



Emerging Markets:

A Review of Business and Legal Issues

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A Corporate Governance Case Study*
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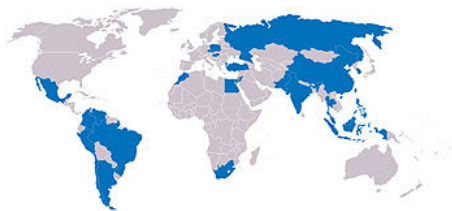
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Wojciech Rogowski

“The Siemens Corruption Outburst and CEOs Combat It: A Corporate Governance Case Study”

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The Siemens Corruption Outburst and CEOs Combat It: A Corporate Governance Case Study¹

Wojciech Rogowski²

ABSTRACT

This article presents a case study of a corruption scandal in a transnational corporation (a global corporation). It attempts to expose facts and analyse the causes and mechanisms of wrongdoing by sales and of financial embezzlements which took place in Siemens AG, Germany, and were revealed in autumn 2006. The article also attempts to answer why such a good company as Siemens, which employs the best staff and is famous for its innovative products, has used corruption. Why has the company been involved in corruption? What are the reasons for this? When does corruption become a crime and when is it only an operational technique? Will the means employed to fight it prove effective? The analysis included the information policy of the company as well as the response of markets, investors, and other stakeholders. Furthermore, the analysis covered the company's response to serious crisis and the influence it has had on the company, on its bodies and individuals in management circles. How were corporate governance and enterprise value affected by the suspected corruption? What was the response of the capital market to the revealed corruption and to measures taken to fight it? How did the company communicate with the market, public opinion or with its own 500,000 employees scattered all over the world? The case study of Siemens AG also helps to update the picture of German corporate governance, as well as to get acquainted with the relation between the corporation and the state.

¹ The author has never meant to evaluate behaviour of private persons mentioned in the case study; he only wanted to present facts related their occupational activity. It aimed at providing teaching materials for jail-house seminars for MBA, Management and Economics studies. I would like to thank InfoCredit-online.pl and Siemens AG for some data and documents.

² Ph.D., Warsaw School of Economics (SGH); Economic Institute of the National Bank of Poland (NBP), ul.Swietokrzyska 11/21; 00-919 Warszawa, Poland; phone +48 22 653 23 07, e-mail: rogowski@c-law.org. The article illustrates the author's personal opinions and not a position of the institution working with.

Furthermore, the case study can be used to know the company's achievements related to management, especially the management extensive global structures, knowledge management and risk management. It should be noted that "scandals" and crises caused by them are often the only opportunity to learn in detail how these complex structures function, as well as what their malfunctions stem from.

The case study of Siemens AG forms part of a wider trend to present case studies of international corporations (Mallin 2006; Ruigrok 2004; Probst 2002, etc). These case studies introduce an empirical hint/data to the discussion on the current problems and condition of corporate governance in the biggest and/or most dynamically developing companies of the world's major economic systems.

The structure of the article has been affected by case study methodology. The first part describes the mechanisms and effects of corruption, revealed as a result of an investigation carried out by the Bavarian prosecutor's office and reported in the press and the company's publications. In the second part the adopted crisis management method and its effects are analysed. Corporate governance and the strategy of a corrupted organisation are described in the third part. Finally, the summary discusses the determinants of corruption and its relations with corporate governance and enterprise value.

Key words: transnational corporation, corruption, corporate governance, reputation, case study.

JEL classification: I22, K42, G3

Prologue

In the misty morning of 15 November, 2006, several hundred German policemen, prosecutors and tax inspectors simultaneously searched over 30 offices and flats of the employees of Siemens AG, one of the world's oldest and most recognisable German companies. The legal basis for the widespread investigative actions referred to as "Operation Amigo", unprecedented for such a large corporation, were justified suspicions of illegal financial transfers (corruption, embezzlements, money laundering) detected by financial supervisory services during secret proceedings which had been carried out in Lichtenstein and Switzerland since 2003.¹ The suspicions were justified and credible enough to issue a search warrant which also covered the offices of the President of the Board of Directors and other top managers, to arrest the suspects, and to bring against them the charges of financial crimes for the amount of EUR 20 mln. As a result of the investigation twelve persons were detained, including ten former Siemens employees (*among others*, the CFO of the Communications Department, the Foreign Sales Manager, the Head of Internal Audit and the Head of Accounting and Controlling), suspected of organising and offering bribes in order to obtain orders.² More than 30,000 documents and several thousand computer discs were seized.³ From the first day of the investigation, Siemens AG management confirmed that there had been irregularities in the functioning of the company and declared their full support in clarifying the truth and punishing the guilty. At the same time they explained that the company acts as witness in relation to the suspected crimes perpetrated by its employees.⁴ The extent of investigative actions carried out against the biggest company in the Federal Republic

¹ In spring 2003, banking supervision noticed numerous financial transactions made through a bank in Liechtenstein by Marthas Overseas Corp., a small company in Panama which belongs to one of the CEOs of the Greek regional company of Siemens AG. A more detailed investigation of those transactions did not confirm suspicions of the financing of international terrorism, on the grounds of which the investigation was launched, yet it revealed one of the greatest corruption crimes. Financial transactions made on suspicious bank accounts were monitored until the first half of 2005; investigations also took place in Italy and Austria. These facts were revealed only two years later. On 18 December 2006, The Wall Street Journal informed that in November 2004 an investigation had begun in Liechtenstein, which concerned money laundering and included Siemens employees.

² Die Presse: *Siemens-Affäre: Korruption "schockiert"*. 13.08.2007

³ The Wall Street Journal: *Siemens investigation grows*, 13.12. 2006

⁴ *ibidem* p. 3.

of Germany caught world mass media attention, which overreacted and named it “a scandal”. However, the quick succession of events as well as the revealed facts soon justified the use of this term.

An anatomy of corruption

Although international public opinion and the world of business (shareholders) might have been completely taken aback by the events of that November morning, which reminded of the unpleasant incidents that led to the collapse of great American corporations such as ENRON, Worldcom, etc, analysts and commentators quickly put the situation in the right context.¹

Regretfully, Siemens had already been referred to in numerous corruption cases.² There have been at least a dozen cases concerning suspected illegal actions in the commercial practice of Siemens, the first one dating back to 1914, when it was revealed that commission was paid to an official in relation to Siemens-Halske winning a contract for supplies to the Japanese navy.³

Obviously Siemens is not the only corporation suspected of bribery. In the last months press agencies reported that companies such as BMW, Daimler-Chrysler, Karlstadt, Samsung, Audi, EADS, BAE, Air Berlin and Volkswagen had been involved in corruption scandals.⁴ Yet it is characteristic that corruption issues have accompanied the changes which have been introduced in the corporation during the last several dozens years. It is true that certain charges of corruption were used by the management of the company to prevent the

¹ The reason for taking legal proceedings is not clear. Unofficially, a case of whistle-blowing is mentioned, although the employee's name has not been mentioned so far. (Leyendecker H.: Die Grosse Gier. Rowolth, 2007, p.64. It has not been explained why the investigation speeded up exactly in autumn 2006. Apart from international commitments (the investigation had started abroad), changes in Bavarian politics (the end of term of office of the Bavarian Prime Minister Edmund Stoiber) could be one possible reason.

² Handelsblatt, 2006, Korruption ist bei Siemens nicht Neues, 16.Dec.; J.Roth, 2006, Der Deutschland Clan, Heyne, Muenchen; J.Wachsberger, 2007, B.Bannenberg, W.Schaupensteiner, 2007, Korruption in Deutschland – Portrait einer Wachstumsbranche, C.H.Beck, Muenchen; A.Piński, 2006, Niemieckie branie, Wprost, 17.12; s.52, The Wall Street Journal, 1980, Two Siemens Officials Are Arrested in Vienna on Bribery Charges, 15.05;

³ R.H.Mitchell, 1996, Political Bribery in Japan, Uni. of Hawaii Press, Honolulu, p.28;

⁴ Corruption in Germany, 2007, <http://www2.dw-world.de>, 28.03;

recurrence of irregularities. One of such incidents was the case of 9 Siemens managers, sentenced in 1992 for using bribes to obtain the location a modern waste water treatment plant in Munich, the seat of Siemens. Thanks to the fact that a building control officer had been also sentenced in that case, Siemens could share criminal responsibility with national administration. The case coincided with the election of Heinrich von Pierer as the new CEO of the corporation¹. He promised then to do everything so that “similar cases” did not repeat.² New rules of conduct were published soon afterwards. Signing relevant declarations was aimed to oblige managers to follow them. Such actions must have brought positive results, as for several years there was no news of “false” money or bribes in the mass-media. Nevertheless, for several years Siemens employees and Siemens subsidiaries have again been suspected of paid protection and bribery related to won tenders or investments undertaken.³

As the extensive investigation progressed in 2006, the mechanism of suspicious payments and crimes on an unprecedented scale was revealed. In the very first week of the investigation the sum of the questioned and suspicious payments revealed increased ten times to EUR 200 mln, after a month it doubled (ca EUR 420 mln)⁴. After a year of investigations and the first trial the suspicious financial transactions revealed to have been used for financial embezzlements amounted to ca EUR 1,614 bn over the period of 7 years⁵. Until the end of September 2007 470 Siemens employees were charged with violating the law.⁶

¹ Further personal detail in the biographical notes in Rogowski W.: Notatki o skandalu korupcyjnym w Siemens AG [Notes on the scandal at Siemens AG]. Przegląd Corporate Governance, 1, 2008;

² A statement made for Der Spiegel after Handelsblatt, 2006, Korruption ist bei Siemens nicht Neues, 16.Dec.;

³ A case of two Siemens managers started in Italy in March 2006. They were accused of offering a EUR 6 mln bribe in exchange for winning the tender for an Italian gas corporation. In 2006, Allianz CEO was sentenced for bribery in relation to the building of a new stadium for Mundial 2006. In USA the medical equipment department of Siemens was suspected of using unacceptable measures connected with attempts to win a tender for equipment for Illinois hospitals. Siemens was also suspected of taking part in embezzlements of EUR 1.6 mln, related to the “Oil for food” UN programme, and of malpractice concerning the use of World Bank assets in Pakistan, B.Balzli: *Lukrative Hilfe*. Der Spiegel, 27, 2007, p. 95. In all these cases the company managed to reject suspicions. The company, however, did not succeed in Singapore, where it was forbidden to participate in public tenders for 5 years.

⁴ The Wall Street Journal: *Siemens fraud inquiry thickens*, The Wall Street Journal 2006;

⁵ Focus, 20.09.2007 after Sueddeutscher Zeitung, which quoted the results of the research carried out by Debevoise & Plimpton LLP law firm.

⁶ According to P.Loscher (CEO), after Sueddeutsche Zeitung, 2007, 470 Siemens-Mitarbeiter wegen Verstoßen bestraft, 8.11;

The investigation concentrated on the telecommunications devices production and sales department, until recently the flagship area of activity of Siemens. Already in the 1990s this department, the so-called COM, was a loss-making business unit. There were several reasons for this situation, e.g. the rapid development of mobile telephony, strong competition in this area (other European corporations belonging to the same business line, like Alcatel, faced similar problems), “conservative” technology used by Siemens, and “tardiness in restructuring” caused by the high position of this traditional area of Siemens activity, and, as a result, the strong position of trade unions and very high salaries.¹ The restructuring of the company, carried out by von Pierer, the President of the Board of Directors at the beginning of 21st century, resulted in a lesser loss, and even in an increased turnover of the COM department in 2004.² Unsatisfactory results and the strategic plans of the company, however, made the next President of the Board of Directors Klaus Kleinfeld³ (cf. the *Dramatis personae* annex), a former COM manager, decide to restructure the area and separate it for the special joint venture with Finnish Nokia. The Nokia Siemens Networks Holding BV company started its operation in January 2007.⁴

As a result of investigations it has been established that in several dozen cases the mechanism was similar. Transfers for the so-called consulting services (the so-called BCAs – Business Consultant Agreements), consulting or agency services, were made to bank accounts (*inter alia*, in Liechtenstein, Switzerland, Austria, Germany, Abu Dabi and Dubai) of the so-called “bogus companies”, companies established e.g. by former Siemens employees to continue “cooperation”.⁵ Next, further transfers were made for persons or companies connected with contracts for which Siemens companies tendered, from accounts with the so-

¹ A German electrotechnician with four-year work experience, employed in Siemens AG, working 35.8 hrs per week, earns app. EUR 35,141 per year (PLN 130,000) after Dohmen F., et al.: *Wankende Titanen*. Der Spiegel, 20, 2007 p. 88;

² Spiegel, 2006, *Karibische Kassen*, 48, p. 70

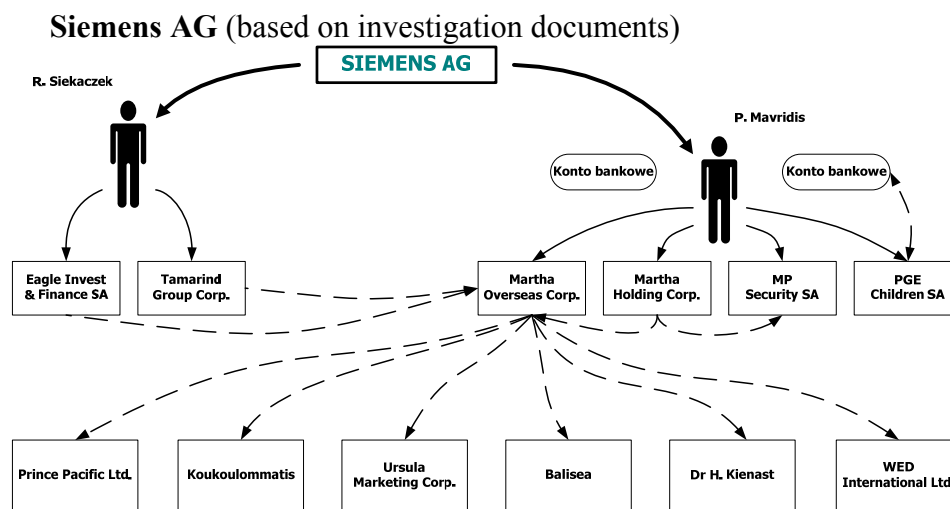
³ Further personal detail in a biographical entry in Rogowski W.: Notatki o skandalu w Siemens AG [Notes on the scandal at Siemens AG]; Przegląd Corporate Governance, 1, 2008;

⁴ Yet this happened several years after the earlier mergers of former competitors (e.g. Alcatel-Lucent); Siemens gained a very respectable and efficient partner;

⁵ e.g. Eurocell, Fiberlite, owned by a former top employee of the Greek branch of Siemens, after Wachsberger (2007:2);

called “slush funds/black money” (German *Schwarze Kasse*). Suspicions shared by prosecutor's offices of several countries include transfers of the illegal funds of Siemens to Egypt, Saudi Arabia, Kuwait, Indonesia, China, Hungary, Israel, Norway, France, Vietnam, Greece, Nigeria, Italy, Serbia, Caribbean countries, Russia, Poland, Libya and other countries. Neue Bank Lichtenstein, LGT Bank Group, Dresdner Bank Schweiz, Deutsche Bank Frankfurt, Societe General Hellad, Raiffeisen Bank and other banks have all cooperated with the police and prosecutors during the investigation.

Chart 1. Links between persons and companies involved in creating “black money” in



Source: Own study based on The Wall Street Journal, 28-30.Dec.2007, Der Spiegel, 14.04.2008 and other sources; continuous lines refer to assets held in particular companies, dotted lines refer to the transfer of assets to entities connected with Siemens AG transactions. Sample transactions only.

The investigation started when numerous financial transactions made by Siemens employees through off-shore companies were incidentally discovered in Liechtenstein in 2003. Banking supervision officials suspected that the revealed transactions could have been used to finance international terrorism. The suspected bank accounts were monitored until 2005. In the meantime, the issue was investigated by Swiss, Austrian and Bavarian prosecutor's offices. In autumn 2004 Siemens head office was informed of suspected

corruption, yet the prosecutors' request for explanation was rejected. In March 2006, investigators searched the premises of the Swiss company of Siemens in relation to suspected corruption in Greece, and froze more than EUR 200 mln originating from suspicious transactions on the company's accounts. The company's reaction was to close down the Swiss branch, although there were no economic reasons to justify such an action.¹ The principal persons involved in the revealed transactions and suspected of corruption in Greece had left Siemens only a few months before the scandal broke out, and some of them – even several months after the crimes were revealed.²

The case concerning suspected corruption in Siemens AG, which ended with a court settlement (*tatsächliche Verständigung*), revealed the details of 77 corruption cases in Nigeria (33 bribes of EUR 9.74 mln), Russia (38 cases of EUR 1.87 mln) and Libya (6 cases), amounting to the total of EUR 12 mln. The court possesses the names of persons and companies to whom the accused Reinhard Siekaczek gave bribes or controlled giving bribes, as was testified by one of the now former Siemens employees, arrested in November 2006. The files included a list of bribes amounting to from EUR 2 thousand to EUR 2.2 mln, paid by transfer or in cash to numerous public administration officials and to telecommunications companies from the countries mentioned above. As established by the court, the bribes earned the corporation "illegal economic profits" of EUR 200 mln, whereas, as the accused testified, they made it possible for 15 thousand Siemens employees to earn revenues of ca EUR 4 bn.³ For the sake of comparison, in the Watergate scandal it was found that Lockheed Aircraft Corporation paid a bribe of USD 12.5 mln to public persons in Japan for the contract worth a total of USD 430 mln.⁴ R. Siekaczek, as a supervision director in the corporation head office until 2004, supervised the sale of telecommunications equipment abroad, reported to the telecommunication department (COM) management, and the latter reported directly to the

¹ D.Crawford, M.Esterl, 2007, Inside Bribery Probe of Siemens, The Wall Street Journal,

² P.Mavridis resigned in April 2006, and the CEO of the Greek subsidiary - not until December 2007.

³ D.Crawford, M.Esterl: *How Siemens paid out bribes across 3 countries*. The Wall Street Journal, 16.11.2007, p. 1;

⁴ R.T.George, Business Ethics, after Klimczak (2006:) The Time: *Lockheed's Defiance: A Right to Bribe?* 1975 <http://www.time.com/time/magazine/article/0,9171,917751-2,00.html>

corporation's Board of Directors. Siemens did not reveal why in 2004 R. Siekaczek left. It is known, however, that he was subsequently employed as a consultant. The files include the testimony of R. Siekaczek, which incriminates other Siemens managers of bribery in 12 other countries, including Brazil, Camerun, Egypt, Greece, Poland, and Spain. They are investigated separately.¹

The accusations that over 50% contracts concluded lately in China involved corruption were rejected by the new President during his first foreign visit to Shanghai. During the visit, however, 20 employees of the Chinese branch of Siemens were dismissed because of "unacceptable behaviour".²

Corporate bribery or private embezzlement?

The actions undertaken against Siemens AG in autumn 2006 by the national public prosecutor's office in Bavaria and cooperating services were aimed to explain whether the company's top management had known about any cases of improper management of the company's funds in the COM department. If it had, whether the funds were used for the company's benefit, if it was done in the company's commercial activity to bribe contracting parties or so that particular persons could become rich themselves.

During the investigation and hearing of suspects two lines of defence were revealed. The first group of suspects explained that bribes paid to contracting parties with the so-called "black money" (German *Schwarze Kasse*) were treated as an ordinary business practice in the COM department. In their opinion, bribery was a traditionally accepted element of business practice. The practice was very popular and known to managers of all levels. "*We were sure that many other people in the company knew about the "black money"*", said Steffen Ufer, the lawyer of one of the suspects.³ To defend themselves the accused stressed that it was not

¹ D.Crawford, M.Esterl: *How Siemens paid out bribes across 3 countries*. The Wall Street Journal, 16.1. 2007, p. 27;

² China has lately become a very dynamic market for Siemens AG, which operates here 90% through agents. In 2006 the market share doubled, the employment rate increased by 23%, and the turnover constitutes nearly 7% of total revenue. *Wirtschaftswoche*, 18.08; *Die Presse*, 2007, *Korruption: Siemens feuert 20 Mitarbeiter in China*, 23.08;

³ *Financial Times*, 2006, *Siemens bribery scandal raises further questions*, 22.12;

an isolated practice on foreign markets, and British, French or American companies did the same.¹ The methods applied at Siemens were only a way to retain the competitive position of the corporation. They implied that top management knew about this way of "supporting" sales growth. The suspicions may be corroborated by the earlier searches carried out in the offices of the top management staff including the CEO. On 11 December 2006 Thomas Ganswindt, a former (until September 2006) member of the Board of Directors at the head office, who had been responsible for the COM department, was arrested, which also may confirm these suspicions.² The investigation revealed corruption transactions in more than 60 countries, which raises suspicions about systemic corruption. Since Siemens possesses one of the best and most modern corporate communication (sales promotion) and knowledge management systems (ShareNet, Communities@Siemens, etc.)³, it seems justified to suspect that superiors had known about multimillion transfers of assets in the company structure.

Klaus Kleinfeld, a President of the Board of Directors, who was merely a witness, adopted a different line of defence. Since the investigation began, he denied that, although in 2004 he had himself supervised the telecommunications department as a member of the Board of Directors, he knew anything about forbidden practices used on the company's lower levels. Other members of the Board of Directors and of the Supervisory Board shared this attitude. They also stressed that they were only witnesses in the case, and not suspects. Considering the traditional role of the telecommunication department in Siemens business activity, many members of the present Board of Directors had worked in the COM department and the company's foreign branches in South America or Africa, where investigative officers were led. They believe that corruption is connected with the embezzlement of company funds by an organised criminal group. The Board of Directors did not deny that they had occasionally been informed about bribery, as in the case of the investigation carried out in Liechtenstein in

¹ so far (October 2007) no specific examples of similar practices in the case of tenders in which Siemens also participated, or of an investigation carried out in a similar case have been mentioned;

² released after several days, Handelsblatt, 2006;

³ M.Franz et al.: *The development of the Siemens Knowledge Community Suport*. [in:] Knowledge Manangement Case Book Best Practices, eds.: T.H.Davenport, G.J.B.Probst, Wiley & Publicis, Erlangen 2002, p.147;

2004, which initiated the current "scandal". They were not aware, however, that it was only a part of a wider practice employed at the company. However, the prosecutor's office have not found that any of the suspects misappropriated even some of the "black money".¹

On the other hand, it is known that Chairman of the Supervisory Board, Heinrich von Pierer, President of the Board of Directors in 1992 – 2005, i.e. when the investigation concerning commercial bribery, contributed to an amendment of accounting law in the late 90s., which led to a systemic ban on posting commissions or "bribes" paid to contracting parties. Interest given to corruption issues may suggest that such practices are known and used, but also that one is aware of its inappropriateness and harmfulness, which can be proved by the support to German accounting reforms. Until 1999 German Law allowed posting such expenses as operating costs. In 1999 such practices were forbidden.

When the irregularities were revealed, H. von Pierer was not afraid of any negative consequences for him, for, as he said, *as a President of the company he had introduced a number of protections against corruption and reinforced the rules.*² The subsequent President of the Board of Directors Klaus Kleinfeld shared this opinion. He claimed that between 2004 and 2006 compliance rules and requirements at the corporation became more strict.³ However, according to Joe Kaeser, the Financial Vice-President, financial control in Siemens was not sufficient.⁴ Although investors association and trade unions implied that the Board of Directors and trade unions were to blame, no personal accusations have so far been made against von Pierer or Kleinfeld.

