertising is also in the art. 16c of Radio and Television act. And according to the art. 4 (11) u.r.t. a hidden advertising consists of presenting in the radio or television auditions goods, services, names, companies, trade mark or business activity of the entrepreneur, who is the manufacturer of the good or service provider, when the aim of the broadcaster, especially connected with remuneration or other benefit, is to have an advertising effect and if it is possible to misleading advertising the audience regarding the type of broadcast.

The press law is also dealing with this problem. The art. 12.2 of press law states, that the journalist cannot perform hidden advertising activity, connected with gaining financial or personal benefits from a person or organizational unit interested in the advertising.

The European Union law regulates this matter in the directive 89/552/EEC. Art.1c and art. 10.4. These two regulations, after implementation to Polish law are stated in the art. 4.11 and art. 16c of the radio and television act. Additionally, the list of forbidden practices² states:

„Using editorial content in the media to promote a product where a trader has paid for the promotion without making that clear in the content or by images or sounds clearly identifiable by the consumer (advertorial).

Hidden advertising is always forbidden, regardless if the information presented are true or false.

The aim of the hidden advertising, which imitates a neutral broadcast is to encourage purchase of given goods. The reason for such regulation is the fact, that the consumers in case of advertisements have some distance and caution, while in case of statements, which in their opinion, are not advertising, they do not have this distance and caution. Therefore this method of advertising is such a big temptation for the advertisers.

In order to protect the consumers it is required „that advertisements are recognizable by the viewer or reader through their distinguishing and clear marking.”³

Hidden advertising can take many forms. In literature on this matter, one can find many forms of this act of unfair competition, but the most often used is the distinguishing of:

-” advertising hidden in broadcast of information character (e.g. in journalistic materials, publicist, news and consumer texts)”⁴

- subliminal advertising.

- product placement, also called „soft advertising”¹

¹ Of a different opinion is T.M. Knypel, who thinks it is not obvious, that the art. 16.1 (4) refers to hidden advertising.

² The list in the annex I to the 2005/29/EC directive on unfair business-to-consumer commercial practices

³ K. G.rzybczyk, Prawo reklamy, Warszawa 2008, p.72

⁴ Elżbieta Traple and others, Prawo reklamy i promocji, Warszawa 2007, p.695

4.2. Types of hidden advertising.

4.2.1 Advertising in broadcast of informative character

„Hiding in front of the viewer the actual character of the broadcast usually takes one of the two forms:

Insufficient distinguishing of the advertising material from the general broadcast (radio program, editorial material (...)

Placement of the pro-supply elements directly in the material, which is supposed to be a neutral information (e.g. in editorial texts, textbooks (...))”²

In order to protect the consumers, it is required, „that the advertisements are recognizable by the viewer or reader through distinguishing it or clear marking”³. This allows the viewer to separate the watched program from the broadcast coming from a different broadcaster.

According to the art. 36.3 of Polish press law, advertisements and announcements have to be marked, so that there is no doubt they are not a part of the editorial material. Polish press law does not determine the method of distinguishing announcements, therefore the publishers use different practices⁴.

In the order of the Krajowa Radiofonii i Telewizji (National Broadcasting Council) on 3rd June 2004 on the method of advertising and telesales in radio and television broadcast, the methods of distinguishing the advertising broadcast and telesales are enumerated. That is:

- § 4. 1. Advertising and telesales shall be distinguished from other parts of the program and marked visually and with sound at the beginning and finish of the advertising block.
2. Advertising mark shall contain the word „advertisement” or „announcement”.
 3. Telesales marking shall contain the word „telesales” or „teleshopping”, unless the telesales is broadcasted with the advertisements in the block marks according to the par. 1 and 2;
 4. Advertising and telesales marking is not included in the time of advertising and telesales broadcast.

More and more popular in media are becoming programs or articles comparing different products, giving advices, discussing new products and their features. In such cases it is easy for the hidden advertising. The scope of the art. 16.1(4) u.z.n.k. deals only with such expressions, which contain the unanimous incentive for purchase a given product. Of course, determining the

¹ This name is used by, among others, E. Nowińska

² Elżbieta Traple i inni Prawo reklamy i promocji, Warszawa 2007, p.697

³ K. Grzybczyk, Prawo reklamy, Warszawa 2008, p.72

⁴ More: E. Nowińska, w: Prawo mediów, red. J. Barta, R. Markiewicz, A. Matlak.

existence of such incentive is often very hard. The author of a given program can have his or her opinion or feeling and favor a given product. But, if in the factual state it turns out, that the evaluation of the product's features is incompatible with the reality or the author is not able to argument his positive or negative evaluation, then we can talk about the hidden advertising.

E. Nowińska is of the opinion, that when determining „intentions” of the broadcaster author, one should also take into consideration the legal or factual bounds between the authors and the producer of the product or the service provider¹ and their benefits.

4.2.2. Sublimal advertising.

The sublimal advertising is strictly connected with the sublimal perception, which consists of recording information without the awareness of their perceivment. „It is about visual or sound stimuli, which last too short to be consciously recorded (in case of the visual perception it requires stimuli that last shorter than 0.04 second) or are masked with other stimuli².”

The problem of the sublimal broadcast has started in the 50s, where, in the cinemas, individual frames where replaced with the notices: „eat popcorn” or „drink coke”. Despite the lack of research confirming the effectiveness of such practices, the sublimal advertising has been forbidden in many countries.

In Poland, the act of 9th July 1990, which ratified the European Convention on Transfrontier Television, which forbids persuasion beyond consciousness and advertising techniques influencing sub consciousness (mainly television and cinema advertising).

In advertising practice this means the implementation of individual frames with advertisement to a movie or implementation of the hidden notice to songs³.

This act of unfair competition does not only consist of hiding persuasive elements, but also a part of information of a given broadcast.