Furthermore, the investigation revealed also other abuses. In March 2007, the incumbent member of the Board of Directors, J. Feldmayer was arrested. His signature was discovered on contracts concluded in 2001 with W. Schelsky, head of the AUB trade union, who allegedly under the cover of "consulting services" was to win unionists favour for the corporation

¹ MF.: *Siemens – dymisje obu prezesów* [Siemens – dismissals of both CEOs] Zarządzanie na świecie, 3, 2007, p.5;

² Siemens: Schaden verdoppelt, 12.12.2006, www.futurezone.orf.at/business/stories/157175/;

³ The Wall Street Journal, Siemens investigation grows, 2006, Siemens chief hops fraud investigation narrows, 22.12;

⁴ Financial Times, 2006, ...op cit. p. 15;

management decisions in return for a total of EUR 14 mln.¹ The investigation also disclosed links between Siemens and other companies and organisations. It turned out that among the members of the Management Board of Deutsche Telekom, responsible for investment purchases of telecommunication equipment, there was L. Pauly, a former member of Siemens AG Board of Directors, who submitted his resignation immediately after the media revealed the information.² Moreover, objections were raised concerning the special auditing supervisory committee (German abbreviation DPR) and the German Accounting Standards Committee (DRSC) since some of its members were in a conflict of interest when audit operations in Siemens AG were supervised.³

Crisis management

Ever since these events happened, the corporation management has kept the media informed about issues related to the investigation and declared their support in order to clarify irregularities and charges. They also stressed from the very beginning that Siemens merely acts as witness concerning embezzlements made by former employees. In their first statements for the media, the company management attempted to reduce the scale of problems, e.g. they informed that the irregularities occurred only in the COM department, stressing that it did not belong to Siemens any longer.⁴ In the first months, the media were also the main source of information, which provided information about the situation in the company for employees and especially employees of subsidiaries.⁵ The subsidiaries' actions were believed to be autonomous, yet it is characteristic that only Siemens AG management

¹ P. Jaklin, 2007, Siemens-Vorstand Feldmayer verhaftet, Financial Times Deutschland, 28.03, p.1;

² M. Esterl, D. Crawford, 2007, Skandal infects Deutsche Telecom, The Wall Street Journal, 1-3.06., p. 5,

³ Der Spiegel, 2006, Befangene Prüfer, Der Spiegel, 52, p. 45.

⁴ Faktycznie pion ten restrukturyzowano poprzez wydzielenie części do *join venture* z Nokią (w którym Siemens ma 50% akcji) a pozostałe funkcje i osoby przeniesiono do pozostałych pionów i spółek koncernu.

⁵ Actually, the department was restructured, and one part to joint venture with Nokia was created (where Siemens has 50% shares). Other functions and persons were moved to other departments and companies of the corporation. As late as in mid-January 2007 there was no information concerning the events at the corporation on its website. Those who wanted to obtain information by phone were sent to the newspapers and informed that irregularities are related only to the head office, not to its dependent companies. There is no record of internal communication with employees until the resignation of on Pierer, who sent a letter to employees.

gave information and commented on the events.¹ In the first stage of the investigation, the management kept ensuring that embezzlements occurred only in the COM department.² However, further internal investigation, carried out, as could be observed, more rapidly than the official one, showed that corruption practices did not occur solely in the COM department but also in other departments, such as the power engineering equipment department or the real estate management department.

Rapid response

As a result of the revealed corruption practices, the company's Board of Directors rapidly took a number of measures in order to fully clarify the suspicions. One of the first measures was to employ a special advisor for corruption suspicions. Michael Hershman, an American corruption expert and the Transparency International co-founder, who had been active already in the Watergate investigation, was appointed to this post. His task was to audit the compliance system in the company and to fully clarify the charges.³ By employing such an expert the company's Board of Directors quickly responded to the wave of criticism and suspicions that they tolerated corruption. In 1998, Siemens had joined Transparency International Deutschland, an organisation which investigates corruption and helps fight it, as a donator. In autumn 2006, when the irregularities were revealed, Transparency International withdrew from the contract with Siemens AG.⁴

The internal investigation

How much can a single expert do, no matter how able he is, in a company which employs nearly half a million people and processes 9 mln financial transactions per day?⁵ Therefore, Debevoise & Plimpton LLP, an external law firm was hired. The task of that

¹ E. Snocka, 2006, Afera korupcyjna w Siemens AG [The corruption scandal at Siemens AG], *Gazeta Finansowa*, 27.11;

² cf. J.Käser's (CFO) statement, after *The Wall Street Journal*, 2006, Siemens investigation grows, 13.12;

³ Ch.Hard, 2006, Balsam für Heinrich von P., *Handelsblatt*, 21.12; p. 15.

⁴ www.transparency.de/Trennung-von-Siemens.978.98.html

⁵ *Der Spiegel*, 2007, Viel Licht und viel Schatten, an interview with K.Kleinfeld, *Spiegel*, 4, p. 83;

American company was to carry out a regular internal investigation concerning the suspicions of corruption and other irregularities. The law firm is supported by chartered accountants and investigative officers from Deloitte & Touch.

The corporation had an internal audit and compliance department already before, which was responsible, *inter alia*, for the protection against corruption and for fighting it, thus referred to in the corporation as the “anti-corruption department”. During the public investigation the department was directed by Albrecht Schaeffer, who was forced to resign in December 2006 since he failed to inform the company management in due time about corruption and embezzlement cases with the use of Liechtenstein bank accounts, which could indicate that he participated in this forbidden practice or protected it.¹

In January 2007, Daniel Noa, a former appeal prosecutor (*Oberstaatanwalt*) in Stuttgart was appointed as new head of the anti-corruption (compliance) department.² Nearly six months later he was persuaded to resign and to become a consultant.³ The dismissal of Noa coincided with Peter Löscher's becoming the CEO of the corporation (cf. Annex 3). Several weeks later Löscher expanded the internal audit department and changed the head of the compliance department again. He employed persons from outside Siemens, including two Americans.⁴

¹ The investigation revealed that in December 2004 the compliance department presented “a confidential note for the authorised“, where it informed that it was likely that the results of the investigation concerning bank accounts in Liechtenstein, carried out by various institutions, might soon be revealed. In the document it was stressed that discussion was needed. The head of compliance at that time, A. Schäfer, wrote to a member of the Board of Directors that an “unofficial crisis staff” would be created, for the sake of prevention. No official measures were taken, and Supervisory Board Audit Committee learnt about the Liechtenstein investigation no sooner than at the end of April 2005. Der Spiegel, 2007: Schäfer soll gehen, 31, p 58.

² Siemens: Schaden verdoppelt, 12.12.2006, www.futurezone.orf.at/business/stories/157175/

³ It was caused, *inter alia*, by strong resistance faced by the internal investigation of middle-level management, including the head of the legal department. One of manager's statement was quoted: “Stop bothering us with investigations, we have business to do here.” Others thought that D. Noa's appointment had not been thought over; other factors than substantial were more important. Noa was a state official, not a compliance expert in a corporation. J.Herr, 2007, Trennung vom Korruptionsbekämpfer, FAZ.net

⁴ P.Solmssen, former legal advisor at GE Health Care, the biggest global competitor of Siemens', was appointed head of department and general counsel. A.Pohlmann, a former administrative manager in Celanese Corp. Chemical corporation, was appointed head of the compliance department, and H. Winters, a former partner at Pricewaterhouse Coopers Germany – head of internal audit. After: M.Esterl, D.Crawford, 2007, Siemens's compliance ranks get new faces, The Wall Street Journal, 20.09; p. 3; These changes are

The open information policy

In the second half of 2007 the management of the corporation pursued a more open information policy, skilfully comparing the revealed embarrassing facts related to the scope of embezzlements in the past years with information concerning the company's future. Particularly important in this respect was the announced change of the President of the Board of Directors, implemented on 1 July 2007. In November the first outcomes for the third quarter of 2007 were announced. On that occasion, a detailed 10-pages long report on legal proceedings carried out in the accounting year 2006-2007 against and with participation of Siemens AG was revealed to the public, a step without precedence in Germany. Another event of equal importance was calling on the company's managers to whistle blow, i.e. to reveal, on their own accord, all information known to them concerning embezzlements and acts of corruption committed by employees or by the managers themselves, in return for a guarantee of employment, but not sooner than after attending training in ethics and changing the post.¹ It is difficult to say what results such actions will bring in German organisational culture. No one knows whether the initiative is of incidental nature only, or whether it will become a systemic solution, as American standards require.²

Succession

Since the beginning of the case in November 2006, the company's top management implemented the “ignorance and help” strategy. They declared support in clarifying the charges and the lack of knowledge concerning the practices applied in the company.³ Although no charges were put to the former President von Pierer, nor to Kleinfeld, the current President, they resigned before the end of their terms of office, within less than six months

characteristic for the new CEO's style- he employs people with experience from other leading corporations, especially American ones, including those from the pharmaceutical industry, which he is familiar with

¹ AFP, 2007, Siemens offers to spare whistleblowing managers, Nov.1; <http://afp.google.com/article/>

² The term 'whistleblowing' was not mentioned on www.siemens.com until September 2007.

³ Spiegel, 2007, Viel Licht und viel Schatten,

since the disastrous events of November 2006. Kleinfeld resigned a few months before the end of his term of office.¹

Therefore, succession in the company's management became the burning question. In the supervisory board it happened in a natural and quick manner. Gerhard Cromme was appointed the President of the supervisory board (cf. Annex 1), who so far directed the supervisory board audit committee and is believed to be the main opponent of, keeping an eye on, the previous chairman of the supervisory board and ex-CEO. Only a few days after the change of the Supervisory Board President, information was released about the search for a successor to Kleinfeld, who was still in charge.² Since there was no committee³ for appointments at the time, the search was conducted by Cromme, the new President of the Supervisory Board. They were of an informal nature, although at the beginning a headhunting agency which used to work for the Board of Directors was asked to present candidates.⁴ Yet Kleinfeld resigned soon and not long after that the press, after some gossip about talk with other potential candidates, revealed the successor's surname – Peter Löscher.⁵ According to the press, Gromme and Löscher did not know each other. It is said that the candidate was suggested by Professor W.Kröll, a long-time member of the Supervisory Board; others say that this nomination is the effect of the fact that G. Gromme has known J. Dorman of ABB, a former CEO of Hoechst-Avensis.⁶

Soon (5 May) the candidate and his references were presented to and accepted by the Supervisory Board. However, German HR experts said that Löscher did not have relevant

¹ Dr Johannes Feldmayer, was believed to be Kleinfeld's successor. He joined Siemens AG when he finished secondary school. Arrested on 27 March on suspicions of bribery. H.Leyendecker, 2007, *Die Grosse Gier*, Rowolth, Berlin, p.118.

² Financial Times Deutschland, 24.04.2007

³ It was established no sooner than July 2007.

⁴ There were the following criteria: knowing the company's offer, age – under 50, experience in contacts with US offices, experience in contacts with capital markets (analysts), experience in managing a multicultural environment, German nationality.

⁵ A.Reitzle, CEO of Linde AG, was mentioned (earlier in Ford MC), F.Kindle from ABB, F.Fehrenbach from Bosch, D.Vasella -Novartis and E.Reinhardt from Siemens; P.Beets, 2007, *Mighty mess at Siemens*, 9.05, p. 16; R.Milne, 2007, *Foreign executives fight with German traditions*, Financial Times, 18.05; p.20;

⁶ Handelsblatt, 2007, *Wie Siemens seinen neuen Chef gefunden hat*, Handelsblat.com, 22.05; H.Leyendecker, 2007, *Die Grosse Gier*, Rowolth, Berlin, s.128; A.Hennersdorf, 2007, *Entfrosten and Entrosten*, Wirtschaftswoche, 22, p. 77;

experience to manage the corporation (he had never been a CEO), did not have any distinctive features, and normally he would never be appointed the corporation's CEO. Unclear selection criteria could have originated from G. Gromme's wish to strongly influence corporation management thanks to the inexperience and the lack of knowledge of the company on the part of the new President of the Board of Directors.¹ G.Cromme and J.Ackermann, the President of Deutsche Bank AG, were the persons who supported Löscher's candidacy. They stressed his strong points, i.e.: the knowledge of international business, including the US market, experience gained in the competitive company (GE Inc.), knowledge of the medical sector, which could help him in supervising one of the company's most important departments, and, finally, his personality traits.

The succession showed characteristics of a crisis model – the current President of the Board of Directors did not participate in the proceedings, which were carried out by the Chairman of the Supervisory Board in haste and under the pressure of time.² The oldest member of the Supervisory Board said that the Board had never made a choice so rapidly.³ This sudden succession was also commented on as “coup d'état” carried out by the Supervisory Board and even as a result of mobbing, which the legally incumbent President was subject to.⁴ In spite of all this, probably due to the extensive experience of Cromme, the nomination of Löscher was fully accepted by the market.⁵ The succession procedure lasted for less than a month, which seems to be the standard in the case of a sudden, post-crisis vacancy.⁶

¹ H.Johannsmann from Interconsillium, after Handelsblatt, 22.05;

² D.A.Nadler, B.A.Behan, M.B.Nadler, 2006, Building Better Boards, Josseys-Bass, San Francisco, p.176;

³ A.Hennersdorf, 2007, Entfrostet and Entrostet, Wirtschaftswoche, 22, p.73;

⁴ P.Beets, 2007, Mighty mess at Siemens, 9.05, p. 16;

⁵ <http://www.marketwatch.com/News/Story/analysts-welcome-pick-loescher-next/story.aspx?guid=%7B003F10D1%2D831C%2D47C1%2DA8FD%2D7FC40770E3FA%7D>

⁶ Cf The succession of the new CEO of Citigroup Inc. lasted almost the same time; a candidate from outside the corporation was chosen, The Wall Street Journal, 2007, Citi may name Pandit CEO next week, 7.12,

On 20 May, P.Löscher was unanimously elected President of the Management Board, the post to be taken on 1 July 2007.¹ The new CEO's first public statement was as follows: "I will be working together with the 475,000 proud Siemensians".²

The programme for regain trust

The events analysed in this case study occurred 159 years after W. Siemens and J.G. Halske established the first company producing telegraphs, the precursor of Siemens AG. The company's 160th, round anniversary was used to promote it and to regain trust, which had lessened as a result of the corruption scandal. All over the world advertisements and articles stressed that Siemens had changed the world by its innovative products, and that today's Siemens "continues such traditional values as business continuity, awareness of customers' needs and high qualifications of its employees".

It was pointed out that with the power of innovativeness and its clear objective, i.e. to become a world leader in corporate governance, the corporation could continue its sustained, profitable growth. "Siemens is more than tradition and ability to adapt", said Peter Löscher, the President of Siemens AG Board of Directors on the occasion of the anniversary.³

These celebrations are part of a global promotion campaign, announced in September 2007. It costs about EUR 300 mln.⁴ The campaign, which reminds all previous achievements of the corporation, is meant to direct customers' and investors' attention to main areas of core business defined in the new strategy (cf. the section about strategy). This should reduce the impact of numerous agency reports related to new stages of the scandal. The campaign's slogan is "*Siemens answers*" major questions of the present for 160 years now. Its objective is "to make people understand Siemens better."⁵ With the new campaign Siemens is catching up

¹ He got 23% more in basic remuneration than his predecessor, and a right to compensation for the lost benefits he would have had in the previous job (Der Spiegel),

² S.Hoffman, 2007, Weltbürger aus Willach, Handelsblatt, 21.05, p.15

³ From the company's documents, e.g. www.siemens.pl

⁴ M.Esterl, 2007, For Siemens, image repair, The Wall Street Journal, Nov.29; p.6; the image campaign is carried out by Ogilvy &Mather

⁵ www.btobonline.com/apps/apps/pbcs.dll/article?AID=/20071105/FREE/711105034/1

on its competitors,¹ who have been controlling their image for their end-customers and investors, and not only for their decision makers. Their campaigns show the features and end-user perspectives, including environmental protection, rather than a company's power and perfection, as Siemens does.

Trial and punishment

So far (March 2008), “suspicious” receipts of “as little as” EUR 449 mln, discovered in the investigation at COM, have been shown officially. The media, referring to sources close to D&P LLP, estimate that suspicious payments sum up to EUR 1.6 billion and about EUR 3 billion² in the whole corporation. As a result of incorrectly booked receipts the recalculated financial result for the accounting year 2005-2006 was lower by EUR 73 mln (EUR 3.033 billion), yet in 2006 the net profit was higher than in the previous year by 34.9%, with a 16% growth in turnover.³

Box 1. List of embezzlements revealed in 2006-2007

Country, sector	Names of person suspected and sentenced	Amount of bribe	Contract value	Financial penalty for Siemens AG
Italy, power industry	Horst Vigener. Andreas Kley	EUR 190 mln	EUR 6 billion	EUR 38 mln
Nigeria, Russia, Libya, telecommunications	Reinhard Siekaczek	EUR 12.9 mln	EUR 4 billion (EUR 200 mln profit)	EUR 1 mln + EUR 200 mln
Greece control engineering	Prodromos Mavridis	EUR 37 mln	no data available	?
Germany, AUB trade unions	Johannes Feldmeyer, Wilhelm Schelsky	EUR 14 mln	EUR 14 mln	?

source: own study based on literature referred to in the article

¹ e.g.. GE Inc. has been implementing a coherent EcoImagination campaign – innovative solutions for ecological challenges, whereas Philips NV has carried out the campaign under the slogan “sense and simplicity” of our products. M.Esterl, 2007, Siemens czyści wizerunek po skandalu korupcyjnym [Siemens cleans up its image after corruption scandal], Dziennik, 3.12.2007

² Der Spiegel, 2007, Beherzt zugegriffen, Der Spiegel, 22, p.82

³ The Wall Street Journal, 2006, Siemens investigation grows, 13.12;

In connection with the irregularities revealed in the investigation the District Court in Munich, acting on the basis of the public prosecution of corruption practices for the amount of EUR 449 mln, committed by “the now former employees of the now former COM” in 2001-2004, performed for the benefit of Siemens AG in winning contracts in Nigeria, Russia and Libya. As a result of admitting to the crime and accepting to pay a financial punishment by mutual agreement (*tatsaechlische Verstaendigung*), the District Court in Munich imposed the penalty of EUR 1 mln on Siemens AG, and, additionally, ordered to return EUR 200 mln, considering the economic profit obtained from the illegal actions of employees, and estimated at no less than EUR 200 mln.¹ Siemens had to pay the additional EUR 179 mln (EUR 168 mln of which were included in reserves) for tax due and unpaid as a result of the revealed embezzlements for the period of 2001-2006.²

The corporation was also charged with the costs of external advisors and legal service in the amount of EUR 347 mln. In the fourth quarter these costs will amount to EUR 159 mln. The Board of Directors estimates that the total costs of the “scandal” in the accounting year that ended 30 September 2007 are EUR 1.3 – 1.4 billion, which is more than 35% of the annual financial result.³ Further indirect costs may be caused by the potential lowering of the credit rating of the company. So far, Standard & Poors has maintained the rating of AA-, whereas Moody’s lowered it from Aa3 in 2006 to A1.⁴

They probably do not include all the costs the corporation will incur as a consequence of the detected irregularities. The international law firm D&P LLP, employed by the management of the corporation to carry out an internal investigation, proved that corruption may corporation transactions with 65 countries, including the USA. Due to the quotations of Siemens AG on the New York stock exchange since 2001, the American Securities and Exchange Commission (SEC) started explanatory proceedings in the case of corruption at

¹ Siemens, 2007, Legal proceedings – Fiscal 2007, 8 Nov. p.1 after www.siemens.com;

² http://w1.siemens.com/pool/en/investor_relations/financial_publications/ad_hoc_announcements/071004_siemens_ad_hoc_message_com_settlement_e_1464784.pdf

³ Süddeutsche Zeitung, 2007, 470 Siemens-Mitarbeiter wegen Verstoßen bestraft, 8.11;

⁴ http://w1.siemens.com/annual/07/pool/download/pdf_finanzinfo/e07_05_fiveyearssummary.pdf

Siemens AG. Corruption practices in international trade are prohibited and severely punished under American law. Corporate crime is particularly severely punished by the law introduced after the ENRON scandal i.e. the Sarbanes-Oxley Act. Further fines may be expected, which may amount to EUR 3-5 billion¹, since the scale of revealed corruption suspicions shows that it is the largest case in the SEC history in terms of value.

The cases in Germany are not over yet. German law as a rule does not allow for criminal responsibility of legal persons. In the court proceedings finished on 4 October 2007 with material arrangement, Siemens was the co-perpetrator of the crime of which Reinhard Siekaczek was accused. According to German law, the court may impose a fine on a company to the maximum amount of EUR 1 million and decide about the forfeiture of the profit generated from criminal activities.² Therefore, Siemens had to pay a fine of EUR 201 million, which, according to the German media, was the highest fine ever imposed by a Bavarian court on a corporation. The ruling in the case of Reinhard Siekaczek, accused of the embezzlement of funds for the benefit of Siemens (and not of bribery) will probably be open in 2008. Reinhard Siekaczek will probably be an accomplice witness in numerous other trials of persons suspected of misappropriations in relation to Siemens. His role is important in the proceedings in Greece and Italy. The arrangement ensures that he will not be subject to prosecution in other cases.

Other central figures in the corruption story in the electrical power engineering sector, namely Andreas Kley and Horst Vigener, accused of the embezzlement of Siemens AG funds and of bribery in Italy amounting to EUR 6 million, received suspended sentences of 2 years (Kley) and 9 months (Vigener) in prison and the payment of EUR 400,000 for charity.³ In 2004 the court in Milan examining this case prohibited Siemens for a year from participating in public tenders in Italy and cooperating with state-owned companies and institutions in relation to the investigation on the attempt to corrupt Enelpower, a branch of ENEL group, in

¹ Der Spiegel, 2007, Beherzt zugegriffen, Der Spiegel, 22, p. 82

² D. Crawford, M. Esterl, 2007, *op.cit.* p. 27

³ H. Leyendecker, 2007, Der grosse Gier, p. 129

order to win contracts for the reconstruction of the power plant.¹ The company's attitude towards persons suspected of wilful corruption activities in case of a court sentence is unknown. The company will probably file a suit with the claim for compensation for incurred losses.

Apart from direct penalties (fines, loss of profits, taxes), the company may also suffer from the consequences of the media hype caused by the scandal and the loss of trust. Suspicions and ambiguities remaining for a long time may cause difficulties in recruiting the best candidates for work. An example of the impact of negative atmosphere is the fact that Siemens was not allowed to increase its capital in Russian Silhovye Machinery.² The investigations on corruption conducted in many countries may also result in the termination of the already concluded contracts by the authorities of those countries. The entry of the company on the so-called "black list", as it has happened in Singapore, Italy, Nigeria or recently in Norway, may also cause trouble.