Despite the doubts regarding the effectiveness of the sublimal advertising, in order to protect the consumers, it is assumed that the sublimal advertising is within the art. 16.1 (4) u.z.n.k, however according to other authors, it should be considered as an act of unfair competition according to the art. 3.1 u.z.n.k. The art. 16.1 (4) u.z.n.k. assumes that the consumer is aware of the broadcast, but is not aware of its advertising character, while in the sublimal advertising he does not even know about the existence of the broadcast. Therefore,

¹ See: E. Nowińska, M. du Vall, Komentarz 2005, p.208.

² http://pl.wikipedia.org/wiki/Reklama_podprogowa.

³ Ibidem.

different authors, like R. Skubisz, are of the opinion, that the subliminal advertising as an act of the unfair competition can be considered only as contrary to good practices, accordingly to the art. 3.1 u.z.n.k.

4.2.3. Product placement.

This form of marketing has been established, because the consumers were „bored” of the traditional forms of advertising. Therefore, the marketing specialist have established a method, which consists of intentional placement of given elements in different broadcasts. The aim of such act is of course the advertising effect. Practically, it consists of placement of contents unanimously pointing given products in films, games, songs, etc., in order to influence the purchase decisions of potential customers.

The product placement has started in the cinematography in the 30s, and started to be popular with its usage in the movie „The Graduate” from 1967. The main character (Dustin Hoffman) has received the remuneration for using the Alfa Romeo car in the movie. The 90s were a breakthrough in thinking about the usage of product placement and since then, this form of marketing has started to be popular.

The authors, gladly use this form of marketing, because it is a good way for gaining financial support for the movie production.

Product placement is also often used by the entrepreneurs because it is cheaper than traditional advertising campaigns. It also gives a better possibility to influence the customers, because it makes it harder to block the marketing content directed at them. It would be hard to avoid all programs and movies, where the product placement is used, while in case of advertising blocks, one can simply change the channel. It is also proven, that the customers are easily influenced by the advertising which they do not notice, and „the recognition of the product seen in the movie stronger influences the purchase decision”¹.

Summing up, in order for a marketing act to be considered as a product placement, it should meet the 2 requirements:

- it must be placed in the content of the broadcast, movie or other piece directed to the audience,
- it must be made for the advertising purpose.

¹ <http://www.czasopisma.pwp.pl/pph-200311.xml?katalog=2003113>

„Depending if the product placement deals with a concrete product, company, brand or a group of products, one can distinguish the following types:

- „Brand placement”, also known as the product placement *sensu stricto*, it is a situation, when in a movie or program a concrete brand of product is shown, e.g. the already mentioned usage of Alfa Romeo in the movie „The Graduate”
- corporate placement, when in a book, movie or computer game a building with a logo or trade mark is exposed, e.g. the McDonald’s restaurant building in the movie „The Fifth Element”;
- generic placement, when in the movie, audition, a category of product is presented, without pointing out a specific brand, e.g. milk in the movie „Léon”;
- historic placement, when a brand, logo is placed in the movie, theatre play, which action takes place long time ago”¹

Product placement is also beneficial for the authors, because it helps in gaining financial support for the movie or play realization.

It is hard to imagine a total ban or limitation for using the product placement, because „in case of works, which action takes place in the real world, it is hard to avoid using specific objects as requisites, and the limitations can contribute to the intervention into the artistic license of authors (writers, screenwriters, directors)”²

Polish theory assumes, that the product placement is permissible, when the consumer has been informed about the relation between the author and the producer.

Also, the directive 89/522/EEC on Television without Frontiers, implements the art. 3h, according to which, like in the USA, the product placement is permitted, after meeting specific requirements.

5. Comparative advertising.

5.1. Notions, general information, legal regulation.

Entrepreneurs, in order to advertise their products or services, gladly use comparative advertising, which is a broadcast relating to the offers of other entrepreneurs. It is caused by many advantages. It is easy to show the advantages of own company by showing the disadvantages of competitors’ offers. It is also easy to show, that the advertised services are as good as the other ones, especially when the other ones have a strong, recognizable brand. As a

¹ <http://etyka.opoka.org.pl/productplacement.html>

² Elżbieta Traple and others, *Prawo reklamy i promocji*, Warszawa 2007, p.701.

consequence of such acts, the consumers create an assumption, that the products of the competitors are worse than the advertised ones.

The comparative advertising, as a strong marketing tool and a threat to the interests of other entrepreneurs was considered in the continental Europe as an act of the unfair competition for a long time. But, as time went by, mainly because of the will to protect consumer's interests, this form of marketing was regulated and permitted, of course after meeting certain requirements, because „the comparative advertising, identifying competitor and its products, increases the information in the advertising and therefore helps the consumer to choose the offer”¹

This issue is hard to regulate, because there are a few conflicts of interest here „the producers pointed out in the advertisement and interests of the consumers – customers, who would like to know the comparison with other similar products”². The legislator avoided this problem in the art. 16.3 u.z.n.k., which considers the comparative advertising an act of unfair competition only if it is contrary to good practices.

The art. 16.3 and 16.4 u.z.n.k. are nearly a literally translation of the art. 3a. 1 and 3a.2 of the directive 84/450/EEC, which assures the concordance of the Polish law with the law of the European Union. The regulation that, the comparative advertising is in accordance with good practices was criticized. This requirement is not available in the art. 3a of the directive 84/450/EEC and forces to differentiate the notion of „good practices” within the act on combating unfair competition.”³. It is about the mutual relation between the general clause in the art. 16.1(1) and art. 16.3 u.z.n.k. The theoreticians are of the opinion, that the notion of good practices from the art. 16.3 u.z.n.k. has an independent content, clearly pointed out by the legislator and is different from the one in the general clause, in the art. 16.1(1) u.z.n.k. Such views are caused by the clear enumeration of non-contradiction of the comparative advertising with good practices, which the legislator places in the art. 16.3 u.z.n.k. The other interpretation could cause cases, „in which the comparative advertising - as in accordance to the good practices – would be allowed, despite not meeting all the requirements from the art. 16.3(1-8), or it would be prohibited, despite it would meet all the requirements from these regulations”.

Because of its importance, the issue of comparative advertising has been regulated in the law of the European Union. Everything started from the ruling of the European Court of Justice

¹ See E.Łętkowska, *Prawo umów konsumenckich*, Warszawa 2002 p.204

² K. Grzybczyk, *Prawo reklamy*, Warszawa 2008, p.76

³ E.Traple and others, *Prawo reklamy i promocji*, Warszawa 2007, p.715

in the case C-362/88:GB-Inno-BM¹, when the harmonization of the comparative advertising legislation has started in the EU. The ruling was about the advertisement informing about a special price offer. The tribunal ruled, that such information are important for the consumers. „Therefore, by accepting the art. 30 TWE, in use with the advertising, the tribunal accepted, that this regulation cannot be a base for limiting consumers' access to information in the national legislation, e.g. about the time of special offer duration or previous price. In consequence, also the national prohibitions of comparative advertising, which contain true information, should be treated as limitation of the free movement of goods, not within the scope of the art. 30 TWE”²

An important legal act is the directive 97/44/EC, which predicts full unification of the member states' regulations on the comparative advertising. This regulation is complete, which means, that the member state cannot implement a narrower or broader level of protection. This directive assumes a few exceptions from the full harmonization rule. „The directive does not influence bans and limitation of the advertising resulting from the European Union law, which may be applicable to the comparative advertising. Furthermore, the comparative advertising can be prohibited in case, where the national law prohibits the advertising of a give products or services”³. Comparative advertising can also be limited in case, where it is directed into a group of particularly susceptible consumers or in case of the freelance occupations advertising.

Another legal act of the EU, regarding the issue of comparative advertising is the directive 2005/29/EC, which implements small amendments to the art. 3a of the 84/450/EEC directive, which enumerates the requirements for the admissibility of the comparative advertising. The art. 3a.1(2) of the 84/450/EEC has also been corrected, by changing the place of the requirements in the letters d-h.

Summing up, one has to highlight, that the entire EU regulation has been implemented to the act on combating unfair competition, which caused, that the art. 16.3 contains issues previously presented in other regulations of this act”. The requirements regarding the comparative advertising within the art. 16.1 are overlapping itself.” Therefore, these regulations are criticized in the theory when it comes to the legislation technique. However, such literally implementation of the EU regulations makes it „complete, without the need to look into other regulations, to evaluate comparative advertisement from the point of view of its concordance with the act on combating unfair competition”, which is a practical facilitation.

¹ Wyrok ETS z 7 marca 1990 r. w sprawie C-362/88 : GB-Inno-BM v. Confédération du commerce luxembourgeois

² E.Traple and others, Prawo reklamy i promocji, Warszawa 2007, p.713.

³ E.Traple and others, Prawo reklamy i promocji, Warszawa 2007, p.714.

5.2. The definition of the comparative advertising.

According to the art. 16.3, a comparative advertising is the advertising enabling to identify, directly or indirectly, the competitor or products or services offered by the competitor.

It is about, the so called, direct competition, when the entrepreneurs compete with each other on the same market. The art. 16.3(2) u.z.n.k. has the requirement of admissibility of such advertising, which:

in a fair and verifiable way compares products or services meeting the same needs or intended for the same purpose.

So, for a given broadcast to be considered as the comparative advertising, its content must point out, „an entrepreneur acting in the same market, that the advertises or pointing out his products or services for the same market, as the advertised products”¹

There are two types of the comparative advertising:

Direct – „when the subject of the advertisement is compared with a concrete subject of the competitor, e.g. out calls rate is lower than the calls rate at X”².

The European Court of Justice has ruled, that the expression „direct identification of the competitor” should be interpreted broadly.

and

indirect – „which does not present a concrete object of the competitor, but informs more or less explicitly about the which object and competition it is about, e.g. „our call rate is lower than the call rate of the leading operator”³. During the evaluation of such advertisement, all elements of the advertising broadcast should be taken into consideration, „which are a sufficient suggestion to the consumers, especially, the form of packaging, colors or other characteristic elements of the competitor’s products, as well as the situational context of its publishing” (e.g. the emission of the TV advertisement after the advertisement of the competitor’s product. One should highlight, that during the evaluation of the possibility of identifying the competitor, one should take into consideration the knowledge and experience of the average consumer.

Surveys or tests, evaluation products of different entrepreneurs, performed by, e.g. independent consumer’s magazines are not comparative advertisements, but they should be performed honestly and diligently.

¹ E. Traple and others, *Prawo reklamy i promocji*, Warszawa 2007, p.718.

² http://pl.wikipedia.org/wiki/Reklama_por%C3%B3wnawcza

³ Ibidem.

The art. 16.3 and 16.4 u.z.n.k. will not be applicable in case of spreading by the entrepreneur the information, which are not advertisement, regarding the competitor or its products.

The broadcast containing so called „systemic comparisons” will also not be considered as a comparative advertising. The systemic comparisons are the ones, that cannot be related to concrete products, but to a class or type of products (e.g. „traditional vacuum cleaner”, „typical dishwashing liquid”. Also, the advertising, which contains expressions, phrases, which we can use to make some conclusions regarding the features of the competitor’s products is not a comparison advertising (e.g. „number 1 in Gdynia”, „The broadest choice in Pomerania”).

5.3. Preconditions for admissibility of the comparative advertising.

In order for a comparative advertisement to be admissible, it has to fulfill together all preconditions from the art. 16.3:

- 1) it is not misleading advertising referred to in section 1 item 2;
- 2) in a fair and verifiable way compares products or services meeting the same needs or intended for the same purpose,
- 3) objectively compares one or several material, characteristic, verifiable and typical features of these products and services, including price,
- 4) it does not lead to confusion on the market place between the advertiser and his competitor nor between their products or services, trademarks, trade names or other distinguishing marks,
- 5) it does not discredit products, services, activities, trademarks, trade names, products, services, activities or circumstances of a competitor,
- 6) in relation to products with geographical regional designation, it relates always to products with the same designation,
- 7) it does not take unfair advantage of the reputation of a trade mark, trade name or other distinguishing marks of the competitor or of the geographical regional designation of

competing products,

- 8) it does not present product or service as imitation or replica of product or service bearing the protected trade mark or another distinguishing designation

Additionally, the art. 16.4 u.z.n.k. regulates the comparative advertising related with a special offer. It has to, depending on its conditions, clearly and unanimously show the expiration date of the offer or contain information, that the offer is valid until depletion of stock or cease of providing the services, and if the special offer is not valid yet, it should also mark the date, from which the special price or other special conditions will be valid.