Corporate governance at SIEMENS AG

Siemens AG is a very complex corporate structure manufacturing products and providing services in over 10 business areas, starting from the production of electric equipment - from light bulbs and espresso machines through medical scanners to turbines and engines and from real estate to financial services. A detailed financial analysis of the corporation is not the purpose of this document. Such an analysis is also difficult to perform due to frequent changes in the corporation structure related to the spin out of parts of the corporation to form joint venture companies or the sale of other assets (VDO, Infineon, etc.). However, in order to get a full picture it is necessary to present the corporate governance profile, the results of corporation management and the changes in the implemented strategy.

The SIEMENS AG joint stock company was established in 1966 as a result of combining a number of companies established by the Siemens family in the period starting

¹ A.P., 2004, Kłopoty Siemensa z tramwajem [Siemens' problems with the tram], Rzeczpospolita, 29.04.

² Handelsblatt, 2007, Siemens sucht neue Wirtschaftsprüfer, 4.12., p. 16.

from 1847.¹ Siemens AG currently controls one of the largest technological corporations in the world. It consists of 1651 subsidiaries² operating in around 290 industrial centres of 190 countries of the world and employing a total of 475,000 persons in 2006. The latter number has increased quickly in the present decade contrary to strategic assumptions (in 2000 the number of employees was 430,200, cf.: chapter on strategy). Currently one in three employees works in Germany and one in four is an engineer or a scientist.³ The scale of operations and the expansion of the corporation is demonstrated by the fact that the costs of business trips amount to EUR 2 billion a year and the number of employees going on such trips is 280,000.⁴

The management of such a huge industrial structure is a major challenge both for the Board of Directors and for the remaining corporate governance bodies, i.e. the general shareholders' meeting, the supervisory board and the auditor. The narrow management of the corporation itself consists of 40 persons, the supervisory board of 20 and the Board of Directors - of 11 persons.⁵ In 2007 over 13,000 persons participated in the general shareholders' meeting.

After 160 years of the existence of the company, the Siemens family remains the largest shareholder.⁶ The shares revealed as at 2 October 2007 constituted 5.44% of the share capital, which results in a block worth approximately USD 5.2 billion. The total participation of the shareholders-founders is currently estimated at 8% of the share capital with the nominal value of around EUR 220 million.⁷ Another major shareholder is Allianz SE, which has 3% of shares through investment funds. Around 650,000 entities are registered in the shareholders' ledger. The shares of other major shareholders (among others, Templeton Growth Fund) do

¹ Ch.Hardt, 2007, Unter Hochspannung, Handelsblatt, 5-7.10.; p. 16. They included the following companies: Siemens & Halske, Siemens-Schuckert-Werke and AEG (Telefunken).

² Including 913 consolidated subsidiaries (11 from Poland) and 738 companies which were not consolidated in the balance sheet (including 7 from Poland) as of 30 September 2007, according to www.siemens.com

³ http://w1.siemens.com/en/about_us/key_information/key_figures.htm

⁴ M.McNulty, 2007, Changing Behavior: Siemens Measures Cost of Non-Compliance, Procurement.travel.com.

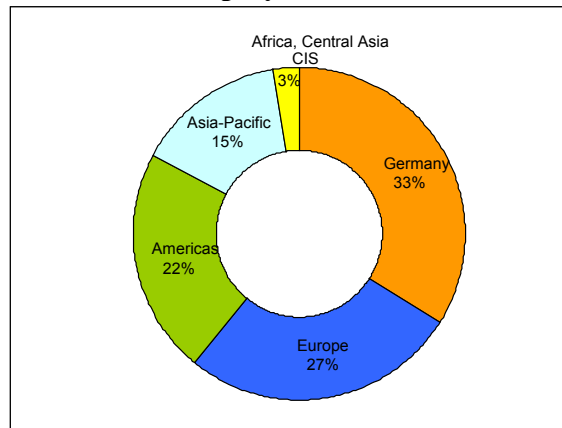
⁵ As at 14 October 2007.

⁶ By Von Siemens Vermögensverwaltung GmbH. The shares of Siemens companies have been quoted since 1899.

⁷ Süddeutsche Zeitung, 2007, Pierer soll „Entschuldigung“ sagen, 24-25.11.2007.

not exceed 0.8% of the capital and are owned by investment funds and institutional investors.¹ It is estimated that currently around 54-60% shares of Siemens AG is in the hands of foreign shareholders.² There are 914 million shares in trade, and free float amounts to around 94%.

Figure 1. Geographical structure of employment in Siemens AG (2006)



Ownership structure - shareholders

Due to a significant dispersion of shares, general shareholders' meetings of the company are mass events traditionally held in the Munich Olympics Hall. The record general shareholders' meeting in terms of the number of participants and duration (12 hours) took place on 25 January 2007 and was attended by around 13,000 shareholders (41% voting rights) and employees concerned about the investigation on corruption and the loss of EUR 420 million, the bankruptcy of mobile phone producing joint venture BenQ-Siemens, the fine for price collusion imposed by the European Commission and amounting to EUR 400 million, and the loss of membership in Transparency International.³ However, the information provided by the Board of Directors and the supervisory board painted a picture filled with success –increased revenues from sales, increased profit, new orders for record amounts (including government contracts for electronic products for the Bundeswehr amounting to a record EUR 7 billion), progress in restructuring, successful takeovers of some companies in the areas in which the corporation specialized (*inter alia*, medical diagnostics), etc. As a result

¹ According to Bloomberg.

² Spiegel, 2006, Spagat zwischen zwei Welten, 52. p. 49.

³ Sueddeutsche Zeitung, 2007, Verfolgt von der Korruption, 26.01.

of a stormy discussion, the management of the company received the vote of approval, but the support of shareholders was at a record low level.¹ The general shareholders' meeting in 2007 represented as much as 41% of share capital of the company.² The problems of the company resulted in the increased interest in the general shareholders' meeting, since in the previous, "peaceful" years the general shareholders' meetings gathered approximately 32% of the capital. In the subsequent year (2008), already 48.45% of the capital was represented on the first general meeting under the management of Peter Loscher.

The Supervisory Board

Pursuant to the German act on codecision procedure in the management of a joint stock company, the Siemens AG supervisory board consists of 20 members, including 10 representatives of employees. Within the period when the analysed events took place (2006-2007), the supervisory board was only slightly changed. Due to the low results obtained at the general shareholders' meeting in April 2007, Heinrich von Pierer resigned from the position of the chairman of the supervisory board. He performed this function since January 2005 when he was replaced in the Board of Directors by Klaus Kleinfeld. Dr. Gerhard Cromme, the previous member of the supervisory board and the head of the audit board committee, who was at the same time the chairman of the supervisory board of ThyssenKrupp AG, was appointed the new chairman of Siemens AG supervisory board. In addition, Georg Nassauer, the chairman of the Combined Works Council in Nokia Siemens Networks resigned from membership in the board due to the appointment to the new position. The vacancies in the supervisory board were filled by prof. Michael Mirow (aged 69) and Bettina Haller (aged 50).

¹ The president of the Board of Directors Klaus Kleinfeld received 71% of votes, the chairman of the supervisory board Heinrich von Pierer 66% (the lowest result in history), the vote of approval for two members of the Board of Directors was suspended until the completion of the ongoing investigation against them; according to M.Balser, 2007, Siemens muntert die Analysten auf, Sueddeutsche Zeitung, 26.01; J.Wachsenberger, 2007, Niemiecki rząd mimo wszystko wspiera Siemens [German government supports Siemens nevertheless], 19.02.

² The result demonstrates the scale of changes in the corporate governance of German companies, reflected in the dispersion of shareholder structure and its internationalisation. In 1992 95.48% of the capital was represented on the Siemens AG general shareholders' meeting, including almost 90% through the banks with the right to represent other shareholders, according to M.Aluchna, 2003, Zmiany w niemieckim systemie nadzoru korporacyjnego [Changes to the German corporate governance system], MBA, 4, p. 42. according to H.Schmidt et al., 1997, Corporate Governance in Germany, Nomos, Baden Baden, p. 101.

Those changes resulted in the decrease in the average age of a member of the supervisory board to almost 62 years and the decrease in the average time of membership in the Siemens board to 6.6 years. The record in this regard belongs to two representatives of the board - Ralf Heckmann (58), the chairman of the Siemens AG Central Works Council and the first deputy chairman of the Siemens AG supervisory board for 19 years, and Heinz Hawreliuk (60), the IG Metal trade union secretary, the member of Siemens supervisory board for 22 years (!) and at the same time the member of 2 other supervisory boards of German companies. The senior of the board was Peter von Siemens (70), the descendant of the founder of the company and the representative of the largest shareholder.¹

The supervisory board appointed 5 committees from among its members. Apart from the Chairman's Committee, which consists of the chairman and two deputy chairmen, they include the Audit Committee, the Conflicts and Mediation Committee, the Ownership Rights Committee, the Compliance Committee and the Nominating and Remuneration Committee (both established in 2007). The committees of the supervisory board include 7 members of the board, including two representatives of employees. An interesting fact is that the representative of the founder's family and the majority shareholder is not a member of any of them. The chairman of the supervisory board is the member of all committees and the head of four out of six. The Audit Committee consists of 3 persons, including two employee representatives with the longest experience in the board, and is headed by a person with powers and knowledge required for performing the function of a member and the head of the Audit Committee (according to SOX).²

The supervisory board is dominated by Germans (90%) with only two members being foreigners (British). This is a characteristic feature of German supervisory boards, in which foreigners account for 8% of composition on average, which is 50% less than the average in supervisory boards of companies in the European Union. In the companies in the

¹ In October 2007, he resigned from the position upon the end of his term in office, due to his age. Cf.: Balser M., K.Ott, 2007, *Siemens ohne Siemens*, Süddeutsche Zeitung, 5.11.

² It is Dr. H. Schulte-Noelle, the chairman of Allianz SE (*Societas Europea*) supervisory board for many years.

neighbouring Switzerland, foreigners on average constitute 45% of the members of the boards.¹ The activity of German supervisory boards is low (they meet 4 times a year on average), as compared to the average for the United Kingdom or the European Union, where the average number of the boards' meetings a year amounts to 9.

Six members of the Siemens AG supervisory board have an academic degree. Seven out of 20 members are also members of other supervisory boards (in 15 German and foreign companies in total²), including also the trade unionists. The record belongs to Gerhard Cromme who upon becoming the chairman of Siemens AG supervisory board in 2007 reduced his involvement in other supervisory boards from 8 to 4, including one foreign company, but retained the position of the chairman of ThyssenKrupp AG supervisory board.

The supervisory board's term in office lasts 5 years. In 2008 the mandates of 11 out of 20 supervisory board members expire due to the end of their term in office. In January 2008 11 supervisory board members were replaced at the ordinary general shareholders' meeting. The replaced members included not only those whose term in office expired, but also the abovementioned persons appointed at the previous general shareholders' meeting. The interesting thing is that the persons with record service in the board who represented employees and trade union were not changed again. Only 4 out of 10 members from this group were replaced, while the replacement had a wider scope among shareholders (7 out of 10).³

The size and structure of the supervisory board (50% of trade unionists and employees) probably will not change until the possible transformation of the company into a European Company, which is not certain taking into account the evolution of the corporation's geographical structure.

¹ Heindrick, Struggless, 2007, Corporate Governance in Europe, according to FT. 9.05; p. 9.

² Allianz SE, ThyssenKrupp AG, Saint-Gobain S.A., GUS plc, Hogg Robinson Group plc, HSBC Holdings plc, DaimlerChrysler AG, Eurocopter Deutschland GmbH, Audi AG, MTU Aero GmbH, Wincor Nixdorf AG, Muenchener Rueck AG, Thyssen Handelsgesellschaft mbH, E.ON AG.

³ According to www.siemens.com

The Board of Directors

The Board of Directors of the company (*Vorstand*) consists of 11 persons appointed for a 5-year term in office. The Board of Directors consists of the so-called 8-person central Board of Directors (*Zentralvorstand*) whose members do not bear operational responsibility, and 3 members responsible operationally for support divisions (finance, strategy, human resources). The Board of Directors supervises the operations of over 30 sector directors in 13 business areas (*Bereichen*) and regional structures consisting of regional companies, branches and representative offices. Subsidiaries report both to the central Board of Directors and to the management of individual sectors.¹

The current Board of Directors (October 2007) includes 5 persons who are new to the Board of Directors, including the President, and their term in office has been less than 2 years. Another 5 members have worked in the Board of Directors for 4 to 8 years. The record term in office is 13 years. Apart from the responsibilities entrusted to them, all members of the Board of Directors perform also functions in the Boards of Directors, mainly of subsidiaries (45), as well as of independent entities (12), both domestic and foreign. The average is 3.75 entities. The record holder - dr Heinrich Hiesienger - is a member of the board in 13 major regional subsidiaries, and in three of them he holds the position of the chairman of the supervisory board (including Polish Siemens Sp. z o.o. See: Box Siemens Regional Company). The president of the Board of Directors Peter Löscher is a member of only 2 supervisory boards of foreign companies, including the new Nokia Siemens Networks Holding BV. In 2007 there were 44 meetings of the Board of Directors.

KPMG Deutschland was the auditor of the company in 2006 and is the auditor also now. The auditor is likely to be changed soon as a result of the conducted competition.²

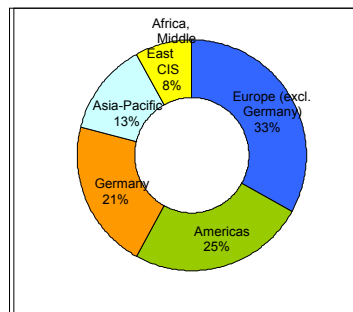
¹ Automatics, energy, transport, medicine, IT and communications, lighting technology, financial services, investments. A.Hennersdorf, 2007, Entfrosten and Entrosten, Wirtschaftswoche, 22, p. 74

² Handelsblatt, 2007, Siemens sucht neue Wirtschaftsprüfer, 4.12., p. 16.

The business strategy

The market capitalisation of Siemens AG amounts to approximately USD 95 billion, which gives it the 60th place among the 500 largest companies of the world in terms of market capitalisation.¹ Its sales volume gives the corporation the 22nd place among the largest companies, according to Fortune.² The relatively seldom use of enterprise value is characteristic of German corporate governance, which mainly involves the analysis of sales revenue, which in 2006 amounted to EUR 87.3 billion with the financial result totalling EUR 3.03 billion. In the analysed years Siemens AG increased revenues and generated positive financial results. It also regularly paid out the dividend of EUR 1-1.6 per share. However, when we compare the obtained results with e.g. the results of General Electric Inc., which is considered to be Siemens' main competitor, though not the leader in effectiveness, we can see that employee productivity at Siemens in 2006, measured by the revenue of the company, is almost 3 times lower than at GE, and the net profit per employee is over 7 times smaller.³ Such a situation has been in place for years.

Chart 2. Geographical structure of Siemens AG revenues (2006)



Siemens AG is financed mainly from its own capital (share capital), and the short-term and long-term debt amounts only to 16% of liabilities.⁴ This percentage and the prices of shares show that the company has been undervalued since 2003. The enterprise value/sales ratio is below the average for the twin group (2.23 against 1.0 for Siemens, and 1.99 DAX),

¹ According to the *Financial Times* of 30.03.2007.

² The Economist, 2007, Tomorrow the World, A special report on European business, 10.02. p. 5

³ According to the data on www.siemens.com and www.ge.com of 20.11.2007

⁴ For the sake of comparison, General Electric Inc. is financed by debt in 54%, according to Bloomberg.

which comprises companies operating in the electrotechnical equipment sector, selected from stock exchanges across the world.¹ The narrowing of the reference group to German companies from the same sector only slightly improves the position of Siemens' (Siemens – 0.81, twin group – 0.97, DAX – 1.91). Other financial indicators, such as price/profit, price/revenues or price/book value, give the company a similar position, i.e. worse than the twin group but usually better than DAX. In such a situation, the strategy of the new Board of Directors provides for the buyback of own shares amounting to EUR 10 billion (approx. 11.4% of the shares), which should significantly increase the price of shares and improve the financial results.²

Siemens competes on the global market (cf. Chart 2) and finances itself on capital markets. Currently over a half of its capital is controlled by foreigners. Siemens' shares are quoted on the XETRA exchange in Frankfurt and Stuttgart and in New York (ADR on NYSE). It is thus justified to assume that it should achieve similar results as its competitors. Although Siemens makes profit, the results in terms of profit and enterprise value are not impressive as compared to the competition and leaders. The reasons for this may be found, *inter alia*, in technology and management.

¹ D.Walewska, 2007, *Próba żelaznego prezesa* [The trial of the iron president], 13.04; own calculations according to Bloomberg.

² S.Clausen, R.Milne, 2007, Siemens plans 10 bn EUR buy back, Financial Times, Nov.8, p. 13;

Table 2. Main competitors and partners of Siemens AG (2007)

Name of corporation	Place in the ranking in 2007	Market value USD billion	Revenues [EUR billion]	Employment [thousand]	Revenues per employee [EUR million]
General Electric Inc. (USA)	2	263	EUR 111.2	310.0	0.359
CISCO Systems Inc.(USA)	28	154	EUR 23.7	63.5	0.374
Telefonica AS (Spain)	47	108	EUR 42.0	233.0	0.180
Merck & Co (USA)	59	95.7	EUR 15.4	60.0	0.256
SIEMENS AG (Germany)	60	95	EUR 87.0	475.0	0.183
Nokia Oyi (Finland)	62	93.9	EUR 51.1	68.5	0.745
Ericsson AB (Sweden)	127	59.1	EUR 18.9	63.7	0.297
ABB SE (Switzerland)	224	37	EUR 16.6	108.0	0.154
Alcatel (France)	328	27.1	EUR 18.3	79.0	0.232
Hitachi (Japan)	338	26.1	EUR 66.1	384.4	0.172
ThyssenKrupp AG (Germany)	355	25.4	EUR 50.7	187.6	0.270
Continental AG (Germany)	494	18.7	EUR 14.9	85.2	0.175

Source: According to the *Financial Times* (2007) http://media.ft.com/cms/4608ca30-e788-11db-8098-000b5df10621.dwp_uuid=f1db8aa0-4d1f-11da-ba44-0000779e2340.pdf and corporate sources.

It is a common belief that the existence of Siemens for so many decades has been the result of its innovation and the reliability of its products. The data on expenditure for research & development amounting to EUR 5 billion and the information about thousands of patents a year, presented in materials for shareholders until 2005, created an impression of a technologically very advanced company. However, when compared to international reference data, those results are no longer a reason for satisfaction. According to senior executives of 1000 largest global companies, Siemens is not the most innovative company.¹

The comparison of Siemens share prices with those of its largest competitors also paints a hardly positive picture of the position of the company. The share price of the majority of

¹ Contrary to General Electric, which was at the 4th place among the most innovative companies in the world. Cf. http://www.businessweek.com/magazine/content/05_31/b3945407.htm

those companies increased much faster within the last 3 years. Siemens share price in this period increased by around 60%, as did the share prices of Philips, Honeywell or General Electric Inc. (in this case only by approx. 10%). At the same time the price of NOKIA shares increased by 120%, of ABB by 350%, and of Alstom by 550%. Investors disposed of the shares of other technological companies such as Alcatel Lucent, whose share price was 50% lower than 3 years ago, as well as Nortel (-70%), Toshiba (-60%) or Ericsson (-20%).

Chart 3. Quotations of Siemens AG shares (orange line)

on the German XETRA exchange against the changes of DAX index (blue line, where Siemens has the weight of 10) and Dow Jones index (green), 1 December 2006 = 100.



Source: Handelsblatt.com, courtesy of Handelsblatt.

The strategy of the founders

Over 160 years ago the partnership of Siemens and Halske began from the production of needle telegraphs, which, along with the construction of cable installations, soon became the leading product in an increasing range of products based on the company's own innovations. As it usually happens with innovations, they drew orders from the army and public authorities of all levels, which later became a characteristic feature of the strategy of the company. Along with the development of the company, the links between the company and the administration

strengthened, especially in those sectors of the economy where natural monopoly existed (telecommunications, railway transport, and postal services). Siemens skilfully used those links and for many years became the “court supplier” of large state-owned enterprises, not only in Germany. Their privatisation in the 1990s and the increased international competition changed the conditions for doing business. It turned out that in the new conditions, despite the high technological level of products, the competition introduced new solutions faster and they were cheaper than the products of Siemens, which is unable to cut their cost in order to offer attractive prices.¹

The strategy under Heinrich von Pierer and Klaus Kleinfeld

The years between 1992 and 2007 is the era of Heinrich von Pierer, who was the CEO of the company until 2004 and subsequently the chairman of its supervisory board. His leadership in Siemens was characterised by caution in making new investments (including capital investments in Poland), the “without sudden ups and downs” company development policy, and complete restructuring as a response to the challenges posed by the competition and the criticism of poor results of Siemens as compared to its competitors.² Due to the strong position of trade unions, those changes excluded instruments related to the reduction of employment. Nevertheless, he took several steps whose consequences have probably only begun to unfold in the results in recent years. He began the spin off of those branches of the corporation which failed to generate the desired margin (e.g. the production of semiconductors, production of electronics). He also made some acquisitions (e.g. Westinghouse), leading to the expansion of Siemens on the US market, which resulted, *inter alia*, in the flow of innovation in the field of management. In the spirit of American practices he introduced the EPA programme (development – promotion – recognition) for middle level managers (around 30 000 people). The programme consists in applying individual pay rises and bonuses depending on the results of work (sales). On the other hand, he introduced a rule

¹ MF, 2007, *Siemens – dymisje obu prezesów* [Siemens – dismissals of both presidents], Zarządzanie na świecie, 3, p.3

² 1996, Rzeczpospolita,

according to which failure to meet the planned results is possible only twice. If it happens for the third time, the person responsible for the failure is laid off.

Klaus Kleinfeld, who was earlier the president of the American branch of the corporation, despite being in the Board of Directors since 2004, had a real influence on the strategy of the corporation only for less than 2 years. It is characteristic that he began his term in office from stating that he would “aim at the maximum transparency of Siemens”. Soon after he took over the management of the company, he announced the change of the existing strategy, which allowed for significant autonomy of 12 business areas. Each of the branches could be an independent corporation from DAX-30 list, in terms of revenues or the number of employees. The majority of them functioned well and generated profits but the results of several were poor (telecommunications equipment, production of mobile phones, IT services).¹ The new strategy envisaged setting ambitious development goals for each department, i.e. getting closer to the best companies in the world (*benchmarking*) and reaching the profit margin envisaged by the head office.² He stated that within two years each branch of the company had to become profitable, and those areas which did not promise improvement would be sold or separated in order to form companies with other partners. Siemens had practised joint venture for a long time (e.g. Siemens-Nixdorf, Fujitsu-Siemens, etc.). The profitability was to be achieved by means of, *inter alia*, reductions of employment by up to 10% in each business unit of the corporation and the planned structural changes – the separation of joint support divisions for all sectors in order to overcome the isolation of individual sectoral branches and jointly deal with the customers using the scale effect (*Siemens One* programme, which, however, is the imitation of *One GE* concept).³ Those plans were to be implemented by the end of 2010 (the *Fit for 2010* programme).

¹ Der Spiegel, 2006,

² Manager Magazin, 2007, *Captain Future* – Welche Spuren Klaus Kleinfeld bei Siemens hinterlaesst. Heft 7. p.32

³ C. Dougherty, 2005, Siemens chief pushes 'one for all' strategy, International Herald Tribune, 26.08;

The first restructuring decisions of president Kleinfeld included the spin out of the mobile phone branch to form a joint venture with Taiwanese BenQ.¹ However, the step was taken too late, since due to mistakes in management made so far and as a result of global competition, the new company quickly went bankrupt. Similar plans were made in respect of the largest sector of the corporation, the so-called COM group which produced telecommunications equipment and generated losses. At the beginning of 2007 it was divided, and formed a company with Finnish Nokia. A characteristic of the strategy was, *inter alia*, the exploitation of the “success” of the sale of installations for large sports venues, implemented in 2004 through equipping the Olympic facilities in Athens and through plans to repeat the offer in all coming large sport events (2006 World Cup, Beijing 2008, etc).

The introduction into management of only certain elements taken by Kleinfeld from the USA, and the skilful use of the improved economic situation resulted in mid-2006 opinions that the improved financial results stemmed from the “success of his restructuring”. The president wanted to take advantage of this success quickly and, even before the end of his term in office, applied to the supervisory board for the increase in the salaries of the supervisory board by 30%. In order to do so, he speeded up the presentation of the exceptionally good results for the first quarter of 2007. However, the issue raised sharp criticisms and remained unresolved since the success was overshadowed by the bankruptcy of BenQ-Siemens, the prosecutor’s proceedings in autumn 2006 and the delays in the creation of Nokia Siemens Networks Holding BV. However, the short period of Kleinfeld’s term in office finished in the annual average growth rate of share price of 26%.²

The new strategy of Gerhard Cromme and Peter Löscher

Contrary to Klaus Kleinfeld and all previous presidents in the history of Siemens, Peter Löscher is a foreigner and a man from outside the organisation, with practice at the great, followed competitor and perhaps also a future investor, i.e. the American General Electric Inc. Though less than 6 months have passed since he became the CEO, he has already made

¹ The condition for the transaction was an additional payment by Siemens.

² According to Bloomberg 2007

important decisions pointing to the main characteristics of the new strategy. The quick start was possible thanks to the experience in the company and the role played by the chairman of the supervisory board Gerhard Cromme, who is considered as one of the strongest and most pragmatic managers in Germany.¹ When introducing Löscher to the palace in the Munich Wittelsbacher Platz,² he articulated four challenges faced by the new CEO and “his” Siemens, namely, to make the corporation transparent, less complex, faster and more productive.³ Peter Löscher began his work inconspicuously, by referring to his links to GE and stating that he did not intend to „General Electrify” Siemens, but to disseminate the “value strategy”, adhered to at GE, in its structures.⁴ However, his first step was to appoint Peter Y. Solmssen to the Board of Directors - a lawyer, former GE manager and partner of the legendary Jack Welsh, the first American on the Board of Directors. Solmssen became the company’s legal counsel and head of compliance issues.⁵ He soon announced major changes to the management structure of the corporation and the acceleration of the achievement of profitability levels planned for 2010.

The new Board of Directors will comprise persons directly managing and bearing responsibility (CEO, CFO) for the results of three main business areas of Siemens (Energy, Industry, Health care) which will include 15 previous and new sectoral divisions (cf. outline)⁶ The structure will be supplemented by the so-called cross-sector businesses (financial services, IT, real estate, supervision of strategic joint venture investments), and two corporate back-office departments. This whole structure will maintain dynamic on-line contact with almost 2 000 subsidiaries around the world.⁷ The first contracts signed by the new president included the sale of the VDO part of the corporation which sells electronic equipment for cars to the amount of EUR 12 billion a year, for the price of EUR 11.4 billion, and the purchase of

¹ Called “Cleaner” by J.Hirzel, K-H.Steinhuehler, T. Treser, 2007, Die Ethik des Dr. Cromme, FOCUS, 27, p.144

² Where Siemens AG headquarters are located.

³ Handelsblatt, 2007, Kommentar: Historischer Umbau, Handelsblatt, 5.10;

⁴ P.Betts, 2007, General Electrification, Financial Times, Jun.28, p.14

⁵ Ch. Hardt, 2007, Löschers Mann für Recht, Ordnung Kunst und Kultur, Handelsblatt, 21.09

⁶ Ch .Hardt, 2007, Die Säulen von Siemens, Handelsblatt, 8.10

⁷ Cf. <http://w1.siemens.com/press/pool/de/events/pressegesprach/press-briefing-silde.pdf>

a US-based company which produces medical diagnostics equipment Dade Behring, for EUR 5 billion. This step means the continuation of the strategy of his predecessors, which assumed that Siemens would win the position of the “global leader in clinical medical diagnostics”.¹ The comparison of Fit42010 strategy announced by Löscher (2007) with the Fit4More strategy of Kleinfeld (2005) reveals insignificant changes. Both strategies concentrate on the same four areas: Operational Excellence, People Excellence, Corporate Responsibility and Performance and Portfolio. The new strategy, scheduled for implementation in 2008-2010, is only different due to emphasis on compliance issues and climate protection (in the area of corporate responsibility), focus on three areas of activity (energy and environmental protection, automatics and industrial and public infrastructure, healthcare), and the stress on the optimal effectiveness of equity (ROE at the level of 14-16%). Other objectives remain virtually unchanged. The corporation’s mission was supplemented with the observance of the values of the corporate code of ethics, and benchmarking was recommended with regard to the transparency of business activities and compliance with corporate rules.²

Conclusions

The synthesis of information performed in the article allowed not only for learning about the paths of corruption, methods of its detection and attempts to overcome it, but also outlined corporate governance and the tendencies of changes in German corporations. The knowledge of those facts gives rise to questions about the reasons of corruption, its repeatedness and, first of all, about the link between corruption and the condition of corporate governance. Why was such a great company as Siemens, which employed the best people and vaunted innovativeness of its products, involved in corruption? Why does corruption occur repeatedly in the history of the company? What are the reasons for such a situation? To what extent is corruption a crime, and when is it just business as usual? Will the means employed to fight it be effective this time?

Cf. http://www.ehealthurope.net/news/2917/siemens_acquire_dade_behring

² According to www.siemens.com

The German model of corporate governance

Although German economy is one of the most important in the world, its corporate governance, which has been developing at least since the industrial revolution, was analysed relatively late.¹ The classic German model of management and corporate governance (*ordnungsgemäße Unternehmensführung*) and its environment consists of, *inter alia*, perceiving the enterprise as a social institution, supervisory board separate from the Board of Directors, significant participation in the supervisory board of employee representatives (from 33% to 50% of its composition) and bank representatives, large blocks of shares and family ownership in listed companies, large impact of banks on the management of the company by means of crediting, trusteeship of voices and/or ownership of blocks of company shares, intersecting capital and personal links between companies and political establishment (the so-called Deutschland AG symptom), as well as relatively low capitalisation of the stock exchange (as compared to the GDP), lesser role of investment funds and of the acquisitions market.² The case of Siemens illustrates the German model but also provides a lot of evidence confirming the evolution of the German corporate system.³ Although the founder's family remains the largest shareholder, it is not the shareholders that decided about the events which took place in the last year, but a group of managers who are members of the supervisory board. Although the representatives of employees and trade unions still dominate the supervisory board, the dispersed structure of Siemens shareholders, with a large share of institutional investors, already reminds of the companies of the American model, though the percentage of shares represented at the general shareholders' meeting is much higher than in the US.

¹ *Inter alia* Prowse S.: *Corporate Governance In an International Perspektive*. BIS Economic Papers No.41, 1994.; K.J. Hopt *et al.*: *Comparative Corporate Governance*. Oxford 1998.; Clarendon, Boehmer E.: *Corporate governance in Germany: Institutional background and empirical results* (1999). [in:] *Corporate governance and economic performance*, ed. K. Gugler, Oxford University Press, Oxford 2002.

² Charkham J.P., H.Ploix: *Keeping Better Company. Corporate Governance Ten Years On*, Oxford University Press, Oxford 2005.

³ Hackethal A., R.H. Schmidt, M.: *Tyrell Banks and German Corporate Governance: on the way to a capital market-based system?* *Corporate Governance: An International Review* Vol. 13 Issue 3, 2005, p. 397

The “classic” model of German corporate governance has changed in the recent decade under the influence of globalisation but also of the poor results of domestic companies. The changes take place through, *inter alia*, the internationalisation of the capital market in Germany, the increase of importance and power of institutional investors, the diffusion and international convergence of corporate law and good practice principles, as well as through the withdrawal of banks from share ownership in companies and the decreasing role of trade unions. Those changes do not take place smoothly and painlessly. German supervisory boards are subject to particular criticism in such conditions.¹ Their dysfunctions (narrow circle of people who are members of numerous boards, low internationalisation, numerous and passive participation of employees and trade union representatives, and in spite of this, poor information flow, lazy manner of work, low rotation, inadequate salaries, etc.) are considered to be the reasons for poorer economic results of German companies and of embezzlements which are sometimes revealed in companies from the DAX index list.² The management boards of German companies are also to blame since they are often under the influence of trade unions and local connections. In order to prevent such situations an increasing number of foreigners is employed as presidents of the management boards of German companies (including Bayer, Deutsche Bank, Deutsche Börse, Epcos, GEA, Fresenius, Lufthansa, MAN, Premiere, ProSiebensat, QuiMonda, RWE). Companies managed by them generate better results than other companies listed on German stock exchanges.³ Recent decisions made by Siemens supervisory board are consistent with this tendency. They prove that the previous management culture has failed and requires major modifications. Their implementation gives the investors hope for improvement of the results of the company under the management of an Austrian with American experience.

¹ Cf. Bihr D., W.Blaettchen, *Aufsichtsräte in der Kritik: Ziele und Grenzen einer ordnungsgemäßen Aufsichtsratsstätigkeit – Ein Plädoyer für den Profi-Aufsichtsrat*, BB 2007, pp.12.85-12.91;

² Milne R.: *Misdirected? Germany's two-tier governance system comes under fire*. Financial Times, 9.05. 2007 p. 9

³ Milne R.: *Foreign executives fight with German traditions*. Financial Times, 18.05. 2007

Shocking incident or business as usual?

Investors evaluate the operations of the company every day, but they are also faced with the problem of information asymmetry, which means that they may also be prone to herd behaviour. The loss of confidence in the company may have disastrous impact since it translates directly into its value. The management of Siemens AG faced this problem in autumn 2006 when the spectacular raid of prosecutors and police put the investors' trust to the test. The price of Siemens AG shares on the main stock exchange market had been increasing since July 2004. The largest adjustment of the price was observed in May 2006, long before the spectacular searches and arrests of corporation employees, and the change of the value of shares was then stronger than in the case of DAX companies.¹ However, the events of November 2006 decreased the company quotations only for a short time. Paradoxically, the disclosure of information about irregularities, progress in the investigation on corruption as well as performed and planned changes in the management of the company were perceived by investors as positive developments, and the share price increased more strongly than the DAX exchange index. The share price reached a three-year peak on the day when Peter Löscher became the president of the Board of Directors at the beginning of July 2007. The price of shares amounted to EUR 109.7, but was nevertheless lower than the record price from July 2000 (EUR 120). This, however, coincided with the growth tendency observed in the majority of stock exchange indices until July 2007. However, the indices quickly lost their value in the following months due to global tendencies related to the situation on the financial markets and commodity markets. The decrease in the price of Siemens shares continued also after the sale of VDO for EUR 11.4 billion and after the disclosure of information about the acquisition of the laboratory equipment producer Dade Behring (for approx. USD 7 billion). The investors' decisions were also influenced by the disclosed information about corruption in other divisions of the corporation, not only in the telecommunications equipment division. From that moment on, the share price has fluctuated significantly, but it has remained at the level

¹ Please, take into account the fact that Siemens AG has a weight of around 10% in DAX index (according to Bloomberg).

exceeding the price from autumn 2006, as does the DAX stock exchange index. The increased volatility of the share price observed since July 2007 as compared to the previous period may also result from the limited confidence of investors in the new management of the corporation and from the uncertainty in respect of company results, which are increasingly influenced by the costs of explanatory proceedings and the fines imposed on the company. Investors' uncertainty concerning the response to the crisis on financial markets, i.e. the so-called subprime crisis, may also contributed to the volatility of share prices.¹

The analysis of share quotations within the period when the events referred to in this document took place points to the limited and poor response of the market to Siemens' corruption problems and a stronger response in relation to the ongoing restructuring of the company. This may be a sign of investors' confidence in the corporation management, but also of treating "Siemens style" corruption as common business as usual which ultimately has a positive impact on the company's results. Despite the multi-billion costs related to the corruption itself (EUR 1.4 billion), the costs of investigation (ca EUR 2 billion) as well as paid or potential fines (ca EUR 4 billion), the corporation is in a relatively sound financial condition, generates positive financial results and informs about subsequent multi-million transactions. The above costs incurred in the course of several years, when compared to the annual turnover of nearly 100 bln, do not seem to be a major item in the balance sheet of the company, although the expected fines may wipe out the annual profit. Judging by investors' reactions one might expect that they perceived the disclosure of corruption as a signal and pretext for changes in company management (management *by means of* crisis). The changes leading to a deeper restructuring, which may improve the use of the corporation's potential (undervalued shares, low financial leverage, excessive employment, etc.) and therefore to better perspectives for the future.

¹ In the last two decades the price of Siemens shares was the lowest in October 1992 (EUR 18.7) and the highest in July 2000 (EUR 120).

Corruption environment in Germany

Both media analyses and court statistics point to the increasing perception of corruption in Germany, particularly during the last decade. Experts on economic crime maintain that corruption in Germany has intensified in the last 10-20 years and is still a “growing sector”.¹ Corruption, bribery, illegal donations to political parties, paying for the excesses of officials, tax fraud and distortions in expert opinions, as well as many other manifestations of irregularities in business-to-state and business-to-business relations are an almost daily occurrence in press reports. Half a century ago such information would be unthinkable in Germany, which vaunted high ethics of traditional civil service and the application of such standards also in corporations. The truth about corruption in Siemens AG, which has been gradually revealed for over a year now, confirms the opinions about the erosion of German business ethics. The surveys of German businessmen paint a similar picture, since almost two thirds of them believe that nowadays bribes are a normal element of business activity. However, in the comparative analysis carried out for *Transparency International* the German susceptibility to corruption is not assessed as high. The annual survey of businessmen and academics opinions on bribery show that Germany is still a country with relatively little corruption, although within the last 12 years it fell from 13th to 18th position among the countries where corruption in social life is the least common.² However, those results are questioned since the method applied does not reflect the actual state of affairs but only gathers opinions about corruption, and the concept of corruption is not explicitly defined. At the same time, another study of businessman opinions in 125 developing countries shows that German companies are perceived as those who bribe local civil servants relatively seldom, since in this ranking Germany is in the 7th place among 30 countries which are the major exporters of

¹ Cf. Bannenberg B., W.Schaupensteiner: *Korruption in Deutschland. Portrait einer Wachstumsbranche*. CH.Beck, München 2007.

² It is at the same place as Ireland or Austria. For the sake of comparison, on the 2007 list Poland was in the 61st place along with Cuba, Tunisia or Bulgaria, as compared to the 44th place in 2001. Corruption is the least common in Scandinavian countries, New Zealand and Singapore. www.transparency.de

goods and services.¹ It is thus difficult to establish the truth about the scope and scale of corruption, as it is difficult to prosecute corporate crime, and corruption in particular.

Although there is no separate police service or special organisation to fight corruption in Germany, as you can see, the perpetrators are taken to court. They are prosecuted by *Bundeskriminalamt* (BKA) and crime offices in lands. The German dispersed system of fighting corruption is not considered to be ideal since law enforcement authorities are dependent on politicians and report to prosecutors, who in turn report to the ministers of justice. Experts on criminal proceedings claim that investigations at the local level are more susceptible to political pressure.² All the more highly should one appreciate the Bavarian investigators who, despite limited possibilities of operational activities, led to the detection of corruption in a global corporation with its headquarters in the capital city of the Land i.e. in Munich. However, it is characteristic that further investigation is mainly conducted by private companies at the order of Siemens itself. The disclosed information about the costs of the investigation in such a large organism as a contemporary international corporation shows that they may exceed the possibilities of not only the Free State of Bavaria, but also the budget of American supervisors (SEC). In addition, it is not simple to punish the crimes of large corporations since the German law as a rule does not allow for criminal responsibility of legal persons, hence the token amount of the penalty adjudicated in the case of Siemens.³

Why do good companies behave badly?

Corruption and its role in the economy has been the subject of the systematic research of economists and sociologists for many years.⁴ The last quarter of the century has seen a dramatic increase in the cases of corruption and in the number of scientific publications on the

¹ An interesting thing about this survey is the fact that companies from Russia, China and India (*sic!*) were assessed as the most corrupting ones, survey for 2006. Source as above.

² Trenkner J.: *Niemcy: wyblakły etos* [Germany: a faded ethos]. Tygodnik Powszechny 2007;

³ Although it is just token money as compared to the corruption payments, this amount, along with outstanding taxes, became a major item in the Bavarian budget. Cf.: Ch.Hardt, 2007, *Schöne Bescherung für Bayern*, Handelsblatt, 12-14.10. p.1;

⁴ K.Nowakowski, 2006, *Korupcja a instytucje w gospodarce* [Corruption and institutions in the economy], [in:] *Ład instytucjonalny w gospodarce* [Institutional governance in the economy], B.Polszakiewicz, J.Boehlke (ed.) Wyd UMK, Toruń, p.137;

subject.¹ The studies show that corruption and its conditions are still not fully investigated. They demonstrate, *inter alia*, that the necessary conditions for corruption include the discretionary power of both public and corporate administration, the use of which results in sufficiently high economic rent which may be taken over by the second participant of the contract and a part of which may then be paid out as a bribe. Another necessary condition is the existence of imperfections/failures in the crime (corruption) prosecution and punishment system.²

The abovementioned perception of corruption is also important for its further dissemination. The more often one hears about and sees corruption, the stronger the temptation is to use this instrument oneself. Tendency to employ corruption increases due to strong incentives which include information about the rewards received by those who corrupted and were not punished. This may explain the increased popularity of corrupting behaviour in large corporations. The psychological mechanism which motivates corruptive behaviour, and may explain corruption in the best companies, is known. The elements which determine the positive image of the corporation, i.e. high morality, pride in work for the company, competition in recruitment and at work, paradoxically may at the same time be the determinants of corporate crime, including corruption.³ In some business situations, e.g. the implementation of a highly prestigious contract, strongly motivated employees filled with pride may be under such a huge pressure of the necessity to succeed, and at the same time under the threat of dishonour in case of failure, that they feel there is no way out. In order to overcome this cognitive dissonance, they are ready to go to extremes, including the use of all possibilities such as the creation of “black money”, the avoidance of internal control and the use of bribes to achieve one’s goals. Apart from losses for the parent company (sale with the use of bribes deteriorates the innovativeness of products) and the bribed customer (who buys

¹ Measured, *inter alia*, with the number of agency reports about corruption, Cf.: A. Jain, 2001, Corruption: a review, *Journal of Economic Survey*, 15(1), p. 36;

² A. Jain, 2001, Corruption: a review, *Journal of Economic Survey*, 15(1), p. 8

³ This was the case according to judge G. Bechert, who examined the corruption of Siemens employees in 1990s. Cf. A. Jachnis, 2007, *Psychologia organizacji, kluczowe zagadnienia* [Psychology of organisation. Key aspects], Difin, Warsaw.

products for a price which exceeds their value), such situations also cause damage to the psyche of employees (neurosis, depression, alcoholism).¹ In the case of Siemens, pride and high opinion of the employees about themselves is demonstrated in a characteristic way, through the use of such terms as “Siemensians” or “employees of the House of Siemens” which refers to “the House of Windsor” or the house of Wittelsbach, i.e. the conscious invocation of elite traditions and the strengthening of self-esteem.² The dominant position of the corporation resulting from tradition, size and internal complexity fosters the tendency and susceptibility to corruption, since the pressure decreases the employees’ sensitivity to pathologies (decreases the natural whistleblowing reaction), which results in the feeling of impunity among senior management.

Due to the traditional business profile, i.e. telecommunications and electrical power engineering, and the importance of this infrastructure for the development of countries, since its origin Siemens has maintained close links with state authorities not only of German states, but also of numerous countries of the world. For decades these sectors were a natural monopoly, not only in Europe, and oligopolistic companies remained (and in many countries still are) under the rule of state administration. Doing business in such conditions was relatively simple and predictable. Along with market liberalisation and internationalisation, and in particular with the fast technological progress, the previous sales methods ceased to be efficient and became risky. At the same time a growing competition and the change of the attitude of shareholders towards the maximization of enterprise value created a pressure on managers to constantly improve the results and cut costs. In such conditions the support of trade or investments with bribes became an easy-to-apply “performance-enhancing drug”.³ The abovementioned features and determinants may be responsible for the creation of a specific corporate culture whose elements include repeated corruption practices, “tolerant”

¹ R. Sennet 206, *The Corrosion of Character: Personal Consequences of Work in the New Capitalism*, MUZA, Warsaw.

² Which, *nota bene*, ruled in Bavaria until 1945.

³ It is worth noting that only ten years ago did the OECD countries adopt the anti-corruption convention, which deems bribery of foreign public officials a crime. However, many countries have not implemented its provisions until today.

internal control services and an acquired/naive ignorance of the Board of Directors. A business model or organisational culture takes decades to form, and it is difficult to change it from one day to the next.¹ The new management of Siemens AG is aware of these circumstances and the constraints which stem from the resistance of the complex structures of the corporation. It is difficult to determine already now whether the measures undertaken by Siemens AG to fight corruption so far will be successful. The repeated occurrence of corruption requires caution in evaluations. On the other hand, the example of GE Inc. shows that corruption can be controlled. The promises and actions of the new president, Peter Loscher, aimed at improving transparency and simplifying the structure of the corporation allow for optimism, since radical changes in the company, the appointment of new key personnel and the occurrence of those who lost as a result of restructuring, results in the erosion of “corruption culture”. The subtle test of determination in the fight with corruption is the language used to talk about corruption. In order to ease the cognitive dissonance, the corruption perpetrators or principals talk about it using euphemisms and allusions, thus avoiding calling a spade a spade.² The announcements of the management and the statements of Siemens AG leaders were also presented in such a language of distancing themselves from corruption.³

However, the final judge of restructuring is the market (of products), while the capital market will evaluate it accordingly. If the price of the company shares „soars” soon as a result of regained customer confidence and the maintenance of good results, it will mean that the restructuring has been successful and corporate culture has been changed. If the market response is poor, it will mean that investors believe that despite restructuring and media silence there are new metastases of the “corruption cancer”. Maintaining a high profitability

¹ J.Wieland, 2007, An dieser Stelle sind wir heuchlerisch, *Die Zeit*, 34, 16.08;

² A.Dylus, 2006, *Kulturowe uwarunkowania korupcji. Doświadczenia Polski*. [Cultural determinants of corruption. Polish experience] [in:] *Korupcja. Oblicza, uwarunkowania, przeciwdziałanie*. [Corruption. Faces, determinants, counteracting] eds. A.Dylus, A.Rudowski, M.Zaborski, Ossolineum, Wrocław; p. 117

³ E.g. in an interview for *Handelsblatt* of 24.12.2007 on the situation in the company and the problem of corruption, Peter Loscher does not use any pejorative terms on the practices applied (corruption, bribes, etc.). Cf.: J.Hofer, C.Hardt, 2007, „Die Kultur muss sich wandeln“ Das Gespräch mit Herr P. Löscher, *Handelsblatt*, 21/26 Dec. p. 17

level and an increase in enterprise value will constitute strong evidence for the claim that ethical behaviour, honest management and investors' confidence do pay.