The interpretation of the above mentioned preconditions in different countries can be different, because they are based largely on the evaluation criteria.

5.3.1. Ban on misleading advertising.

The first of the mentioned preconditions is the ban on misleading advertising. The art. 16.3 (1) u.z.n.k. refers to the art. 16.1 (2) u.z.n.k. The most theoreticians are of opinion, that the art. 16.1 u.z.n.k. is unnecessary, because the art. 16.1 (2) is applicable for all misleading advertising, including the comparative advertising¹. The opponents of such view, point out that the legislator has purposely enumerated a closed catalogue of preconditions regarding the admissibility of comparative advertising.

The European Court of Justice has made the interpretation of the misleading advertising precondition in the ruling in the case C-44/01: Pippig Augenoptik. In the factual state: the advertiser – Harlauer has issued leaflets, in which he compared the price of his rims to the price of rims of other Austrian company – Pippig Augenoptik. The rims contained different lenses: from Optimed, the other of Zeiss brand, which was marked in the leaflets. However, in the television and radio advertisements of the same rims, it was not mentioned, that the rims contain lenses of different brands. In the opinion of European Court of Justice, in such factual state, the customers have been misleading advertising.

Another ruling regarding the comparative legislation, was ruled in the case C-356/04 Lidl. In the factual state the company Etablissements Franz Colruyt NV was having a retail supermarket chain „Colruyt” in Belgium. In Colruyt advertisements, a following expression was

¹ The supporters of this theaore include: E. Nowińska

used „a family, which spends EUR 100 a week for shopping in Colruyt, has saved between EUR 155 and EUR 293 by shopping at Colruyt’s instead of a hard discounter or wholesaler (Aldi, Lidl, Makro). These data was calculated on the basis of our average price index for the past year. Each month, and then each year the store recorded the prices of specific goods, which were taken into consideration in the general „price index”, depending on the quantity, in which they were bought by the advertiser”.

The European Court of Justice ruled that this type of comparative advertisement can be misleading, if it:

1. does not reveal that the comparison related only to such a sample and not to all the advertiser’s products,
2. does not identify the details of the comparison made or inform the persons to whom it is addressed of the information source where such identification is possible, or
3. contains a collective reference to a range of amounts that may be saved by consumers who make their purchases from the advertiser rather than from his competitors without specifying individually the general level of the prices charged, respectively, by each of those competitors and the amount that consumers are liable to save by making their purchases from the advertiser rather than from each of the competitors.”¹. Therefore, in the case of Colruyt’s advertisement, it was only considered as misleading only in such extent, in which it „contains a collective reference to a range of amounts that may be saved by consumers who make their purchases from the advertiser rather than from his competitors”²

5.3.2. Accuracy, objectivity and verifying of comparisons of goods or services and their substitution.

In the art. 16.3 (2) u.z.n.k. the legislator wants to „limit the comparison to the same types of products and services”³. For example, beer should be compared to beer, whole meal bread to whole meal bread and a carpenter’s workshop to a carpenter’s workshop.

This regulation also contains the requirement, that the comparison should be accurate and objective and performed in a way, that makes it possible to verify – on the basis of a specific verifiable data.

¹ E. Traple and others, Prawo reklamy i promocji, Warszawa 2007, p.725

² Ibidem.

³ E. Nowińska, M. du Vall, Komentarz do ustawy o zwalczaniu nieuczciwej konkurencji, Warszawa 2006, p.248.

Therefore, one should start from determining if the given goods or services are the same or have the same purpose. A consumer decides about it, „by evaluation the features of specific products”¹.

Introduction the goods or services for sale in different ways (e.g. through the authorized dealer or from import) cannot be evaluated in the context of substitution, because this rule does not require the introduction to the market in the same way.

5.3.3. Objective comparison of the important product features.

According to the art. 16.3 (2), the advertisement must objectively compare at least one or several characteristic features of a product or service, which is important for the consumer. Such feature must be characteristic, verifiable and typical. „In theory it was highlighted, that this requirement is to prevent triggering the false impression through referring to secondary features of the goods”²

From the consumer’s point of view, the price comparison is important, because mainly it is a main advantage of a given offer and decides on purchase.

The entrepreneurs, who want to present the prices in the most beneficial way for them, are often breaking the rules of fair competition. „It seems, that usually the research will deal with a market situation in a given time. At this time, the prices of compared products may differ, which does not³ mean that, in a different time it will still be like that”.

Also, when comparing the same type of products, their other important features may differ. For example, the price and the name of the wine can be the same, but the wine valleys may differ, pasta can have a different nutritional value, etc.

As one can see, it is very easy to manipulate the data referring to different features of products, such as e.g. price and for this reason, the legislator has so precisely determine the requirements for comparing the important features of products in the art. 16.2 u.z.n.k.

¹ See: R. Stefanicki, Warunki dopuszczalności reklamy porównawczej, Pr. Spółek 2002, nr 6, p.39

² E. Nowińska, M. du Vall, Komentarz do ustawy o zwalczaniu nieuczciwej konkurencji, Warszawa 2006, p.249.

³ Ibidem, p.249.

5.3.4. Prohibition of confusion.

The art. 16.3 (4) was created in order to protect the features which individualize the company, its goods and services. It is about to avoid mistakes in distinguishing the advertiser and its competitor or between their services or goods.

According to the act, the threat of mistake is not enough, the mistake has to actually take place.

It is mainly about the prohibition of using someone's else's reputation or about situations, when e.g. the consumers attributed to the advertised product the features of the competitive product.