From the Polish perspective...

The findings from the study may prove to be useful also in Poland due to the predicted growth of the presence of international corporations, related to the development of the Polish economy and infrastructure. This will mean an increased scale and scope of investments and thus the cooperation with increasingly powerful corporate partners at various levels of public administration and business.

In Poland Siemens is an important economic partner with a particularly visible presence in the medical equipment sector, power industry and infrastructure.¹ These sectors still undergo restructuring and, unfortunately, are far from market competition and private management. Also corruption remains a severe problem here. Poland is currently on the eve of large investments related to the expansion of infrastructure, including sports infrastructure before EURO 2012. This segment of the market is also a strategic goal for Siemens AG. The disclosure of irregularities in trade in these areas and the ongoing restructuring in the German corporation should protect Polish companies and administration from corruption temptations/charges.

The success of the restructuring of Siemens may have positive consequences for Poland also in the longer perspective related to the inevitable construction of a nuclear power station. If the tender for the construction of a Polish nuclear plant is carried out, it will certainly be the largest investment in the country. Siemens is the co-owner (34%) of AREVA NV, the leading supplier of nuclear reactors and nuclear power stations in the region. The majority shareholder in the company is the French AREVA, which is controlled by the French State Treasury (88%).

As regards corporate governance, the case of Siemens should also be carefully analysed and should stimulate reflection and vigilance. Do we know how the company whose

¹ Rogowski W.: Notatki o skandalu korupcyjnym w Siemens AG [Notes on the corruption scandal in Siemens AG]. Przegląd Corporate Governance, 1, 2008.

supervisory board we are a member of acquires contracts? Are the communication channels between the internal audit services and company employees and the supervisory board passable? Don't we disregard or turn a blind eye to the rumours and information we hear about the irregularities in commercial activity? Are all company accounts and transactions authorised? Do we aim at introducing the necessary whistleblowing procedures in our company? What do we know about the quality of our corporate truth? Are we not afraid of asking inconvenient questions at the meetings of the board?

As regards public administration, the history of corruption at Siemens AG provokes reflection on the need of order and peace in the functioning of the judiciary services. Although, contrary to our country, there are no special central anti-corruption bureaus in Germany, corruption is prosecuted, disclosed and punished. Though it is too early to make unambiguous assessments and there is no information about the political context, the analysed case points to the power of public services in Bavaria, which are ready to handle the irregularities of its largest taxpayer and the largest global corporation in Germany. Unfortunately, this case, similarly to the majority of corruption scandals, once again reveals the imperfections of the corporate governance practice, including the weaknesses of auditors. It makes us aware of the task of constant care for the high quality of the functioning of corporate governance authorities.

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"Capital market supervision in Poland"

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Capital market supervision in Poland¹

dr Andrzej Michór

1. Organization of the supervision

One of the particularly significant segments of economy is the turnover of financial instruments, which results from its importance for the state's economy, as well as from its mass character relating to engagement of substantial capital from dispersed investors and relatively high risk involved. Noteworthy – eventual disturbances in functioning of the financial market may become a cause of difficult and hardly foreseeable negative effects for the economy, especially ones connected with loss of considerable capital to finance it².

For this reason, the state's authorities interfere in organizing and organization of the financial market, on following planes: creation of civil law regulations connected with the object of the market, principles of the turnover, civil law institutions involved in this turnover, such as stock exchange or State Deposit of Securities, as well as participants in the turnover, creation of norms of administrative law determining or forming institutions of public administrations and their competences, and procedures in the scope of organizing and organization of financial market. Moreover – such interference is connected also with creation of norms of penal law, which protect organizing and organization of the financial market. Finally – the state executes by it's organs the above-indicated regulations of administrative and criminal laws, as well as procedures of enforcement in this respect³.

Polish Financial Supervision Commission (PFSC) initiated its activity on the 19th of September 2006, i.e. on the day when the Act on Financial Market Supervision of July 21st

¹ The English translations of the texts of polish law used in the article are available on www.knf.gov.pl.

² J. Czekaj, M. Woś, J. Żarnowski, "Efektywność giełdowego rynku akcji w Polsce", Warsaw, 2001, 16; W. Dębski, "Rynek finansowy i jego mechanizmy. Podstawy teorii i praktyki", PWN, Warsaw, 2003, 87-95; A. Kozaczewska, "Kompetencje KPW wykraczające poza zakres prawa administracyjnego w świetle zasad konstytucyjnych", *PUG*, 1997, no 7-8, 30; R. Kuciński, „Przestępstwa giełdowe”, CH Beck, Warsaw, 2000, 47; J. Majewski, (in:) "Prawo karne gospodarcze", red. O. Górniok, Warsaw, 2003, 341; A. Michór, "Przesłanki ingerencji państwa w organizowanie i organizację obrotu instrumentami finansowymi", *Opolskie Studia Administracyjno-Prawne V*, Opole, 2008, 195, 205.

³ A. Michór, "Przesłanki...", 195-205.

2006¹ came into force. The new supervisory body took over the tasks of the Insurance and Pension Funds Supervisory Commission and of the Securities and Exchange Commission, which were abolished by the said Act.

The PFSC is composed of a Chairperson, two Vice-Chairpersons and four members: the minister competent for financial institutions or such minister's representative; the minister competent for social security or such minister's representative; the Governor of the National Bank of Poland or Deputy Governor of the National Bank of Poland delegated by the Governor; a representative of the President of the Republic of Poland. The FSC's Chairperson is appointed by the President of the Polish Council of Ministers for a five-year term of office. The President of the Polish Council of Ministers shall dismiss the FSC's Chairperson before the expiry of his (her) term of office only if the Chairperson has been convicted of an intentional offence or a fiscal offence by way a final and binding judicial decision, or has resigned from the position, or has lost Polish citizenship, or has lost the ability to perform his (her) duties as a result of a prolonged illness, lasting more than three months. The term of office of the FSC's Chairperson shall expire upon the Chairperson's death or dismissal.

Tasks of the Polish Financial Supervision Authority cover banking supervision, capital market supervision, insurance supervision, pension scheme supervision and supervision of electronic money institutions (Article 1 (2) FMSA). Moreover, the aim of the PFSC is to ensure proper operation, stability, security and transparency of the financial market, as well as confidence in that market, and to safeguard the interests of the financial market participants through the pursuit of objectives stated in particular in the Banking Law, the Act on Insurance and Pension Fund Supervision and the Insurance Ombudsman dated May 22nd 2003, the Act on Capital Market Supervision of July 29th 2005, the Electronic Payment Instruments Act of September 12th 2002, and the Act on Supplementary Supervision of Credit Institutions, Insurance Undertakings and Investment Firms in a Financial Conglomerate dated April 15th 2005 (Article 2 FMSA).

¹ Dz.U. of 2006, No. 157, item 1119, as amended; hereinafter referred to as the FMSA.

Article 4 (1) FMSA provides that FSC's responsibilities comprise the following:

- 1) exercising supervision over the financial market;
- 2) taking actions fostering proper operation of the financial market;
- 3) taking actions promoting development of the financial market and its competitiveness;
- 4) taking educational and informational actions related to the operation of the financial market;
- 5) participating in the preparation of drafts of legal acts related to financial market supervision;
- 6) creating opportunities for amicable and conciliatory dissolution of disputes between the participants of the financial market, including in particular disputes arising from contractual relationships between the entities subject to FSC's supervision and the customers buying their services;
- 7) performing other statutorily assigned tasks.

Within the scope of its competence the FSC adopts resolutions and issues administrative decisions and rulings defined in other laws. The FSC adopts its resolutions by simple majority of votes, in an open vote held in the presence of at least four of its members, including the Chairperson or a Vice-Chairperson. In the case of a tie, the Chairperson has the casting vote. Resolutions are signed on behalf of the FSC by the FSC's Chairperson, or in the event of his (her) absence, by a Vice-Chairperson authorized by the Chairperson. Except where specific regulations stipulate otherwise, the proceedings conducted by and before the FSC are governed by the provisions of the Code of Administrative Procedure of June 14th 1960¹.

Furthermore, the FSC may authorize its Chairperson, its Vice-Chairpersons and the employees of the FSC Office to take actions within the FSC's scope of competence, including to issue rulings and administrative decisions. However the authorization may not relate to any

¹ Dz.U. of 2000, No. 98, item 1071, as amended.

matter-of-fact decisions specified in other regulations, concerning in particular the capital market with respect to exclusion of securities from trading on a regulated market; deletion of a securities broker, a commodity broker or an investment adviser from the relevant list or suspension of his (her) rights to practice the profession; granting of a brokerage license; revocation or limitation of a brokerage license; reporting an objection against a proposed acquisition, subscription, or disposal of shares in an investment fund company; imposition of fines.

Having regard to the Article 12 FMSA, PFSC has adopted the Resolution No. 22/2006 dated October 13th 2006, concerning authorization for the Chairperson and Vice-Chairpersons of the PFSC to take actions within the scope of the PFSC's competence, including authorization to issue administrative decisions and rulings. In 2007, pursuant to the said Act a total of 1,431 decisions and rulings were issued, including 815 decisions and rulings concerning the capital market, 308 decisions and rulings concerning the funded pension market, 265 decisions and rulings concerning the financial intermediation market, and 43 decisions and rulings concerning the insurance market¹.

In order to be effective, in civil-law cases arising from the relationships entered into in connection with participation in trading on the banking, pension, insurance or capital market, or relating to entities operating on those markets, the PFSC's Chairperson has the powers of a prosecutor ensuing from the provisions of the Code of Civil Procedure of November 17th 1964². On the other hand - in some cases- the PFSC's Chairperson, upon his (her) petition, is vested with an injured party's rights in criminal proceedings³.

¹ "Report on activities of the Polish Financial Supervision Authority in 2007", Warsaw, KNF, 2008, 10.

² Dz.U. No. 43, item 296, as amended.

³ Relating to the offences specified in the Banking Law, the Act on the Organization and Operation of Pension Funds of August 28th 1997, the Act on Occupational Pension Programs of April 20th 2004, the Act on Personal Pension Accounts of April 20th 2004, the Act on Insurance Activity, the Act on Insurance Intermediation of May 22nd 2003, the Act on Trading in Financial Instruments of July 29th 2005, the Act on Public Offering, Conditions Governing the Introduction of Financial Instruments to Organized Trading and Public Companies dated July 29th 2005, the Act on Investment Funds, the Act on Commodity Exchanges of October 26th 2000, and the Electronic Payment Instruments Act of September 12th 2002; pertaining to any acts aimed against the interests of the market participants, committed in connection with the activities of the entities operating on that market.

Within the scope of Chairperson's competence, he/she performs his/her duties like a ombudsman in financial market cases¹.

Capital market supervision, a part of the supervision over the financial market, is subject to relatively extensive regulation, governed mainly by the provisions of the Act on Capital Market Supervision of July 29th 2005², the Act on Trading in Financial Instruments of July 29th 2005³, the Act on Public Offering, Conditions Governing the Introduction of Financial Instruments to Organized Trading and Public Companies dated July 29th 2005⁴, the Act on Investment Funds of May 27th 2004⁵ and the Act on Commodity Exchanges of October 26th 2000⁶.

The said Acts implement, within the scope of its regulation, EU Directives, in particular Council Directive 93/6/EEC of March 15th 1993 on the capital adequacy of investment firms and credit institutions⁷, Directive 2003/6/EC of the European Parliament and of the Council of January 28th 2003 on insider dealing and market manipulation (market abuse – MAD Directive)⁸, Directive 2002/87/EC of the European Parliament and of the Council of December 16th 2002 on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate and amending Council Directives 73/239/EEC, 79/267/EEC, 92/49/EEC, 92/96/EEC, 93/6/EEC, 93/22/EEC and Directives 98/78/EC and 2000/12/EC of the European Parliament and of the Council⁹, Directive 2003/71/EC of the European Parliament and of the Council of November 4th 2003 on the prospectus to be published when securities are offered to the public or admitted to

¹ M. Wierzbowski, (in:) R. Czerniawski, M. Wierzbowski, "Ustawa Prawo o publicznym obrocie papierami wartościowymi. Komentarz", Warsaw, 2002, Article 16 (1); A. Michór, "Komisja Papierów Wartościowych i Giełd jako centralny organ administracji rządowej w zakresie publicznego obrotu papierami wartościowymi. Wybrane zagadnienia", *Acta Universitatis Wratislaviensis No 2724, PPIA LXV*, Wrocław, 2005, 209-211.

² Dz.U. No. 183, item 1537, as amended; hereinafter referred to as the CMSA.

³ Dz.U. No. 183, item 1538, as amended; hereinafter referred to as the TFIA.

⁴ Dz.U. No. 184, item 1539, as amended; hereinafter referred to as the POA.

⁵ Dz.U. No. 146, item 1546, as amended; hereinafter referred to as the IFA.

⁶ Dz.U. of 2005, No. 121, item 1019, as amended.

⁷ OJ L141, 11.06.1993, as amended.

⁸ MAD; OJ L96, 12.04.2003, as amended.

⁹ OJ L35, 11.02.2003, as amended.

trading and amending Directive 2001/34/EC¹, Commission Directive 2004/72/EC of April 29th 2004 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards accepted market practices, the definition of inside information in relation to derivatives on commodities, the drawing up of lists of insiders, the notification of managers' transactions and the notification of suspicious transactions² and Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC³.

CMSA defines the organization and procedures for the exercise of supervision over the capital market. The rules, laid down by the said Act, are applied to the market of securities and other financial instruments, and the market of services offered by investment funds and other collective investment undertakings, and commodities market (Article 2 (6) CMSA).

Whereas, for the capital market to be able to play its role effectively, every measure should be taken to ensure that market operates smoothly. For this reason, the objective of the supervision of the PFSC is to ensure proper operation of the capital market and, in particular, security of trading and protection of investors and other market participants, as well as compliance with the principles of fair trading.

The Commission is obliged to take actions intended to ensure proper operation of the capital market; exercise supervision over the activities of the regulated entities and performance by such entities of the obligations related to their participation in trading on the capital market, to the extent defined in legal regulations; perform activities related to education and information on the operation of the capital market; perform other tasks specified in legal regulations. The PFSC also has to drafts of legal acts related to the operation of the capital market and may apply to the competent authorities for enactment or amendment of secondary legislation provided for in the statutes (Article 7 (1-3) CMSA).

¹ OJ L345, 31.12.2003, as amended.

² OJ L162, 30.04.2004.

³ OJ L390, 31.12.2004, as amended.

The PFSC's supervision covers entities which conduct activities on the capital market on the basis of authorizations issued by the PFSA or another competent administrative authority, as well as other entities – to the extent they are subject to the obligations related to the participation in such market, as specified in other regulations, and in particular investment firms, investment firm agents, custodian banks, companies operating a regulated market, investment funds, management companies, companies operating commodity exchanges and foreign legal persons conducting brokerage activities related to trading in commodities in the territory of the Republic of Poland (Article 5 CMSA).

2. Administrative sanctions in EU law

For it to ensure that the provisions of the law of the capital market are applied, the PFSC is able to impose sanctions on abuse behavior. These sanctions are not of a criminal law nature, however they are often very hard¹. Moreover - the current EU legislation, in particular MAD Directive (2003/6), Directives 93/22, 97/9, 2001/34, 3003/6. 2003/71, 2004/109 and 2004/39, obliges the Member States, including Poland, to impose administrative sanctions on the persons responsible where the provisions adopted by the said Acts have not been complied with.

Among others, article 14 (1) of the MAD Directive provides that without prejudice to the right of Member States to impose criminal sanctions, Member States shall ensure, in conformity with their national law, that the appropriate administrative measures can be taken or administrative sanctions be imposed against the persons responsible where the provisions adopted in the implementation of this Directive have not been complied with. Member States shall ensure that these measures are effective, proportionate and dissuasive².

¹ A. Michór, "Odpowiedzialność administracyjna w obrocie instrumentami finansowymi", Wolters Kluwer, Warsaw, 2009. See also – J.Boć, (in:) J.Boć, K.Nowacki, E.Samborska-Boć "Ochrona środowiska", Kolonia Limited 2004, 395-396.

² Furthermore - in accordance with the procedure laid down in Article 17 (2), the Commission shall, for information, draw up a list of the administrative measures and sanctions referred to in paragraph 1. Member States shall determine the sanctions to be applied for failure to cooperate in an investigation covered by Article 12. Member States shall provide that the competent authority may disclose to the public every measure or sanction that will be imposed for infringement of the provisions adopted in the implementation of this

In accordance with Article 25 (1) of the Directive 2003/71/EC, without prejudice to the right of Member States to impose criminal sanctions and without prejudice to their civil liability regime, Member States are obliged to ensure, in conformity with their national law, that the appropriate administrative measures can be taken or administrative sanctions be imposed against the persons responsible, where the provisions adopted in the implementation of this Directive have not been complied with. Member States shall ensure that these measures are effective, proportionate and dissuasive.

Also Directive 2004/109 lays down rules for administrative penalties, stating in Article 28 (1) that without prejudice to the right of Member States to impose criminal penalties, Member States shall ensure, in conformity with their national law, that at least the appropriate administrative measures may be taken or civil and/or administrative penalties imposed in respect of the persons responsible, where the provisions adopted in accordance with this Directive have not been complied with. Member States shall ensure that those measures are effective, proportionate and dissuasive.

3. Administrative sanctions in TFIA

Also the current polish legislation provides for a set of rules on the administrative sanctions, in particular in cases mentioned below. Noteworthy – they are specified in regulations other than CMSA, which states only some procedural rules connected with imposing penalties. In some cases they are imposed by the minister of finance.

The PFSC may impose as well pecuniary as no pecuniary penalties. The amounts due in respect of the imposed penalties shall constitute revenue of the state budget (Article 11 CMSA). The PFSC is also empowered to impose no pecuniary sanctions, in particular exclusion of securities from trading on a regulated market, deletion of a securities broker, a commodity broker or an investment adviser from the relevant list or suspension of his (her) rights to practice the profession, revocation or limitation of a brokerage license, deletion of an

Directive, unless such disclosure would seriously jeopardize the financial markets or cause disproportionate damage to the parties involved (Article 14 (2-4)).

investment firm agent from the register, revocation of an authorization to conduct activities by an investment fund company, prohibiting the marketing of units issued by a foreign fund, prohibiting the operation of a management company or its branch, as defined in the Act on Investment Funds, in the territory of the Republic of Poland, or prohibiting such company to enter into any transaction in the territory of the Republic of Poland¹.

The Act on Trading in Financial Instruments defines the rules, manner and conditions for commencing and conducting business which involves trading in securities and other financial instruments, the rights and obligations of entities engaged in such trading and the supervision thereof. The administrative sanctions established by the said Act are laid in Part VIII of the Act – “Administrative Sanctions for Infringement of Regulations”, as well as in other Parts of the Act (in particular Article 108 and Article 130 TFIA).

In accordance with the Article 108 (1) TFIA if a shareholder or shareholders of a brokerage house who hold shares which represent 10% or more of the total vote or 10% or more of the share capital exert detrimental influence on the management of such brokerage house, the Commission may order that such detrimental influence be discontinued, specifying the final date, the conditions for and the scope of appropriate measures to be taken, and in the event of non-compliance with such an order it may prohibit, for a period of up to two years, the exercise of voting rights attached to the shares. Such voting is then not valid².

For this reason, in order to make the sanction effective, Article 108 (2) provides, that if following the lapse of the period of prohibition referred to in Article 108 (1) the grounds for the prohibition of the exercise of voting rights do not cease to exist, the Commission may order the shareholder or shareholders to whom the prohibition applies to dispose of all or some of the shares they hold by a final date set in the decision. Noteworthy not only shareholders shall be punished under this Article - also persons, who indirectly acquired

¹ A. Michór, ”Odpowiedzialność administracyjna w obrocie ...”, 77-214.

² Judgment of the Supreme Court of Poland (Sąd Najwyższy) from the 12th of December 1973, II CR 686/73, OSPiKA 1975/5/102; E.Marszałkowska-Krześ, “Uchwały zgromadzeń w spółkach kapitałowych”, Warsaw, 2000, 80; M.Romanowski, ”Prawo o publicznym obrocie papierami wartościowymi. Komentarz”, CH Beck, Warsaw, 2003, 834.

shares in a brokerage house exercise detrimental influence on the management of such brokerage house. In such case the PFSC may order that the exercise of such detrimental influence be discontinued, specifying the final date, the conditions for and the scope of appropriate measures to be taken (Article 108 (3) TFIA).

The current legislation establishes also liability of brokers and advisers in capital market, as a result of infringement by such broker or adviser in the performance of their professional duties of the law or rules and other internal regulations that such broker or adviser is obliged to comply with in practicing their profession. In such cases PFSC may delete them from the register or suspend his or her authorization to practice the profession for a period from three months to two years (Article 130 (1) TFIA). The said measures are facultative - the Commission is not obliged to punish a broker or a advisers, since administrative decisions issued by the PFSC are discretive¹. Moreover - the Commission is empowered to choose the most appropriate kind of sanction as well as to impose another, harder one, if the grounds for the decision do not cease to exist².

The Commission issues a decision to delete a broker or an adviser from the register or to suspend the authorization to practice a profession after a relevant investigation is held. In order to ensure to protect public interest, if there is such a need, the PFSC may suspend the broker's or the adviser's authorization to practice the profession from the moment of commencement of the proceedings relating to the matters referred to in Article 130 (1) TFIA until a decision is issued on such matters, but in any case for no longer than 6 months.

Since the person deleted from the register of brokers or advisers for the reasons referred to in Article 130 (1) or Article 131 (3) TFIA is not reliable, may not be re-entered in such register prior to the lapse of 10 years from the date on which the decision on the deletion was issued³. However, if the deletion was a result of the circumstances referred to in Art.

¹ M.Romanowski, "Prawo...", 258; A.Michór, "Odpowiedzialność administracyjna w obrocie ...", 83; M. Wierzbowski, "Ustawa...", Article 27 (3).

² M.Romanowski, "Prawo...", 257; A.Michór, "Odpowiedzialność administracyjna w obrocie ...", 84.

³ In the case referred to in Article 130 (1) TFIA, in issuing the decision on the deletion from the register of brokers or advisers, the PFSA may shorten the period referred to in Article 130 (5) TFIA.

131(3), the broker or adviser may not be re-entered in the register prior to the canceling of an entry of sentence for the offence the commitment of which served as the basis for the issuance of the decision on the deletion from the register (Article 130 (5) TFIA). If such a person within the said period of time made an application in order to re-enter in the register, the TFIA would be obliged to refuse¹, issuing an administrative decision. Such decision is a kind of additional administrative sanction connected with the delict².

The PFSC's tasks falling within the scope of supervision over the trading in financial instruments are also carried out through imposing administrative sanctions on companies operating a stock exchange or companies operating an OTC market if they violate the provisions of the law, fail to comply with the principles of fair trading or compromise the interest of trade participants.