5.3.5. Prohibition of discrediting the competitor.

The prohibition of discrediting, „according to the art. 16.3 (5) refers to the case, when the advertising performed according to other conditions of the art. 16.3 presents, that the competitor's product or service are much more worse, and secondarily discriminates it”¹. It is about slandering the competitor, his goods, services, trademarks or other distinguishing marks.

The art. 16.3 (5) is the implementation of the art. 3a.1 (e) of the 84/450EEC directive, which was interpreted in the ruling of the European Court of Justice in the case c-44/01: Pippig Augenoptik. The tribunal claims, that it is not a discreditation of the competitor to compare the products, which have a large difference in price. So, in the advertisement based on the comparison of the two products prices, the advertiser does not have to „refer”² to the average price level used by him and the competitor.”

5.3.6. Geographical designations.

Comparison of goods with protected geographical designation or protected name of geographical designation is permitted only in case, where both advertisers' and competitor's products share the same designations. Such requirement has been made, because the geographical designation can influence particular features of a given good, increasing or decreasing its attractiveness. The art. 16.3 (6) will be only applicable to the protected geographical designations, not to other geographical designations.

¹ E. Nowińska, M. du Vall, Komentarz do ustawy o zwalczaniu nieuczciwej konkurencji, Warszawa 2006, p.249.

² E. Traple and others, Prawo reklamy i promocji, Warszawa 2007, p.728

For example, it will be allowed to compare different type of „porto” wines, but it will be prohibited to compare the „porto” wines with other wines, e.g. Italian ones.

5.3.7. Taking unfair advantage of other’s reputation.

The art. 16.3 (7) disallows taking advantage of the reputation, trade mark, name mark of the competitor, etc. Generally, in every comparative advertisement, there is an element referring to someone’s reputation, therefore the legislator has specified as an act of unfair competition only such usage, which is unfair. „It is not clear, how this regulation should be understood. If one only assume, that taking advantage of the competitor’s reputation is fair only when the advertisement is limited to the comparisons in a way described in other paragraphs of the art. 16.3., the article in question would be unnecessary. If the point is to take advantage of this reputation in other way, then it also would be hard to point out its specific normative content, because according to the art. 3, each taking advantage of someone’s reputation is forbidden, when it constitutes an act of unfair competition”¹

5.3.8. Prohibition of imitation and replica.

The entrepreneurs are replicating products, which have a wide recognition and are purchases by the customers. The art. 16.3 (8) prohibits the advertising, which present a product or service as imitation or replica of product or service bearing the protected trade mark or another distinguishing designation.

One should assume, that this regulation protects reputed goods, those, which bear a risk of being replicated.

According to the theory, this regulation has been constructed incorrectly. The point is in the used expressions: „imitation” and „replica”, which are synonymous, while the context of the art. 16.3 (8) shows, the that scope of any of the words does not lie within the other.

The prohibition of imitation and replica, deals mainly with products (services) bearing the protected trade mark or another distinguishing designation. „It is a slightly different take then in the law of European Union. According to the art. 3a (h) of the 84/450/EEC directive, it is not allowed to present in a comparative advertisement goods or services as imitations or replicas of

¹ E. Nowińska, M. du Vall, Komentarz do ustawy o zwalczaniu nieuczciwej konkurencji, Warszawa 2006, p.250.

goods or services bearing a protected trade mark or trade name. As one can see, the national take on this matter has a broader scope of behavior”¹

The example of companies, which are under protection of the art. 16.3 (8) are „manufacturers of perfumes, which products are compared in advertisements with identically chemical, non-branded products”²

5.4. Special offer in comparative advertisement.

A comparative advertisement connected with a special offer should meet the requirements of the art. 16.3 and art. 16.4 u.z.n.k.

In case of such advertising, the rules of fair competition can be easily disrupted, especially when it comes to the information regarding the price. It appears, that for the consumer, one of the most important features of a product, often being the decisive factor i price.

Therefore, the comparative advertising connected with a special offer should, depending on its terms, clearly and unequivocally indicate the date on which the offer expires or to contain information that the offer is valid till the stock of products is exhausted or till cessation of rendering services.”. The aim of the last limitation is „the prevention of the situation, when the advertiser will be pointing out in the comparative advert special conditions of purchase, in situation, where it is clear, that he will not be able to meet the demand”³. the Only in such way, having all information, the potential buyer can make a consciousness decision and will not be misleading advertising.

While, where the special offer is not binding yet, it should also indicate the date since which the special price or other specific terms of the offer shall be binding.

„Fulfilling the requirements of the art. 16.4 will cause, that the special offer will also fulfill the requirements of the art. 66§1 in connection with the art. 71 of polish civil code.”⁴

¹ Ibidem.

² See: K. Grzybczyk, Prawo reklamy, Warszawa 2008, p.77.

³ E. Traple i inni Prawo reklamy i promocji, Warszawa 2007, p.730.

⁴ E. Nowińska, M. du Vall, Komentarz do ustawy o zwalczaniu nieuczciwej konkurencji, Warszawa 2006, p.251.

Seema Rao and Syed Burhanur Rahman

Author: Seema Rao (seemarao1986@gmail.com) holds a Bachelor's degree in Law from Amity Law School, New Delhi, affiliated to Guru Gobind Singh Indraprastha University, New Delhi. She was a Law Researcher to a High Court Judge in New Delhi. Presently she is practising as an advocate in the High Court of Delhi, assisting a Government Counsel.

Author: Syed Burhanur Rahman - Holds a graduation and post graduation degree in History from the prestigious St. Stephens College, Delhi University, India. He has pursued his LLB from Campus Law Centre-Delhi University. Syed is presently working as a Law Resarcher/ Research Assistant to a High Court Judge inNew Delhi, India.

“Islamic banking”

“That is because they say, trading is only like usury and Allah has allowed trading and forbidden usury” - Surat Al Baqara v.275

Islamic banking refers to a system of banking or banking activity that is consistent with the principles of Islamic law (*Shariah*) and its practical application through the development of Islamic economics. *Shariah* prohibits the payment of fees for the renting of money (*Riba*) for specific terms, as well as investing in businesses that provide goods or services considered contrary to its principles (*Haraam*). While in earlier times these principles were used as the basis for financial transactions, it is only in the late 20th century that a number of Islamic banks were formed and these principles were applied formally in private or semi-private commercial institutions for the benefit of Muslim communities.