In the 1st case the Commission may impose a pecuniary penalty of up to PLN 1,000,000 or even - if the company operates the stock exchange in breach of the provisions of the law, fails to comply with the principles of fair trading or compromises the interest of trade participants - also apply to the minister competent for financial institutions for revoking the authorization to operate a stock exchange. Noteworthy - not all breaching of the provisions of the law may lead to revoking the authorization, which is the hardest administrative sanction, but only connected with operating the stock exchange³.

According to the Article 166 (1) TFIA if a company operating an OTC market violates the provisions of the law, fails to comply with the principles of fair trading or compromises the interest of the trade participants, the PFSC may impose a pecuniary penalty of up to PLN 1,000,000, revoke the PFSC's authorization to operate an OTC market, or revoke the authorization and impose the pecuniary penalty. However, not all of the behaviors exercised by the companies operating an OTC market which lead to compromise the interest of trade participants empower the PFSC to punish such firms, but only illegal, unlawful activities⁴,

¹ M.Romanowski, "Prawo...", 257.

² A.Michór, "Odpowiedzialność administracyjna w obrocie ...", 88-89.

³ A.Michór, "Odpowiedzialność administracyjna w obrocie ...", 91.

⁴ M. Wierzbowski, "Ustawa...", Article 27 (4).

since, with respect to the law, interests of the companies and interests of the trade participants may often be contradictory, for example when the companies impose new fees.

The PFSC exercises also comprehensive supervision over the investment firms. The tasks falling within the scope of supervision are in particular executed by imposing penalties in accordance with Article 167 TFIA, Article 169 TFIA, Article 99 (1) TFIA and Article 114 (1) connected with Article 99 (1).

According to the rules established in Article 167 (1) TFIA the Commission may revoke the brokerage license or limit its scope if an investment firm:

- 1) grossly violates the provisions of the law, in particular the regulations issued under Art. 94 (1.1-2) TFIA and 94 (1.5) TFIA;
- 2) fails to comply with the principles of fair trading;
- 3) compromises the customer's interest;
- 4) has discontinued the activities specified in the license for at least six months;
- 5) no longer meets the conditions on the basis of which the license was granted, subject to Art. 95 (10) TFIA;
- 6) has been granted the license on the basis of misrepresentations or false documents.

Moreover - in the cases referred to in Article 167 (1-3) TFIA or Article 167 (1.6) TFIA, the PFSC may also choose not to apply the sanctions referred to in Article 167 (1) TFIA but impose a pecuniary penalty of up to PLN 500,000 on the investment firm, or impose one of the sanctions referred to in Article 167 (1) TFIA and the pecuniary penalty referred to in Article 167 (2.1) TFIA – if justified by the nature of the investment firm misconduct.

According to the Article 167 (3) TFIA the Commission may also impose the said sanctions on an investment firm which has commissioned an agent to perform their activities, in connection with its services for the investment firm, the agent violates the provisions of the law or the principles of fair trading or compromises customers' interests.

The entity whose brokerage license has been revoked shall not reapply for such a license for five years from the date when the decision revoking the license became final, unless the Commission agrees to shorten this period.

The relevant decision shall be issued following a hearing. The Commission's resolution serving as a basis for the decision has to be published in the Official Journal of the PFSC. The Commission may order published the resolution in two daily newspapers with nationwide circulation at the cost of the punished entity, which is a kind of a additional repression¹, since it may lead to lost of their good name and position on the capital market².

Noteworthy - the provisions of Article 167 are not applied to the foreign investment firms conducting brokerage activities in the Republic of Poland, since TFIA lays down rules for supervision over foreign investment firms in Article 169, which is an implementation of former EU Directive 93/22/EEA and actually EU Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC (MIFID I Directive)³. Article 62 (1) of Directive 2004/29 provides, that where the competent authority of the host Member State has clear and demonstrable grounds for believing that an investment firm acting within its territory under the freedom to provide services is in breach of the obligations arising from the provisions adopted pursuant to this Directive or that an investment firm that has a branch within its territory is in breach of the obligations arising from the provisions adopted pursuant to this Directive which do not confer powers on the competent authority of the host Member State, it shall refer those findings to the competent authority of the home Member State the home Member State or because such measures prove inadequate, the investment firm persists in acting in a manner that is clearly prejudicial to the interests of host Member State investors or the orderly functioning of markets, the competent authority of the host Member State, after informing the competent authority of the home Member State shall take all the appropriate measures needed in order to protect investors and the proper functioning of the markets. This includes the possibility of preventing offending

¹ M.Wierzbowski, "Ustawa...", Article 45 (17).

² A.Kozaczewska, "Kompetencje KPW wykraczające poza zakres prawa administracyjnego w świetle zasad konstytucyjnych" *PUG*, 1997/7-8, 34.

³ OJ L35, 30.04.2004, as amended.

investment firms from initiating any further transactions within their territories. The Commission shall be informed of such measures without delay. Accordingly to the Article 62 (1) of the MIFID I 2004/29 where the competent authorities of a host Member State ascertain that an investment firm that has a branch within its territory is in breach of the legal or regulatory provisions adopted in that State pursuant to those provisions of this Directive which confer powers on the host Member State's competent authorities, those authorities shall require the investment firm concerned to put an end to its irregular situation steps, the competent authorities of the host Member State shall take all appropriate measures to ensure that the investment firm concerned puts an end to its irregular situation. The nature of those measures shall be communicated to the competent authorities of the home Member State. If, despite the measures taken by the host Member State, the investment firm persists in breaching the legal or regulatory provisions referred to in the first subparagraph in force in the host Member State, the latter may, after informing the competent authorities of the home Member State, take appropriate measures to prevent or to penalize further irregularities and, in so far as necessary, to prevent that investment firm from initiating any further transactions within its territory. The Commission shall be informed of such measures without delay.

In accordance with the Article 169 TFIA if the PFSC ascertains that a foreign investment firm or an investment firm's agent representing a foreign investment firm violates the provisions of the laws regulating brokerage or custodial activities binding in the Republic of Poland, it shall order, by way of a decision, that the foreign investment firm discontinue the violation and shall determine the deadline for remedying such violation. The Commission notifies the authority competent for the foreign investment firm of the violation and failure to meet the deadline for remedying such violation. If the foreign investment firm fails to discontinue or remedy the violation within the set timeframe, then following the lapse of one month from the time the competent authority was notified, the Commission may take the following steps:

1) prohibit, in whole or in part, the conduct of brokerage or custodial activities in the Republic of Poland, or

- 2) suspend, in whole or in part, the right to conduct brokerage or custodial activities in the Republic of Poland for up to six months, or
 - 3) impose a pecuniary penalty of up to PLN 500,000, or
 - 4) impose one of the sanctions referred to in Art. 169.3.1 and 169.3.2 and the pecuniary penalty specified in Art. 169.3.3;
- and shall concurrently inform the authority competent for the foreign investment firm that such steps have been taken.

The relevant decision shall be issued following a hearing. The Commission's resolution serving as the basis for the decision is published in the Official Journal of the PFSC. Moreover - the Commission may order to publish the resolution in two daily newspapers with nationwide circulation at the cost of the foreign investment firm.

If a foreign investment firm is prohibited from conducting brokerage or custodial activities in Poland, it shall not resume such activities for five years from the date when the decision prohibiting such activities became final, unless the Commission agrees to shorten this period.

If justified by the need to protect the public interest, before taking the steps referred to in Article 169 (1-3), the Commission may, suspend, in whole or in part, the right to conduct brokerage or custodial activities by a foreign investment firm in Poland for up to one month, and shall notify accordingly the European Commission and competent authority in another Member State which has granted the authorization to the foreign investment firm. The PFSC has to notify the European Commission of the sanctions imposed in accordance with Article 169 (3).

Fulfilling the obligation under the MAD Directive (2003/6), TFIA states administrative liability connected with the market manipulation referred to in Article 39 (2.4b) or Article 39 (2.8) TFIA. In such cases the Commission by way of a decision, may impose a pecuniary penalty of up to PLN 200,000 or a pecuniary penalty of up to ten times the financial benefit gained, or both. The same penalties shall be imposed on anyone who engages in collusion with other persons for the purpose of market manipulation (Article 172

(1-2) TFIA). Other kinds of manipulations are treated as criminal offences (Article 183 TFIA¹). Such decriminalization is intended to make the anti - manipulation procedures quicker and more effective².

Acting in accordance with Article 174 (1) in conjunction with Article 156 (1.1.a) and Article 159 (1) TFIA, PFSC is entitled to impose a pecuniary penalty of up to PLN 200,000 on any of the persons enumerated in Article 156 (1.1.a), i.e. the members of the management board, supervisory board, proxies or attorneys-in-fact of the issuer, its employees, qualified auditors or other persons related to the issuer under any mandate contract or any legal relation of a similar nature³, if during the restricted period they commit the actions set forth in Article 159 (1)⁴, unless such person has commissioned an authorized entity conducting brokerage activities to manage such person's securities portfolio in a manner which excludes such person's influence on the decisions made for its account⁵.

¹ Anyone who engages in the market manipulation referred to in Article 39 (2.1-3), 39 (2.4.a) or 39 (2.5-7) TFIA shall be liable to a fine of up to PLN 5,000,000 or a penalty of imprisonment for a period from three months to five years, or to both these penalties jointly. Anyone who engages in collusion with other persons for the purpose of the market manipulation referred to in Art. 39.2.1-3, 39.2.4a or 39.2.5-7 shall be liable to a fine of up to PLN 2,000,000. See also – M.Pachucki, “Przestępstwa giełdowe. Charakterystyka i skala zjawiska”, *Nasz Rynek kapitałowy*, 2004, No 9, 1-2.

² „Nowe regulacje rynku kapitałowego – najważniejsze zmiany i ich konsekwencje dla uczestników”, Warsaw, KNF (PFSC) 2005, 20.

³ For example notaries public performing documents for a company. A.Michór, “Odpowiedzialność administracyjna notariuszy jako insiderów pierwotnych w obrocie instrumentami finansowymi”, *Rejent*, 2007, No 11, 66-94.

⁴ According to this regulation during a restricted period persons enumerated in Article 156 (1.1.a) TFIA may not acquire or dispose of, for their own account or for the account of a third party, any of the issuer shares, derivative rights attached thereto or other financial instruments related to such shares, and may not take for their own account or for the account of a third party any other legal transactions which lead or might lead to the disposal of such financial instruments.

⁵ Also in this case the relevant decision shall be issued following a hearing. The resolution serving as a basis for the decision is published, in whole or in part, by the Commission in its Official Journal, or the Commission may order to publish the resolution in two daily newspapers with national circulation at the cost of the party concerned, unless such publication could cause disproportionate damage to trade participants or pose a serious threat to financial markets (Article 174 (2-3) TFIA).

4. Administrative sanctions in POA

The proceedings connected with imposing administrative sanctions are carried out also according to the regulations laid in the Act on Public Offering, Conditions Governing the Introduction of Financial Instruments to Organized Trading, and Public Companies dated July 29th 2005. This Act defines rules and conditions for carrying out a public offering of securities and for seeking admission of securities or other financial instruments to trading on a regulated market; obligations of issuers of securities and other entities participating in trade in such securities or other financial instruments; consequences of obtaining the status of a public company as well as special rights and obligations relating to the holding of and trading in shares of such companies (Article 1 POA). The administrative sanctions established by the said Act are laid in Part VII of the Act – “Administrative Sanctions for Infringement of Regulations”, as well as in other Parts of the Act. Noteworthy – although there are only two articles in Part VII, they penalize infringements of most of the regulations of the POA.

Art. 96 (1) POA establishes rules of administrative liability of issuers and selling shareholders. If the said persons fail to perform or unduly perform the obligations referred to articles pointed in Article 96 (1) POA¹, or fail to perform or unduly perform the obligations under Article 42 (5) in conjunction with Article 45, Article 46, Article 47 (1), 47 (2) and 47 (4), Article 51 (4), Article 52, Article 54 (2) and 54 (3), or fail to perform or unduly perform the order referred to in Article 16 (1), infringe upon the proscription referred to in Article 16 (2), or fail to perform or unduly perform the obligations referred to in Article 22 (4) and 22 (7), Article 26 (5) and 26 (7), Article 27, Article 29 through Article 31 and Article 33 of EU Regulation 809/2004², the PFSC may:

¹ I.e. Article 14 (2), Article 15 (2), Article 37 (4) and 37 (5), Article 38 (1) and 38 (5), Article 39 (1), Article 42 (1) and 42 (6), Article 44 (1), Article 45, Article 46, Article 47 (1), 47 (2) and 47 (4), Article 48, Article 50, Article 51 (4), Article 52, Article 54 (2) and 54 (3), Article 56, Article 57, Article 58 (1), Article 59, Article 62 (2), 62 (5) and 62 (6), Article 63 (5) and 63 (6), Article 64, Article 66 and Article 70. Further – A.Michór, “Odpowiedzialność administracyjna w obrocie ...”, 140-215.

² Commission Regulation (EC) No 809/2004 of 29 April 2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements, OJ L49, 30.04.2004.

- 1) issue a decision excluding given securities from trading on a regulated market for a definite or indefinite period, or
- 2) impose, taking into account in particular the financial standing of the entity on which the penalty is to be imposed, a pecuniary penalty of up to PLN 1,000,000, or
- 3) apply both these sanctions jointly.

If a decision stating infringement of the obligations has been issued, the Commission may additionally oblige the issuer to promptly publish the required information in two newspapers of country-wide circulation or otherwise make it available to the public.

Noteworthy - agreements on transfer of securities concluded prior to the issuance of the decision remain valid.

According to the Article 96 (6) POA for gross infringement of the obligations referred to in Article 96 (1) POA, the Commission may impose pecuniary penalties on the members of the management board of a public company or a management company which is a governing body of a closed-end investment fund. An amount of such penalty shall be of up to triple the monthly gross remuneration of such person, as computed based on the remuneration for the three months preceding the imposition of the penalty. However, no penalty may be imposed after the lapse of six months as of the date of the decision referred to in Article 96 (1).

Moreover, the PFSC is entitled to disclose to the public the contents of the decisions stating the issuer's failure to perform its obligations referred to in Article 96 (1) POA (Article 96 (10) POA). Noteworthy - the said disclosure by the Commission of the information is without prejudice to the obligation of professional secrecy as defined in the Act on Trading in Financial Instruments.

The powers conferred upon the PFSC under the provisions of Article 96 (1-11) POA, to the extent relating to Article 57 (1)¹ and 57 (2)¹, shall apply to events which have occurred

¹ If discharge of the obligation referred to in Article 56 (1) POA might violate the legitimate interest of the issuer of securities admitted to trading on a regulated market in the Republic of Poland or any Member State, irrespective of whether transactions concerning that security are executed on that market, such issuer may – to the extent relating to the information referred to in Article 56 (1.1) POA – delay discharge of these obligations for a defined period at its own responsibility and in accordance with the regulations issued under Article 60 (1)

in the Republic of Poland or another EU Member State and relate to financial instruments which have been admitted or are sought to be admitted to trading on a regulated market in the Republic of Poland; events which have occurred in the Republic of Poland and relate to financial instruments which have been admitted or are sought to be admitted to trading on a regulated market in the territory of any other EU Member State (Article 96 (12) POA).

Art. 96 POA also states administrative liability of the issuers or the selling shareholders (13) and entities seeking admission of financial instruments other than securities to trading on a regulated market (14).

Noteworthy - in cases pointed in Article 96 the relevant decision may be issued without following a hearing, which is very criticized by the polish doctrine, pointing that a hearing is a condition of fair procedures and the right to defense, since each suit is different and unique².

Not only issuers and selling shareholder may be punished according to the regulations laid in the POA. The measures necessary for the PFSC's tasks falling within the scope of supervision over capital market are laid also in Article 97, which lays down administrative liability of anyone who breaches the provisions adopted by the said Acts, pointed in Article

POA, notifying the Commission of such delay, specifying the reasons justifying this delay, and specifying the deadline by which the information concerned shall be provided to the entities referred to in Article 56 (1) POA.

¹ Delay in the disclosure of information, as referred to in Article 57 (1) POA, may occur only if the issuer guarantees that confidentiality of that information is maintained until discharge of the obligation and such delay does not mislead the public.

² R.Czerniawski, (in:) R. Czerniawski, M. Wierzbowski, "Ustawa Prawo o publicznym obrocie papierami wartościowymi. Komentarz", Warsaw, 2002, Article 85 (3); R.Jurga, M.Michalski, "Z problematyki prawnej wycofywania papierów wartościowych z publicznego obrotu", *Glosa*, 2000, No 3, 7; A.Michór, "Odpowiedzialność administracyjna w obrocie...", 153.

97 POA¹. In such case, by way of a decision, the Commission may impose a pecuniary penalty of up to PLN 1,000,000. Noteworthy – a decision may be issued only after a hearing².

In order to make the sanction effective, the pecuniary penalty in the amount specified above, may be imposed separately for each act specified therein³. To ensure that the obligation or act which is required under applicable regulations, the breach of which was the reason for imposing the pecuniary penalty, is fulfilled, in the decision the PFSC may also determine a deadline for their repeated performance. If the obligation or act is not performed by such deadline, the Commission may again, by way of a decision, impose a pecuniary penalty.

5. Summary

The PFSC's tasks falling within the scope of supervision over the capital market are very wide. They are carried out especially through imposing administrative penalties for breaches the provisions adopted by the capital market law. This article concerns only the most important aspects of this part of activity of the Commission, since capital market supervision

¹ I.e. acquires or disposes of securities in breach of the proscription referred to in Article 67; fails to make a notification referred to in Article 69 within the time prescribed or makes such a notification in breach of the provisions of Article 69; exceeds the defined threshold of the total vote in breach of the conditions referred to in Article 72 through Article 74; fails to meet the conditions referred to in Article 76 or Article 77; fails to announce or carry out a tender offer within the time prescribed, or dispose of shares within the time prescribed in the events referred to in Article 72 (2), Article 73 (2) and 73 (3), Article 74 (2) and 74 (5); discloses to the public the information on his intent to announce a tender offer prior to the notification referred to in Article 77 (2); despite receiving the request referred to in Article 78, fails to introduce necessary changes in or supplements to the contents of the tender offer or fails to deliver explanations concerning the contents within the time prescribed; in the case specified in Article 74 (3), fails to pay a difference in the share price within the time prescribed; in the tender offer referred to in Article 72 through Article 74 or Article 91 (6), proposes a price lower than a price determined under Article 79; acquires his own shares in breach of the procedures, dates and conditions specified in Article 72 through Article 74, Article 79 or Article 91 (6); despite the obligation specified in Art. 86.1, fails to make documents available to the special-purpose auditor or furnish explanations to him; commits the acts specified in Article 97 (1.1-11), while acting on behalf or in the interest of a legal person or an organizational unit without legal personality.

² See also – A.Michór, ”Odpowiedzialność administracyjna w obrocie...”, 179.

³ Moreover - the pecuniary penalty may be imposed separately on each entity bound by the agreement referred to in Article 87 (1.5).

is subject to relatively extensive regulation. Nowadays, having regard to the global crisis, the importance and necessity of such supervision is obvious.

Kseniya Yurtayeva

**"Cybercrime challenges in the framework of
information-oriented society"**

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Cybercrime challenges in the framework of information-oriented society.

Kseniya Yurtayeva

1. Evolution of a computer crime notion.

Computer crime is a category that is widely discussed in the scientific literature and news headlines over the last decade. Criminologists and governments of the leading countries of the world came to understanding of security threats that are posed by computer crimes to international community. It is proved by a number of international and local initiatives which in one or another way deal with issues raised by the growing damages caused by computer crimes and potential for their effective prosecution.

So, what is now understood by the term “computer crime”? There is no a single definition of a computer crime. In general terms it can be defined as a violation of criminal law that involve a computer and knowledge of computer technology. In other sources computer crimes are referred as cybercrime, i.e., crime the commission of which entails the use of computer technology¹. The last definition emphasizes virtual character of the actions engaged for the achievement of malicious results.

Traditionally computer crimes are divided into three categories according to the computer’s role in the particular crime². First, a computer may be the *object* of a crime. This category primarily refers to theft or direct physical damage of computer hardware. This type of computer crimes shouldn’t be referred as cybercrimes, because they do not involve the use of computer technologies and mainly correspond to the physical actions of the criminal that cause an actual damage or violate property rights of the victim. Second, a computer may be the *subject* of a crime. In this case the damage is caused to the computer, its software and hardware as well as information and programs contained on the hard disk of the computer by the illegitimate attack such as distribution of viruses (worms, Trojan horses, logic bombs) and

¹ Susan W. Brenner, Is There Such a Thing as Virtual Crime?, 4 CAL. CRIM. L. REV. 1 (2001).

² Robert Ditzion, Elizabeth Eddes, Mary Rhodes. Computer Crimes. 40 Am. Crim. L. Rev. 285, p. 289-290 (2003).

other types of harmful programs. This type of crime is particularly popular among juveniles and professional hackers who want to show off their skills. Third, a computer may be an *instrument* used to commit traditional crimes in a more complex manner. These traditional crimes include identity theft, child pornography, copyright infringement, counterfeiting, fraud etc. In the recent years computer crimes of the third category also include such serious transnational offences as terrorism¹ and money laundering² that is noted in works of the leading criminologists as well as in international documents.

The last two types of computer crimes (cybercrimes) are indispensably linked with the usage of computer networks, and mainly the Internet, which technically began as a four site experiment by the U.S. government to guarantee uninterrupted communication between strategically important sites in the event of a nuclear war in 1960's and 1990's integrated over 18000 private, social and national networks, the number of which is continuously growing³.

At present Internet is the publicly available worldwide system of interconnected computer networks. It enables its users to communicate and share ideas and information that is done with or without the use of security, authentication and encryption technologies, depending on the local requirements. Internet is also successfully used by businesses, banking institutions and governmental agencies that nowadays heavily rely on it in their operation. Cheap, fast and almost anonymous Internet has no single jurisdiction or central regulation. All these factors and also sparse policing on Internet makes its numerable users vulnerable targets for criminal cyber attacks.

Cybercrime sometimes is referred as a as the “perfect crime” because it can be committed anonymously and is not easily traceable. Internet gives cyber criminals unique

¹ See: Resistance of Internet use in terrorist objectives. Organization for Security and Cooperation in Europe. Council of Minister, 05.12.06, Brussels, MC.DEC/7/06 / <http://www.osce.org/item/22559.html?lc=RU>; Naden O. Problems of legal regulations of social relations in Internet in the context of their illegal use by the terrorists organizations. Legal Ukraine, 2006, № 7(43). – P. 90-97.

² See Rajeev Saxena. Cyberlaundering: The Next Step For Money Launderers? 10 St. Thomas L. Rev. 685 (1998); Jonathan P. Straub. The Prevention Of E-Money Laundering: Tracking The Elusive Audit Trail. 25 Suffolk Transnat'l L. Rev. 515 (2002).

³ Wejmann G. How modern terrorists use Internet: Special № 116 (March 2004) — <http://www.usip.org/pubs/specialreports/sr116.html>

advantages allowing them easily hide evidence pertaining to cybercrime, hide their identity and increase their criminal activity with minimal effort. According to Susan W. Brenner the differences between real-world crime and cybercrime are: 1) cybercrime does not require any degree of physical proximity between victim and victimizer at the moment an illegal conduct is committed; 2) cybercrime is an “automated crime” which denotes an individual’s ability to use technology to multiply the number of discrete offenses he is able to carry out in a given period of time; a single perpetrator can commit thousands of cybercrimes in a short period of time; 3) perpetrators of cybercrime are not restricted by the constraints that govern action in the real, physical world; 4) it’s impossible to identify patterns of cybercrimes comparable to those that exist for real-world crime, that it is impossible to derive conclusions as to how various types of cybercrime will manifest themselves geographically and demographically¹. These peculiarities of cybercrime and also its global nature pose additional challenges of legal and technical character on law enforcement. Understandably, the problem of cybercrime can be solved only through a universal legal framework equal to the worldwide reach of the Internet.

2. Significance of territorial element in computer crime prosecution.

As was noted above, law enforcement agencies in different countries encounter a number of problems investigating computer crimes. Due to the constituent features of these crimes and problems which arise during their detection and prosecution, only a small amount of cases come to the sight of specialized organs and subsequently go to court. A primary reason for this is territorial element of computer crime and indispensable jurisdictional issue that frequently derive from it.

Peculiarities of the territorial element of cybercrimes lie in the sole nature of Internet that represents a medium which connect a perpetrator with his potential targets. Internet is extraterritorial by its nature and it is not restricted by traditional state borders. In fact Internet

¹ Susan W. Brenner. Toward a Criminal Law for Cyberspace: A New Model of Law Enforcement? 30 Rutgers Computer & Tech. L.J. 1, p. 26-34 (2004).

technology casts doubt on the whole system of international law with its geographical territoriality doctrine. For instance, a criminal being geographically situated in China or Russian Federation can perpetrate a bank system in the U.S., or break the computer network in France and send viruses to its users, or place information that contain child pornography on the website that geographically is situated in Spain (let us also take into account that this site can be accessed by the indefinite number of Internet user from different countries of the world). In these examples that routinely take place in the virtual environment cybercriminals possessing certain practical skill can perpetrate targets in other countries not even leaving their homes. The offender and actual targets are separated by great distances, and the only connection between them is the network that binds its users.

So what should be considered the place of perpetration of the cybercrime or, in other words, how can we define its territorial element?

In general theory of Criminal Law a place of perpetration is understood as an objective category that represents a basis for application of territorial jurisdiction of the state. The last relies on the territorial supremacy of the state, which lies in its sole right to exercise jurisdiction, including criminal jurisdiction, over its territory, if other is not provided in the norms of International Law or in its international agreements. By general rule the place of perpetration is defined as the territory where harmful activity took place and where harmful consequences happened, or where accessories to a crime acted¹. With regard to cybercrimes, harmful actions and results frequently take place at the very least in two countries, which will have an equal right to prosecute an illegal conduct (for example, a criminal cracks a server in another country and steals personal information of its users)². But it seems almost impossible to identify a geographical place of perpetration in cases of computer viruses' distribution³ or

¹ Blum M.I. Effect of Soviet Criminal Law in Space. – Riga, 1974. – P. 133.

² In these fairly straight forwarded cases we do not take into account that a criminal might use Internet servers that are geographically situated in the third countries for committing a crime.

³ For instance in 2000 notorious virus "ILOVEYOU" cloaked itself with an e-mail message and once opened rapidly spread worldwide, causing billions of dollars in damage and halting corporate networks. Causing damage to computer information of the victim it redirected Microsoft Internet Explorer surfers to a predetermined website where a separate program scanned the victim's computer for passwords and log-in names. After this the virus sent a copy of itself to every name in the user's address book, overloading computer

in placing child pornography on the Internet server which is accessible from almost any country of the world.

Foresaid examples prove that development of such technologies as Internet change traditional understanding of territory and space. Internet binds computers of all its users in the integrated network that goes beyond conception of geographical borders. Erin L. Anselmo outlines that interrelation between addresses of Internet sights place an additional complexities in conception of territory in Internet. Due to the cross-references of Internet sights their division is conditional. Internet addresses are non-material, and even their URL indicators of the state (".ua", ".ru", ".pl") should not necessarily be exact¹. This means that there is no strict relation between Internet addresses and their real geographical position. Addresses may stay invariable, at the time when servers may change their geographical location. So Internet as well as cybercrimes committed in Internet can't be viewed in the notions of traditional conception of territory and space. It represents a separate virtual space that exists beyond a physical world, and therefore is often referred as cyberspace.

3. Criminal jurisdiction and international norms concerning computer crimes' prosecution.

Extraterritorial nature of Internet places a number of obstacles on effective control over cybercrime threats and creates conflicts of criminal jurisdictions. Cybercrimes hardly fit in to the conception of traditional principles of jurisdiction under International Law², though international agreements concerning transnational crimes and practice of national courts still hold old formulas.

systems worldwide. See: Shannon C. Sprinkel. Global Internet Regulation: The Residual Effects Of The "ILOVEYOU" Computer Virus And The Draft Convention On Cyber-Crime. 25 Suffolk Transnat'l L. Rev. 491, p. 493 (2002).

¹ Erin L. Anselmo. Cyberspace in international legislature: Is territorial principle in International Law denied by the development of Internet? – Economic Strategies, 2006, №2. / http://www.inesnet.ru/magazine/mag_archive/free/2006_02/anselmo.htm

² Present system of international law is based on five theories of criminal jurisdiction identified in Harvard Research on International Law, 1935: territorial; protective; nationality; universal; and passive personality. See: Harvard Research in International Law, Jurisdiction with Respect to Crime, 29 AM. J. INT'L L. 474 (1935).

The general rule is that the states' right to apply their laws extraterritorially is unrestricted, and in the cases of concurrent jurisdiction over criminal matters the issue is decided according to the rules international comity, if there is no applicable international provision that will resolve an issue in a different way¹.

In practice two basic models for resolving jurisdictional conflicts are applied. According to the first model the crime falls under jurisdiction of the state, where the crime was committed, so first of all the place of perpetration is taken into account. When illegal activity was performed in the state and was detected there, there are usually no jurisdictional difficulties in taking the criminal under arrest and prosecuting him (*subjective territoriality*). This situation is possible under the condition that the conduct is illegal under Criminal Law statutes of the state. With respect to criminalization of computer crimes, the situation is constantly improving: more and more countries worldwide recognize harmful use of computer technologies as a crime under their national laws. Lag in this process can seriously harm the cybercrimes' prosecution and provide a refuge for offenders, who create a threat for security in Internet². On the other hand, computer crimes have a high potential for latency, and their detection and prosecution in overwhelming majority of cases is aroused by the country where detrimental effect took place (*objective territoriality*). In those situations the criminal and investigating agencies are separated by state borders and a number of possible legal obstacles (requirements of double jeopardy, differences in Criminal Law statutes, absence of treaties for mutual legal assistance in criminal matter etc.). In some cases countries find some original methods for bringing a cybercrime criminal to justice. In the case *United States v. Ivanov* in 2000 a citizen of Russian Federation Aleksey Ivanov hacked e-commerce corporation situated

¹ This basic provision that summarized existing rules of international law was identified in *S.S. Lotus Case*. This case involving collision of French and Turkish marine vessels was decided in 1927 by the Permanent Court of International Justice (The Case of *the S.S. Lotus* (France v. Turkey), 1927 P.C.I.J. (Ser. A) No. 10, p. 19 (Sept. 7)).

² For instance, in the cited above "ILOVEYOU" virus case the criminal went unpunished, because criminal conduct such as computer hacking was not criminalized in Philippine Criminal Code at the time, when the virus attack was performed. In response to the "ILOVEYOU" virus, Philippine President Joseph Estrada signed the Electronic Commerce Act on June 14, 2000, outlawing computer crimes (Shannon C. Sprinkel. Note: Global Internet regulation: the residual effects of the "ILOVEYOU" computer virus and the Draft convention on cyber-crime. 25 Suffolk Transnat'l L. Rev. 491. P. 494 (2002).

in Connecticut, USA, and obtained the “root” passwords granting access to and control over an entire computer system, including the ability to manipulate, extract, and delete any and all data. Ivanov then threatened the corporation with the destruction of its computer systems, if they will not hire him as security expert. He was invited for the interview to the U.S. and after arrival was arrested on charges of conspiracy, computer fraud and related activity, extortion, and possession of unauthorized access devices. Ivanov argued that US court didn’t have subject matter jurisdiction over his conduct, because he was physically located in Russia at the time of the attacks. The court denied his arguments and asserted that Ivanov being physically outside United States territory at the time of actual perpetration intended to cause detrimental effects within the United States making it reasonable to apply to him a statute, which is not expressly extraterritorial in scope¹. In this way US court confirmed objective territoriality principle over the computer crimes. However it is rather an exception than a rule that a country takes a cybercrime criminal into custody using its own powers or assistance of other states.

The second basic model for resolving jurisdictional conflicts gives priority for nationality of the cybercriminal. This principle is based on the assumption that a person grants the country of which he is a national the right to regulate his conduct, no matter where located. In this way country adopting a proper criminal legislation can control and bring into custody its nationals for committing cybercrimes in other jurisdictions. This model seems to be effective, if a country where a cybercrime was committed and the country where detrimental effect took place doesn’t have a proper legislation in the question. Obviously countries are not restricted by the models for resolving jurisdictional conflicts stated above, and readily use other legitimate grounds for extraterritorial prosecutions, when it’s required by their national interests.

International documents in this field also preserve a wide range of powers and obligations for cybercrime prosecutions. Council of Europe Convention on Cybercrime,

¹ *United States v. Ivanov*, 175 F. Supp. 2d 367, p. 1-15 (2000).

adopted on November 23, 2001, is the first and thus far only multilateral treaty to address specifically the problem of computer-related crime and electronic evidence gathering. Despite of its European origin the Convention on Cybercrime from the beginning was viewed not only as a regional instrument. Taking into consideration global character of cybercrime, Council of Europe invited 4 non-member states, namely the United States, Canada, Japan, and South Africa to make their proposals for the draft during the preparatory stage. The scope of regulation of the Convention, defined in Chapter II Section 1, includes computer crimes of various characters, such as data and system interference, computer-related fraud, copyright infringement, distribution of child pornography, and other offenses perpetrated over computer networks. Article 22 of the convention includes two basic principles of criminal jurisdiction – territorial principle and nationality principle. In addition Part 3 of this Article sets an obligation on the Parties to adopt such measures as may be necessary to establish jurisdiction over the cybercrimes that are punishable under the laws of both Parties concerned by deprivation of liberty for a maximum period of at least one year, or by a more severe penalty, in cases where an alleged offender is present in its territory and it does not extradite him/her to another Party, solely on the basis of his/her nationality, after a request for extradition. Otherwise CU Cybercrime Convention in any way doesn't exclude any criminal jurisdiction exercised in accordance with domestic law of the Party or give strict guidelines for resolving jurisdictional conflicts (Article 22, Parts 4,5). Thereafter jurisdictional regulations of the Convention do not vary from the rules cited above and provided by International Law.

Complexity of Internet regulations and cybercrimes themselves brings additional challenges for application of criminal jurisdiction. Due to the almost unlimited reach of Internet and its neglect of geographical borders some states consider that informational resource is within reach of their criminal jurisdiction, if it is freely accessible for its nationals, regardless of its actual geographical location. This approach will make such cybercrimes as distribution of child pornography through Internet, usage of Internet for terrorist support and propaganda, distribution of information that rouses national or ethnic hatred accessible for criminal prosecution for almost any country of the world. There are some examples of the

attempts to exercise this principle under the national law, although nowadays it doesn't yet enjoy international support and recognition¹. Gus Hosein outlines also technical as well as legal difficulties, when Internet services' providers all over the world are placed in the complicated situation, in which they are forced to comply with the laws of several jurisdictions beside their own². Cited clashes of jurisdiction and material Criminal Law shows perspectives for the further harmonization of international norms in this field.

4. Models of Internet regulation in the terms of computer crimes' prosecution.

International organizations and criminologists of different countries continuously work on the resolutions for proving effective cybercrime prosecution. Certainly, as some scientists emphasize, privacy issues will undoubtedly arise from imposing new Internet regulations. In fact privacy issue was the main critique of CU Cybercrime Convention of 2001. Identifying scope of privacy and its limitations should place a central position in further Internet regulation. One of the main issues that should be resolved on international level will be finding a proper balance between preserving privacy on Internet and providing proper instruments for combating cybercrime. Apparently in the cases of preparation or committing a crime privacy issues should not be placed above interests of potentials victims of the crime.

There are a number of suggestions for jurisdictional issues' regulations in Internet. One of the most popular is the idea of cyberspace with its own jurisdiction which will not so heavily rely on geographical context of modern society. For example, the Report of the United Nations Working Group on Internet Governance from June 2005 states that along with

¹ For example, in the so called *Yahoo! Cases* two non-profit organizations of French citizens, sought to prohibit Yahoo!, Inc., a business incorporated in the United States, from allowing Nazi paraphernalia to be sold on Yahoo!'s auction sites accessible from France. The Paris Court ordered Yahoo! to prevent French citizens from accessing illegal material and post a warning on Yahoo.fr to French citizens stating that any search for illegal Nazi paraphernalia might subject the citizen to criminal prosecution. Subsequently, Yahoo! sought in the U.S. District Court for the Northern District of California a declaration that any resulting judgment of the French court would not be enforced in the United States. (Samuel F. Miller. Prescriptive Jurisdiction over Internet Activity: The Need to Define and Establish the Boundaries of Cyberliberty. 10 Ind. J. Global Leg. Stud. 227, p. 240-241 (2003).

² Gus Hosein. Politics of the Information Society: The Bordering and Restraining of Global Data Flow. Institute of Statistics – Paris, p. 11 (2004).

safeguarding personal life, private information and other human rights countries should study and work out instruments and mechanisms, including treaties and mutual assistance, that will provide effective investigation and prosecution of crimes committed in cyberspace against networks and technical resources with concern of transnational jurisdiction regardless of territory, where the crime was committed or where the applied technical devices are situated, with the full respect to the states' sovereignty¹. Other initiatives in this field also pay thorough attention on the question of criminal jurisdiction on Internet. According to the Draft Conception of Legal Regulation of Internet worked out in the Institute of International Law and Economy, Moscow, Russian Federation, the choice of models (mechanism) in the case of conflict jurisdictions should be based on the following factors:

- Subject of the relations (is suggested as the main factor);
- Object of the relations;
- Objective of the relations (“principle of business objective”);
- Territory;
- Without defining strict boundaries (“principle of universal prosecution”);
- Provider;
- Principle of subjective imputation².

Examples cited above indicate a clear tendency of diversion from territoriality doctrine and shifting the emphasis to universal prosecution and to the separate informational activity of a person regardless of his/her nationality. Understandably pure national measures can be only an interim increment on the way of building collective system of cybercrimes prosecution. The future is viewed in universal regulation bodies and virtual courts that will resolve conflicts and issue indictment for crimes committed within cyberspace. Virtual courts

¹ The Report of the United Nations Working Group on Internet Governance. 05-41151, p. 21-22 (June 2005) / http://www.un.org/russian/esa/ict/wgig_report.pdf.

² The Draft Conception of Legal Regulation of Internet (version from 10.12.2008), Department UNESCO on Copyright Law and Other Branches of Intellectual Property Law, Institute of International Law and Economy, Moscow, Russian Federation / <http://www.unescochair.ru/index.php?option=content&task=view&id=398>.

won't require physical presence and will assist in substantial decrease in the costs of cybercrime investigation and prosecution. These innovative methods should eventually replace present inflexible and obsolete national-based system of computer crimes' prosecution.

5. Combating computer crimes in Ukraine.

Ukraine on its way from industrialized to informational society experience a number of challenges posed by increasing flow of information in all the spheres of life. However, besides fast economical transformations and building up an open democratic society Ukraine also experience all the benefits and threats of globalized world, including rapid growth of Internet industry and cybercrimes' threats.

Acknowledging perils of computer crimes in the modern world Ukraine is an active participant of international cooperation on combating of cybercrimes. The first international agreement in this field Ukraine signed in 2001 in Minsk. That was an Agreement on Cooperation of Commonwealth of Independent States in combating the crimes in the sphere of computer information. This agreement established a common notion of computer crimes, determined measures of mutual help and cooperation. The list of crimes in the sphere of computer information according to the Agreement contained:

- illegal access to electronic information that led to elimination, blocking or modification of such information;
- creating, use or distribution of viruses;
- violation of the maintenance rules of computer networks by persons who have access to such systems, which led to harmful consequences;
- illegal use of computer programs or other violation of intellectual property rights.

The next major step for Ukraine in international cooperation in computer crimes' combating was accession in 2001 and ratification in 2005 EU Convention on Cybercrime.

Ukraine ratified the Convention with restrictions, including neglecting requirements for establishing criminal liability for some type of computer crimes formulated in Article 6(1) and 9 of the Convention. Later on Ukraine also ratified Additional Protocol to CU Cybercrime Convention. Obligations that followed from ratification of the Cybercrime Convention Ukraine implemented in its criminal legislation and national programs on computer crimes' suppression.

Official statistics of the Ministry of Internal Affairs of Ukraine states that the number of computer crimes from 2001 (a year of adopting of current edition of Criminal Code of Ukraine) to 2007 has grown substantially. During 2001 there were registered 16 crimes, in 2002 - 30 crimes, in 2003 - 74 crimes, in 2004 - 159 crimes, in 2005 - 186 crimes, in 2006 – 585 crimes and in 2007 – 678 crimes¹. During the whole year of 2008 there were registered 151 hacking attacks in “.ua” sector of the Internet, 28 during the first six months and 123 during the second. It is a substantial growth comparative to only 17 hacking attacks that took place in 2007 among all the other computer crimes².

However official statistic information does not prove insignificant number of these crimes in Ukraine. According to independent information provided by Kaspersky Laboratory of computer crimes studies, Ukraine is on the fourth place by the cyber hacking attacks in the world. This indicates that official statistics represent the latency of computer crimes in Ukraine, the lack of knowledge and advanced methods of their detection as well as certain gaps of Criminal Code of Ukraine.

A main reason for the high latency of computer crimes in Ukraine lays in passive behavior of the vast majority of their victims³:

- victims do not complain to law enforcement organs about computer crimes being afraid of publicity that can undermine customers' trust (particularly banks and financial institutions);

¹ Criminal statistics in the sphere of computer technologies in Ukraine / <http://websecurity.com.ua/1660/>

² Summary of hacking activities in UA-net in 2008 / <http://websecurity.com.ua/2875>.

³ Golubyev V.O. Theoretical-legal problems of combating cybercrimes / <http://www.security.ukrnet.net/modules/sections/index.php?op=printpage&artid=124>.

- consequences of the computer crimes are viewed as failures of computer systems, telecommunication systems or software;
- consequences of some computer crimes (for instance computer security leak) are viewed as a damage from other types of illegal behavior.

Another reason for legal and practical complexities in computer crimes' prosecution is that they are a relatively new phenomenon for Ukrainian legal system. Criminal liability for this type of crimes was for the first time provided in 1994 in Criminal Code of 1960 edition. In Criminal Code of 2001 edition a separate chapter was devoted to computer crimes, which at first contained only 3 articles. The objects of these crimes were defined as electronic information and its protection. In 2003 this chapter and all its articles were amended twice. Multiple changes in criminal legislature during short period of time surely brought certain instability into criminal legal relationship and law enforcement practice. Major amendments to Chapter XVI in 2003 included:

- providing separate criminal liability for virus distribution that became a wide-spread crime in Ukraine in recent years;
- establishing criminal liability for illegal copying information that is under operation in computer, computer system or computer network or information that is stored there;
- criminal fines for computer crimes were increased, and a penalty of prohibition to occupy certain position were provided for wider range of computer crimes.

At present time Chapter XVI of Criminal Code of Ukraine contains 6 articles which provide criminal liability for illegal intrusion in the work of computer, computer system or computer network, distribution of harmful software programs (viruses), theft of the computer information, violation of the maintenance rules of computer networks and other types of computer crimes. Current edition of Chapter XVI of Criminal Code of Ukraine still stays an object to a number of criticisms. For instance, some computer crimes such as computer fraud

and content-related computer offences did not obtain a separate criminalization and has to be qualified in combination with a “real-world crimes” of other Chapters, applying computer crime qualification as an aggravated circumstance. Some researches in the field also consider formulations of some of the articles in the Chapter cumbersome and outdated. That is why it is important to bring the norms of Criminal Law of Ukraine in compliance with international norms, give a separate criminalization to computer crimes that now are qualified by two or more articles of different chapters and state computer crimes’ definitions in a more compact manner using modern terms.

Another inadequacy in Ukrainian legislature in this field is that some of the statutes that regulate civil relationships in the sphere of computer information and electronic communications were adopted after the legislator established criminal liability for violation of these relationships. For example, the statute on Telecommunication was adopted five months later then relevant amendments to Criminal Code of Ukraine came into force. So regulation of criminal liability for computer crimes in Ukraine in some cases even goes ahead of regulation of positive relationships, which indicates the lack of theoretical as well as practical research and legislative planning.

Making a conclusion it is important to underline that legal measures in combating computer crimes should be supplemented by effective and qualified use of legal instruments, growth of public awareness of the perils of cybercrimes, promotion of professionalism and adequate technical support of law enforcement.

Burlakov Sergiy Yurievych

“Judicially legal forms of copyrights property protection (exceptional) according to the legislation of Ukraine and EU”

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Judicially legal forms of copyrights property protection (exceptional) according to the legislation of Ukraine and EU

Burlakov Sergiy Yurievych

If materially legal requirement is not provided by a certain mechanism of judicial realization, this norm grows into a norm-slogan which will never be effectively used. Therefore, a judicial form of protection of equitable author rights on the results of intellectual, creative activity is one of the most effective and, at the same time, most difficult in its practical realization.

In 2003 the Law of Ukraine „On changes to some legislative acts of Ukraine as to the legal protection of intellectual property” was adopted [1]. Then the institute of temporary measures was created in the domestic judicial legislation as a preventive measure. In articles 133–135 of Civil code of procedure of Ukraine [2] (hereinafter – CCP of Ukraine), in articles 133–135 and in section V-1 of Economic code of practice of Ukraine [3] (hereinafter – ECP of Ukraine) in section V-1 „Preventive measures” there appeared norms which today regulate a new institute of judicial law which regards temporary judicial measures as preventive measures. Such innovation has become one of the manifestations of Ukrainian legislation harmonization with the legislation of member-countries of the World Trade Organization (Agreements on trade aspects of intellectual ownership right (hereinafter Agreement of TRIPS) [4] and European Union (hereinafter EU).

The adoption of the European Union Directive 2004/48/EG on realization of intellectual ownership rights [5, p.16] (hereinafter EU Directive 2004/48/EG) has become a new stage in the development of judicial law in the European Union. This directive is related to other judicial EU clauses, in particular, the secondary right. Clauses of international EU civil procedural law (Regulation of 22.12.2000 «Brussels I» [6, p.12], EU Regulation on documents delivery [7], EU Regulation on proofs investigation [8], EU Regulation on the

European executive document as to indisputable demands [9], etc.) concern protection of intellectual ownership rights.