When Islamic Banking with its ethical values first appeared, it was treated as a utopian dream by the financial circles in the world.¹ The attitudes are, however, now changing. Recently when the worst recession after the great depression of 1930s hit different parts of the globe, institutions based on the principle of Shariat Banking remained unaffected from its deleterious effect.

Islamic banking is steadily moving into an increasing number of conventional financial systems. It is expanding not only in nations with majority Muslim populations, but also in other countries where Muslims are a minority, such as the United Kingdom or Japan. Over the last decade, this industry has experienced growth rates of 10-15 percent per annum—a trend that is expected to continue. In fact, Islamic banking, is predicted to become a \$4 trillion global industry over the next five years, and is the least affected sector in the current global economic meltdown triggered by subprime tsunami in the United States.²

1. Historical Evolution of Islamic Banking

¹ Ferlenius, Bengt, “Islamic Banking: An Alternate system” Kristianstad University College Journal (2004). Available at, eprints.bibl.hkr.se/archive/00000223/01/pdf. Last visited on April 15, (2009).

² John, Issac., “Islamic Banking Set to Emerge as a \$4 Trillion Industry”, *Khaleej Times Online*, December 30 (2008). Available at http://www.khaleejtimes.com/biz/inside.asp?xfile=/data/business/2008/December/business_December806.xml§ion=business, last visited on April 15, (2009).

Islamic banks appeared in the global market actively over two decades ago. However, many of the principles upon which Islamic banking is based have been commonly accepted all over the world, for centuries.

During the Islamic Golden Age, early forms of proto-capitalism and free markets were present in the Caliphate, where an early market economy and an early form of mercantilism were developed between the 8th-12th centuries, which some refer to as "Islamic capitalism".¹ A vigorous monetary economy was created on the basis of the expanding levels of circulation of a stable high-value currency (the dinar) and the integration of monetary areas that were previously independent.²

After the Golden Age, a period between the 15th and the 20th centuries followed, which is remembered as a period of stagnation and decline. The reasons for this might be that the Islamic world suffered a double break – not only with its own past but also with the West. The Renaissance, the Reformation, even the scientific revolution and the Enlightenment passed unnoticed in the Muslim world.³

The colonization during the 16th and 17th centuries delayed the development of the Islamic financial models. Instead European banks were established at the end of the 17th century in Turkey, Egypt and Iran. Most institutions with relevance to finance that exist today – capital markets, corporations, etc – did not exist in the early days of Islam.⁴

The practice of Islamic banking did not start at the national level; instead individual Islamic banks were established in many countries during the seventies. These Islamic banks had to operate with the economic and legal constraints of the country. They also had to face competition from interest-based banks, which were already established in the system. This environment gave little protection to Islamic banks, which are based on sharing (or partnership). Therefore the low levels of honesty and trustworthiness in the market, the poor system of audits and accounts, lack of means for monitoring a business and the failure of legal system to help the finance providers in case of default by the fund-users, were some of the reasons preventing Islamic banks from applying the practice of profit-sharing. Instead they turned to trade and industry as partners, sometimes even as sole proprietors, so that they could have full control over

¹ Labib, Subhi Y., "Capitalism in Medieval Islam", *The Journal of Economic History*, Vol. 29, No. 1, The Tasks of Economic History (Mar., 1969), p. 79. Available at www.jstor.com, last visited on April 15 (2009).

² "Islamic Banking", available at http://en.wikipedia.org/wiki/Islamic_banking#cite_note-0. Last visited on April 15 (2009).

³ Warde, Ibrahim., *Islamic finance in the Global Economy*, Edinburgh University Press, (2000). Available at, <http://books.google.co.in>. Last visited on April 15 (2009).

⁴ *Ibid*

the use of funds.¹

A special mention must be given to Tabung Haji in Malaysia, a financial institution, which played an imperative role in the evolution of Islamic banks. The reason for the creation of this institution was due to the demand that money for pilgrimage (Hajj) to Mecca (one of the pillars of Islam) should be clean of interest, which wasn't possible with conventional bank. The objective of Tabung Haji was firstly, to enable Muslims to save in order to provide their expenses for performing the pilgrimage. Secondly, to enable Muslims, through their savings, to participate in investment according to the Sharia. Thirdly, to provide for the welfare of Muslims on pilgrimage.²In 1963, Tabung Haji started with 1281 depositors and a total of 46,600 Malaysian dollars as deposits. By 1985, this had increased to 867,220 depositors with total deposits over one billion Malaysian dollars, and had 65 branches. Although strictly speaking, Tabung Haji is not a bank but it operates on similar lines. It performs two important banking functions, accepting deposits and making investment. However, due to its success it gave courage and confidence to Muslim thinkers that Islamic banking can work.³

Some pioneering Islamic banks on a very modest scale were established in Egypt in the 1960s and operated as rural social banks along the river Nile, where banking didn't exist at the time. The idea of Interest-free banking in these rural areas proved successful and therefore gave the boost to promote a more substantial movement towards a new Islamic economic and financial system.⁴ The very first Islamic bank to be developed as a result was the Nasser Social Bank, which began operating in Cairo, Egypt, in 1972. Then in 1975 Dubai Islamic Bank was established.⁵The late King Faisal of Saudi Arabia played an integral part towards the development of current Islamic Banking System. It was his belief that that since the Qur'an prohibited interest and laid down specific rules and regulations on how Islamic economic should be conducted, he felt that Islamic nations must create a structure, which would comply with Islamic Law and also modern financial techniques in order to produce a viable financial system.⁶

In 1970, during the second Islamic conference of Foreign Ministers, it was proposed that ways of establishing an international Islamic Bank for Trade and Development, together with a

¹Khan, Mohsin S. Abbas Mirakhor, *Theoretical Studies in Islamic Banking and Finance*, Islamic Pub. Int. (2000). Available at www.google.books.co.in. Last visited on April 15 (2009).

²Haiwad, Abdullah., "Islamic Banking System, Islamic Banking Concept, Islamic Banking, Afghanistan, Kandahar", October 12, (2008). Available at SSRN: <http://ssrn.com/abstract=1283093>. Last visited on April 15 (2009).

³Arif, Mohamed., "Evolution of Islamic Banking". Available at http://www.islamicity.com/Finance/IslamicBanking_Evolution.htm, last visited on April 15 (2009).

⁴*Supra* note 5.

⁵"Islamic Banking", available at http://en.wikipedia.org/wiki/Islamic_banking#cite_note-0. Last visited on April 15 (2009).

⁶*Supra* note 14.

Federation of Islamic Banks should be studied and examined. Experts from eighteen Muslim countries examined the proposal and recommended that interest-based financial system should be replaced by a system of participation schemes linked with profit and loss sharing. Also it was decided that a Federation of Islamic banks together with an International Islamic bank should be established.¹

In 1975, the Islamic conference of Finance Ministers in, Saudi Arabia approved the establishment of the Islamic Development Bank (IDB) with capital of two billion Islamic Dinars. The member states of the Organization of Islamic Conference became members of the bank. The creation of the Islamic Development Bank (IDB), gave push to the Islamic banking movement. The IDB was established as an international financial institution according to the declaration made in the 1973 Conference of Finance Ministers. The purpose of the IDB is to promote the economic development and social progress of the Muslim community, individually and jointly, in accordance with the principles of the *Shariah*.

It was the first time an international financial institution was allowed to conform to the *Shariah*. The official publications of the Islamic Development Bank declares that it is clearly and unequivocally committed to the principles of the *Shariah* in its conduct of all its financing operations and the performance of its activities, and it tries constantly to identify the modes of financing that conform to the *Shariah*. With the development of the IDB, a number of Islamic banking institutions have been established around the world.

2. Holy Quran and islamic finance

The Quran and *Sunnah* have both placed tremendous stress on justice, making it one of the central objectives of the *Shariah*. *Shariah* literally means a straight path. In Islamic terminology, *Shariah* means the way of life prescribed by God through Prophet Muhammed. The Qur'an teachings and the practices of the Prophet, called the *Sunnah*, make up the *Shariah*.

One section of the *Shariah* is related to beliefs, while the other is related to individual and collective life. *Fiqh* (Islamic Law) is the part of the *Shariah*, which deals with the latter. It specifies the Do's and Don'ts, the Permissible (*Halal*) and the Forbidden (*Haram*).²

Islamic economics is based on 'socio economic justice' as the primary objective. It is based on the belief that human beings are a creation of that one & the only god and all resources at their disposal are held by them in trust for the god to be used in a just manner for wellbeing of

¹ *Supra* note 13.

² Ahmed, Shaikh Mahmud., *Towards Interest- Free Banking*, Adam Publishers, (2007).

all. Islam provides guidelines to regulate the economy and seeks to curb the unbridled race for material pursuit. Concern for equity and justice, *halal* and *haram* and a sense of responsibility towards the weaker sections of society and the need to share the economic resources with them, are some of the principles which guide and control the economic activity in Islam.

Islam accepts the market forces of supply and demand and the reference of the same has been made in the Holy Quran too. In fact Islam gave the concept of Market Forces 1300 years before Keynes presented the modern model of Economics in 1927. Islam accepts the right to private property and accepts the right to maximize profits. But these rights are not rampant and un-conditional rather there are some prohibitions.

3. Fundamentals of islamic banking

All interest-free banks agree on the same basic principles. However, individual banks differ in their application. These differences can be because of several reasons including the laws of the country, objectives of the different banks, individual banks circumstances and experiences, the need to interact with other interest-based banks, etc.

Some of the essential principles which are followed by all the banks practicing *shariah* banking are¹:

- Any predetermined payment over and above the actual amount of principal is prohibited;
- the lender must share in the profits or losses arising out of the enterprise for which the money was lent;
- Making money from money is not acceptable;
- *Gharar* (uncertainty, risk, or speculation) is also prohibited;
- Investments should only support practices or products that are not forbidden. Such prohibitions include alcoholic beverage production or sale, investment in real estate for a casino, etc.

The Islamic banking system aims at developing new financial instruments to deal with the problems of the Muslim communities. This can be done by mobilizing resources into a banking system which conforms to the Islamic teaching and principles. The main objective is to encourage the habit of investment and saving among Muslims, so that funds effectively circulate in the economy and do not remain idle.

¹Available at www.islamic-banking.com, last visited on April 15 (2009)

The fundamental reason for the prohibition of interest in Islam is that the depositor should not profit unduly from the hard work and risk bearing of others. Interest rates affect savings and investment and efficiently allocate capital from where it is plentiful to where it is scarce. In competitive markets, this allocation of capital is achieved most efficiently; namely, capital is attracted to where it will earn the highest rate of return (“ROR”).¹ Moreover, interest rates offer policymakers an important instrument for macroeconomic management.² Although Islam prohibits interest (*riba*), it encourages profit and -return from investment where the investor takes calculated risk.

4. Instruments involved

After discussing the fundamentals pertaining to Islamic Banking it is imperative to briefly mention about the important instruments involved in this financial arrangement. Prominent instruments as formulated by different thinkers are mentioned below:

Sale and Buy Back Agreement (Bai' al-Inah)

- The financier sells an asset to the customer on a deferred-payment basis, and then the asset is immediately repurchased by the financier for cash at a discount.
- The buying back agreement allows the bank to assume ownership over the asset in order to protect against default without explicitly charging interest in the event of late payments or insolvency.

Deferred Payment Sale(Bai' Bithaman Ajil)

- Sale of goods on a deferred payment basis at a price, which includes a profit margin agreed to by both parties.
- This is similar to Murabahah, except that the debtor makes only a single installment on the maturity date of the loan.
- By the application of a discount rate, an Islamic bank can collect the market rate of interest.

Credit Sale(Bai muajjal)

- This is like a credit sale.
- It is a contract in which the bank earns a profit margin on the purchase price and allows the buyer to pay the price of the commodity at a future date in a lump sum or in installments.
- It has to expressly mention cost of the commodity and the margin of profit is mutually agreed.

¹ Rehman, Scheherazade S., “Globalization of Islamic Finance Law” 25 Wis. Int'l L.J. 625.

² *Ibid*

Profit Sharing (Mudaraba)

- An arrangement between the bank, and an entrepreneur, whereby the entrepreneur can mobilize the funds of the former for its business activity.
- The entrepreneur provides expertise, labor and management.
- Profits made are shared between the bank and the entrepreneur according to predetermined ratio.
- In case of loss, the bank loses the capital, while the entrepreneur loses his provision of labor.
- It is this financial risk that justifies the bank's claim to part of the profit.
- The profit-sharing continues until the loan is repaid.
- The bank is compensated for the time value of its money in the form of a floating rate that is pegged to the debtor's profits.

Cost Plus (Murabaha)

- Sale of goods at a price, which includes a profit margin agreed to by both parties.
- The purchase and selling price, other costs, and the profit margin must be clearly stated at the time of the sale agreement.
- The bank is compensated for the time value of its money in the form of the profit margin.
- This is a fixed-income loan for the purchase of a real asset (such as real estate or a vehicle), with a fixed rate of profit determined by the profit margin.

Musawama

- A general and regular kind of sale in which price of the commodity to be traded is bargained between seller and the buyer without any reference to the price paid or cost incurred by the former.
- Thus, it is different from Murabaha in respect of pricing formula.
- Both the parties negotiate on the price.
- All other conditions relevant to Murabaha are valid for Musawamah as well.

Bai salam

- A contract in which advance payment is made for goods to be delivered later on.
- The seller undertakes to supply some specific goods to the buyer at a future date in exchange of an advance price fully paid at the time of contract.
- It is necessary that the quality of the commodity intended to be purchased is fully specified leaving no ambiguity leading to dispute.
- The objects of this sale are goods and cannot be gold, silver, or currencies. Barring this,

- Bai Salam covers almost everything that is capable of being definitely described as to quantity, quality, and workmanship.

Gift (Hibah)

- This is a token given voluntarily by a creditor to a debtor in return for a loan.
- This usually arises in practice when Islamic banks involuntarily pay their customers interest on savings account balances.

Istisnaa

- Under Istisna'a a party (bank) undertakes to produce a specific thing that is possible to be made according to agreed specifications at a determined price and fixed date of delivery
- As banks do not normally carry out manufacturing, a parallel contract for manufacture is instituted
- The bank charges the buyer the price it pays to the manufacturer plus a reasonable profit (monetary installment) and takes the risk of manufacture of the asset.

Tawarruq

- Tawarruq is the mode adopted by banks to lend cash
- The customer buys a commodity from the bank under Murabaha which is then sold to a third person on cash at a price less than the purchase price.
- The customer hence obtains cash without taking an interest-based loan
- If the customer resells that commodity to the bank, it is called Al-'inah

Ijarah

- The bank buys and leases out the asset for a rental fee, which includes the capital cost of the equipment plus a profit margin.
- The ownership of the equipment remains with the lessor bank and in case of a finance lease, is transferred on pre-determined terms.
- Available under both operating lease and finance lease (Ijara-wa-iktana)
- Widely used in house and aircraft financing.

Joint Venture(Musharakah)

- A relationship between two parties or more, of whom contribute capital to a business, and divide the net profit and loss pro rata.
- This is often used in investment projects, letters of credit, and the purchase of real estate or property.
- In the case of real estate or property, the bank assesses an imputed rent and will share it as

agreed in advance.

- The profit is distributed among the partners in pre-agreed ratios, while the loss is borne by each partner strictly in proportion to respective capital contributions.

Good Loan(Qard Hassan)

- This is a loan extended on a goodwill basis
- The debtor is only required to repay the amount borrowed.
- However, the debtor may, at his or her discretion, pay an extra amount beyond the principal amount of the loan (without promising it) as a token of appreciation to the creditor.
- In the case that the debtor does not pay an extra amount to the creditor, this transaction is a true interest-free loan.

Islamic Bonds (Sukuk)

- An Islamic equivalent of bond.
- However, fixed-income, interest-bearing bonds are not permissible in Islam.
- Hence, Sukuk are securities that comply with the Islamic law and its investment principles, which prohibit the charging or paying of interest.
- Financial assets that comply with the Islamic law can be classified in accordance with their tradability and non-tradability in the secondary markets.

Islamic Insurance (Takaful)

- Takaful is insurance based on mutual co-operation, responsibility, protection and assistance between groups of participants
- It is akin to a cooperative insurance wherein members contribute a specific sum of money to a common pool
- Every policyholder pays his subscription to help those that need assistance
- Losses are divided and liabilities spread according to the community pooling system

Safekeeping (Wadiah)

- A bank is deemed as a keeper and trustee of funds.
- A person deposits funds in the bank and the bank guarantees refund of the entire amount of the deposit, or any part of the outstanding amount, when the depositor demands it.
- The depositor, at the bank's discretion, may be rewarded with a hibah (gift) as a form of appreciation for the use of funds by the bank.
- In this case, the bank compensates depositors for the time-value of their money (i.e. pays interest) but refers to it as a gift because it does not officially guarantee payment of the gift.

Agency (Wakalah)

- This occurs when a person appoints a representative to undertake transactions on his/her behalf, similar to a power of attorney.

5. Conclusion

Islamic banking is at an incipient stage. Appropriate models need to be selected and implemented to suit society's diverse financial needs. The importance and relevance of Islamic banking in the context of "Financial Tsunami" that has taken place in recent times further enhances the need of Sharia banking. With only minor changes in their practices, Islamic banks can get rid of all their cumbersome and sometimes doubtful forms of financing and offer a clean and efficient interest-free banking.. Such a system will offer an effective banking system where Muslims may invest in pursuant to Islamic principles and the rest may have an alternative to interest bearing conventional banking.



Emerging Markets:

A Review of Business and Legal Issues