It should be noted that EU Directive 2004/48/EG refers to rather wide procedural orders of TRIPS Agreement (articles 41–50). At the same time, unlike Agreement of TRIPS, article 8, 9, 11 EU Directive 2004/48/EG provides for possible application of protection facilities not only to the offender but also to the third persons. It seems that these clauses fully meet Agreement of TRIPS, as it provides minimum level of legal protection only, and which can be improved and increased by the TRIPS members by their legislative acts. Foreign scientists share the same point of view [10, p.159]

In accordance with a subject sphere EU Directive 2004/48/EG covers all types of intellectual ownership rights – from a copyright to the right of industrial ownership, as well as all parts of offences. It does not provide for the limited circle of offences parts and does not limit the circle of offenders according to subjective or objective signs (for example, an offender -entrepreneur, eventual user, user, etc). At the same time, within the limits of certain orders (for example, articles 10–12 in relation to the preventive measures article 13 – damage compensation) there are sometimes certain features depending on the type of illegal action or type of offender (entrepreneurship , actions of private individual, guilt, etc.).

In our view , of great importance is the definition of the *list of principles* in EU Directive 2004/48/EG, in which procedures of intellectual ownership protection and penalties for offence have been specified, in particular: 1) correctness and justice; 2) prevention of too difficult and costly procedures; 3) rapid realization of protection (item 1, clause 3 of EU Directive 2004/48/EG); 4) procedures and penalties must be effective, proportional and intimidating (item 2, clause 3 of EU Directive 2004/48/EG); 5) facilities of protection must not be utilized for establishment of impermissible obstacles for legal trade. The indicated principles in majority coincide with item 1, 2 clause 41 of TRIPS Agreement but the principle of proportionality is new in EU Directive 2004/48/EG.

Regulations of EU Directive 2004/48/EG on realization of intellectual ownership rights are based on five points : 1) right to claims in case of offence; 2) evidential right; 3) provisional facilities; 4) allocation of judicial charges; 5) publications of court decisions.

Description of the directive indicated above will be carried out subsequently.

In accordance with Article 4 of EU Directive 2004/48/EG the ***right to claim*** as a judicial competence on an address to the court after protection of rights is given to the right holders, as well as users (licensees, organizations under team management of property rights, professional associations), if such a possibility is provided for by the legislation of the state-member, or civil legal agreement between the user and the right holder. As most positions of World convention on copyright, EU Directive 2004/48/EG, should it be granted the right to claim by users, organizations under team management of intellectual property rights, professional associations refer to the norms of the national law. Therefore, the tendencies in standardization of the right to claim seem to be insignificant, as they directly depend on the national features in the legislation.

As to the ***proofs***, EU Directive 2004/48/EG, provides for the following possibilities: 1) to provide proofs during a legal proceeding (article 6) and 2) to provide the proofs prior to the beginning of a legal proceeding (article 7). Thus, in accordance with article 6 of EU Directive 2004/48/EG, the court within the limits of legal proceeding after the claim of one of the parties can require the proofs to be presented by the other party¹. To realize this right, a claimant is to distinctly specify the proofs to be demanded. In this part item 1 of article 6 in EU Directive 2004/48/EG coincides with conditions of item 43 of Agreements of TRIPS. At the same time, item 2 of article 6 of the indicated directive goes into a detail offence, distinguishing between

¹ In our opinion, the basic document which confirms the user's property rights (legal or physical entity) is an agreement on the result of intellectual activity. Transfer (retreat) and grant of property copyrights is done on the basis of author agreement, in a written form on the basis of the articles 1107, 427 CC of Ukraine, articles 31, 32, 33 of Law of Ukraine «On a copyright and neighbouring rights». Available civil relations between the subjects executed by making other agreements can not serve as the fact of assignment of exceptional rights. Thus, an agreement of an ordinary society is not a ground for the origin of property (exceptional) copyrights for the participant of the ordinary society, as in this agreement the substantial conditions of the author agreement about the methods of their use, territory, size of reward, etc. are not stated. Other proofs in matters about violation of property copyrights can be, for example, a playlist, an act fixing counterfeit products sale, verification act of a shop, etc.

offence in a commercial scale¹ and the offence not connected with commercial use. Consequently, in accordance with item 2 of article 6 of EU Directive 2004/48/EG, during realization of offences in a commercial scale the court can decree a decision about granting of bank, financial, trading documents by an opposite party. In this case, unlike offences, not connected with the commercial use, the documents which will be required from a credible offender may not be clearly determined (for example, financial documents concerning quantity and prices of the realized counterfeit goods, etc.).

Providing of proofs prior to the beginning of legal proceeding as an institute of judicial law and judicial method of protection of the violated copyrights in accordance with Article 7 of EU Directive 2004/48/EG was entered in the European legislation with the purpose of granting possibility to the rights holder whose rights are violated or contested to fix proofs of offence directly at the moment of committing illegal actions or in the shortest time after their commitment. Thus, the information preserved on counterfeit disks can be quickly destroyed by their heating, exposing to electric magnetic field, etc. Efficiency of application of civil legal methods of property copyrights protection directly depends on the maintainance of proofs of offences, that is why in any case it is impossible to assume elimination of illegal activity results. Article 7 of EU Directive 2004/48/EG as well as Agreement of TRIPS allows to arrest counterfeit goods, equipment, and also allows access to land plots and apartments with the purpose indicated higher. However in this article we do not specify the group of people in relation to whom backer-up proofs should be used prior to legal proceedings. In our opinion, legal proceedings should be directed against persons who actually own the proper proofs.

As A. Trunk justly remarks, application of backer-ups with a purpose of offence prevention goes beyond providing proofs or providing implementation of future court decision [11, article 127]. Article 9 of EU Directive 2004/48/EG sets general principles of

¹ In accordance with item 14 of preamble of EU Directive 2004/48/EG, on *realization of intellectual ownership rights of 29.04.2004*, offence in a commercial scale occurs when a person accomplishes illegal actions for the purpose of achievement of direct or mediated economic or commercial profit.

terms and possible maintenance of backer-up implementation of the court decision. At the same time it provides for the terms of acceptance of such facilities, without establishment of their exhaustive list. This makes possible development of such facilities of protection in the future, for example, when new methods of violations of absolute titles appear. So, backer-ups in accordance with article 9 can be applied not only against the violator of copyrights but also to the mediators. For example, internet providers can not be mediators. This exception comes out of system interpretation of normative - legal acts of EU , as legal position of these organizations is specially regulated by EU Directive of 08.06.2000 on electronic commerce which is excluded from the article of EU Directive 2004/48/EG regulation (items «a», 3 article 2) and has priority over the latter.

Judicial charges in accordance with article 14 of EU Directive 2004/48/EG are distributed by general rule proportionally to the penalty sum . At the same time, this article does not forbid to apply the principle of justice and deviate from the proportion.

Considering the domestic procedural law, it should be noted that from the point of view of the purpose of preventive measures as temporal measures CCP of Ukraine corresponds to the spirit of Agreement TRIPS, that is why in future we are going to analyse normative legal regulation and practical application of this institute from the standpoint of economic procedural law. Analysing CCP of Ukraine we are going to consider only new and interesting aspects in the legal regulation of this institute.

Thus, in accordance with part 1 of article 43 ECP of Ukraine a person who is concerned that giving necessary proofs will become impossible or difficult for him later , and believes that his rights have been violated or there is a real threat of their violation, has the right to appeal to the economic court with a claim about the use of preventive measures prior to the lawsuit. Accents have been slightly changed in CCP of Ukraine, in accordance with part 1 of article 133 persons, who take part in proceeding and believe that granting of necessary proofs is impossible or they have difficulties in presentation of these proofs, have the right to make a claim to protect these proofs.

In our opinion, the use of protective measures must be carried out with the purpose of 1) *warning on violations* of copyrights on the results of intellectual, creative activity and 2) *maintainance of proofs* of such violation.

In the international aspect, the origin of this institute goes back to article 41 in Agreement TRIPS, according to part 1 of it, the members provide that their legislation provides for procedures of intellectual ownership rights observance which allows to take effective measures directed against any violation of intellectual ownership rights . Among such measures article 41 of Agreement TRIPS provides for: 1) urgent preventive measures of legal protection against violation (procedural aspect) and 2) facilities of legal protection which is legal penalty against subsequent violations (financial aspect).

According to part 3 of article 41 of Agreement TRIPS decision in essence of the case must be based exceptionally on proofs in relation to which the party is given possibility to speak out . This norm-making agreement directly correlates with article 43 of this Agreement and is determining in subsequent development of institute of preventive proofs both in Ukraine and in other countries of Europe. In accordance with part 1 of article 43 of Agreements TRIPS, if a party has presented reasonably accessible proofs, sufficient to support the requirements , and specified the proofs related to the justification of its requirements which are under control of the opposite party , the court has the right to issue the order of court which orders granting of these proofs to the opposite party under observance of terms in the proper cases which provide protection of confidential information.

If the party of legal proceeding purposefully and without substantial reasons refuses in access to the required information or does not give it during the reasonable period of time, or considerably complicates the procedure related to the measures providing observance of rights, a member country has a right to confer the right to the law court to accept *preliminary* and final decisions, on the basis of the information given by a claimant including a complaint or statement negatively influenced by refusal in access to the information.

Thus, procedures which provide the observance of intellectual ownership rights must be *equal* and *just* (part 2 article 41 of Agreement TRIPS).

In accordance with part 1 of article 50 of Agreement TRIPS a law court has a right to issue the order of court about adoption of urgent and effective facilities, directed on: (à) prevention of violation origin of any right of intellectual ownership and, in particular, prevention of channels goods movement which are under their jurisdiction, goods , including goods imported directly after a customs clearance; (b) storage of the proper proofs related to a probable violation.

Moreover, a law court has a right to apply temporary measures of *inauditaalteraparte* when it is expedient, in particular, in cases if there is possibility that any delay will result in inevitable damage or there is a risk that proofs will be destroyed and this risk is well-proven.

Another guarantee of a just consideration of the case is possibility of the law court to demand the grant of any reasonable accessible proofs from a claimant to be sure that a claimant is 1) the rights owner 2) his right is violated or such violation is inevitable. Part 3 of article 50 of Agreement TRIPS gives possibility to require from the claimant to pay deposit or to give an equivalent guarantee which is sufficient for the rights protection of a defendant in case of illegal requirements of a plaintiff and prevention of possible abuses by the right.

Concerning the normative legal acts of EU, there are no special norms which would regulate application of preventive measures except for administrative facilities. Only in accordance with part 2 of article 8 of the Directive of the European Parliament and Council of Europe 201/29/ of 22.05.2001 on harmonization of certain aspects of copyright and neighbouring rights in informative society each member state takes measures necessary for the subjects of rights whose interests have been violated through illegal activity, executed on their territory, to make a complaint in relation to the compensation of the damage or/and to demand the act of law, and, in a proper case, confiscation of illegal material, devices, goods or components used to circumvent technical facilities of protection. Also in accordance with part 3 of article 8 of the Directive mentioned above, the member states provide conditions for the subjects of rights for requirements of the act of law against mediators whose services are used by the third person for copyright infringement.

Analysis of the articles of CCP and ECP of Ukraine concerning temporary measures has shown that there is a significant difference between them as to the types of preventive measures. In accordance with article 432 ECP of Ukraine the preventive measures include: 1) obtaining of proofs on demand ; 2) inspection of rooms in which actions related to violation of rights take place; 3) imposition of arrest on property which belongs to the person or is in his possession or in other people's possession to whom the preventive measures have been used.

Slightly different list is in part 2 of article 133 of CCP of Ukraine. Methods of proofs provision by the court are: 1) interrogation of witnesses, 2) setting of examination, 3) obtaining on demand and (or) review of proofs, including after their location. *Other ways* of proofs provision can be applied when necessary. Unlike the civil procedure, where application of other preventive measures is acceptable, in the economic legal proceeding the list of these measures is exhaustive (table 1). The Higher Economic court of Ukraine stands on the same position. In accordance with item 2 of the Informative Letter of the Higher economic court of Ukraine „On some practical issues of the use of preventive measures” of 20.04.2007 № 01-8/251 [12] the list of types of preventive measures specified in article 43² ECP of Ukraine is exhaustive.

Table 1. Comparative table of types of preventive measures according to Agreement of TRIPS, CCP and ECP of Ukraine

No	Types of preventive measures		
	As to article 50 of Agreements of TRIPS ¹	As to article 133 of CCP of Ukraine	As to article 432 of ECP of Ukraine
1	Actions directed on keeping of proofs (obtaining of proofs on demand)	Obtaining on demand and (or) review of proofs, including on their location	Obtaining of proofs on demand
2	Actions which prevent appearance of violation, including administrative measures (stopping of custom procedures)	Interrogation of witness	Imposition of arrest on property which belongs to the person or is in his possession or in other people's possession to whom the preventive measures have been used.
3		Setting of examination	Inspection of rooms in which actions related to violation of rights take place;
4		Other ways of proofs provision	

Experience of foreign countries in relation to practical application of temporary measures in accordance with Agreement TRIPS is interesting for the awareness of essence of preventive measures and peculiarities of their application.

For example, in Great Britain there exists famous practical application of decision in case of Anton Piller [13, p. 719] (*warrant of Anton Piller*), according to which search and confiscation of proofs in the apartment of a probable violator is possible according to the court decision , however in other countries such a measure is sometimes considered too difficult².

A decision in the case of the company Doorstep is considered effective for application [14, p. 252], by which way enquiries can be sent for the receipt of documents and objects without a right to get into the apartment.

Another measure, known as a decision on freezing or decision in the case of company Mareva [15, p. 509], is used to block bank accounts and other assets of the defendant, until the

¹ Agreement of TRIPS does not list any specific procedural actions , it only specifies the criteria these actions are to meet.

² Analogous to English *Anton Piller warrant* French legislation has the institute of proofs provision (*saisie-contrefaçon*).

case is not thoroughly analysed by the court in accordance with paragraph 1 of article 25 of the Law on civil procedure of Great Britain.

The legislation of France provides for effective instruments to obtain the proofs (*procedure of saisiecontrefaçon*). According to articles L-332-1, L-521-1, L615-5, L-716-7 of Code of intellectual property of France [16] a legal subject in case of exposure of counterfeit products can send a claim in relation to confiscation to a judge in the court of the first instance. Such measure can be used in the form of confiscation by description or actual confiscation of illegal goods. Similar order acts in Italy.

On the contrary, in Germany legal possibilities to obtain proofs are limited. They concern only the receipt of proofs by the receipt of statements of witnesses, certificates of experts and search, but does not spread on documents or audit of the parties. In Austria, Denmark and Sweden, unlike other countries, a decision-making order does not provide for investigation without hearing of the other party.

There are differences in traditions and approaches to application of temporary court measures between the member-states.

For example, in the Netherlands in accordance with article 289 of Law on civil procedure the simplified *procedure of kort geding* is used, which is the substitute of ordinary judicial procedure. In the case C-53/96, Rec. 1998, c. I-3603 the court had to confirm the character of a temporary measure in accordance with article 50 of Agreement TRIPS.

In Great Britain it is ordinary to apply previous court prohibition as a decisive factor in the evaluation of court decision by ability of the defendant to pay indemnification, sufficient to cover losses of the plaintiff, in case the court decision is in his favour.

In France it is possible to apply decision on temporary measures after the procedure has begun in essence, but it happens rarely enough, as, on the one hand, it is possible to make a claim as to listing or confiscation of counterfeit goods and, on the other hand, temporary measures do not allow to require indemnification of the damage.

Thus, it is possible to sum up that preventive measures are widely used in foreign countries. The character of these temporary measures meets the substantive provision of EU Directives and at the same time has the specific national differences.

Going back to the application of preventive measures procedure while securing intellectual ownership rights for the objects of copyright in Ukraine it should be noted that in accordance with articles 431, 433 ECP of Ukraine a person who believes that his rights are violated or there is a real threat of their violation, has a right to appeal to the economic court with a statement about the use of preventive measures prior to the lawsuit giving the following information : 1) the name of economic court to which the application is sent ; 2) name of the applicant and the person in relation to which preventive measures are asked for, their postal addresses; the documents which confirm the status of subject of entrepreneurial activity of a claimant-citizen; 3) type and essence of a preventive measure 4) circumstances which a claimant grounds as necessity to apply the preventive measures 5) a list of documents and other proofs which are added to the statement; 6) signature of the claimant or his representative, if handed by a representative.

The documents which confirm payment of state duty in order and amount set by the law¹ are added to the application about the use of preventive measures .

In accordance with item 4 of article 433 ECP of Ukraine petition about the use of preventive measures should contain circumstances by which a claimant grounds the necessity to use preventive measures . Such circumstances are to conform to the orders of article 43¹ ECP of Ukraine, and according to the context of item 5 of article 43³ and part 3 of article 434 ECP of Ukraine also and to confirm by the proper proofs, obtaining on demand and the estimation of which is carried out by an economic court according to general rules of ECP of

¹ It should be noted that the Act of the Cabinet of Ministers of Ukraine „On state duty” does not provide for the amount of state duty from the application on preventive measures. That is why, until such changes are made in the mentioned Act the economic court has no legal grounds to make decisions on considering such an application without movement because it was not paid as state duty (part 1 article 43⁵ ECP of Ukraine). The law does not provide for payment of expenses for information-technical maintenance of the court proceedings on application of preventive measures.

Ukraine on proofs. In particular, a claimant has to present proofs, *sufficient* for the confidence that his right is violated or inevitably will be violated as well as proofs of available right of intellectual ownership (information about registration of the right on the object of intellectual ownership right, proper legal actions, etc.). Among such proofs, for example, can be copy of counterfeit disk containing software, database or cinematographic work purchased by an author together with a check about its purchase, a copy of CD-,DVD cover, a copy of a book which has signs of imitation (change of design, off-grade paper, reformatting, etc.).

According to part 2 of article 43³ ECP of Ukraine together with a petition on the use of preventive measures its copies are distributed in accordance with the number of persons in relation to which preventive measures are asked. However, in accordance with item 14 of the Recommendations of the Presidium of the Higher economic court of Ukraine „On some practical issues of solution to disputes related to protection of intellectual ownership rights” [17] and item 5 of the Circular of the Higher economic court of Ukraine „On some issues of practical application of preventive measures” of 20.04.2007 No. 01-8/251 the norm does not make mandatory for the economic court to distribute these copies. The copies of statement can be handed to the interested persons during its consideration, carried out in accordance with article 434 ECP of Ukraine. If a person in relation to whom preventive measures are asked for did not receive copies of the proper statement or a waiver of receipt of such a copy, such situation is not an obstacle for consideration of the statement.

Part 1 of article 434 ECP of Ukraine obligates an economic court to inform the interested persons about consideration of a statement about the use of preventive measures by the court. It is necessary to note in connection with this that the information about the time and place of a statement consideration for the interested persons is carried out by an economic court by making the proper decision keeping to requirements of article 86 ECP of Ukraine, and should it be necessary - by sending a telephone message, teletype message, using electronic communication means, etc. (item 14 of Recommendations of Presidium of the Higher economic court of Ukraine from 10.06.2004 No. 04-5/1107 „On some practical issues of solution to disputes related to protection of intellectual ownership rights”).

At the same time, the important feature of consideration of the statement about the use of preventive measures is judicial possibility of its consideration without participation of a person in relation to whom such measures are asked for, in particular, if there is a possibility that any delay in the use of preventive measures will inflict irreparable harm to a claimant or there is a risk of proofs about copyright infringement being destroyed or lost. In accordance with part 2 of article 434 ECP of Ukraine the requirement about consideration of statement about the use of preventive measures without notification and participation of the person they are used in relation to, is to be grounded. For example, to completely destroy information on magnetic (optical CD-, DVD) disks it is sufficient to place them in a strong electric magnetic field. In this case it is necessary to operate instantly, without notification of the manufacturers of piracy products.

Almost similar requirements to the statement about providing of proofs are given in article 134 CCP of Ukraine in relation to civil procedure.

Taking into account concrete circumstances resulted in a statement about the use of preventive measures, the persons to which preventive measures apply are also: 1) those who possess the proof which a claimant requires to obtain ; 2) whose apartment is subject to inspection ; 3) those who own or use the property which a claimant demands to be arrested ; 4) other persons, whose rights or interested protected by law are the subject of the statement about preventive measures imposition.

In case of statement on provision of proofs prior to presentation of point of claim a claimant is to hand in a lawsuit application during ten days from the day of making decision about providing of proofs. In case of backing-away of point of claim in the noted term a person who handed in an application about providing of proofs is under an obligation to recover judicial charges, as well as losses, caused in connection with providing of proofs.

In the economic court ruling about the use of preventive measures in accordance with part 5 of article 434 ECP of Ukraine the order and method of their implementation are stated. Thus an order and method must be determined in accordance with the selected measure of prevention , *the list of which is exhaustive*.

Requirements of proofs according to Article 38 ECP of Ukraine is carried out by an economic court. Inspection of rooms where actions related to violation of copyrights and imposition of arrest on property of a person to whom the preventive measures are accepted and who himself or other persons possess the property, in accordance with part 1 of article 436 ECP of Ukraine is carried out by a state executor in an order specified by Law of Ukraine „On executive realization” (article 3, 5), on the basis of the proper economic court ruling which is an executive document.

Article 16 of Recommendations of the Presidium of the Higher economic court of Ukraine „On some issues of practical solution to disputes related to intellectual ownership rights protection” in a decision about the use of preventive measures is to specify that in the case of backing-away of the proper point of claim by a claimant in statutory ten days' term, as to part 3 of article 433 ECP of Ukraine, the preventive measure is halted in accordance with item 1 of article 439 ECP of Ukraine.

Unlike ECP of Ukraine, part 2 of article 133 CCP of Ukraine formulates the types of preventive measures as a non-exclusive list and directly provides for a court to have the right to apply other ways to provide proofs.

Article 135 of CCP of Ukraine regulates the order of consideration of statement about providing of proofs. For example, a statement about providing of proofs is examined by the court which examines the case and if a claim has not been made, – by a local general court within the limits of territorial cognizance of which law proceedings as to providing of proofs can be carried out , similar requirements as to territorial cognizance are used by economic courts in accordance with part 1 of article 434 of ECP of Ukraine.

A statement about providing of proofs is examined during *five days* from the day of its receipt with notification of the parties and other persons taking part in the case (part 2 of article 135 ECP of Ukraine) and by an economic court during a *two-day* term (part 1, of article 434 ECP of Ukraine), presence of these persons in both cases is optional. It seems that such short terms of consideration of the indicated statement fully meet the requirements of

instantaneousness of part 6, article 50 of Agreement TRIPS and are effective as they allow the persons to keep the proofs and to halt subsequent offences in the field of author law.

Subject composition of persons who are to execute the preventive measures adopted by the economic court is to be determined by the contents of the economic court ruling about the use of preventive measures .

As for the order and method of implementation of preventive measures, they are to be determined in accordance with the selected preventive measure (article 432 ECP of Ukraine) , and obtaining of proofs on demand after the rules of article 38 ECP of Ukraine is carried out by the economic court. As to the inspection of rooms in which actions related to violation of rights, and impositions of arrest on property, which belongs to the person to whom the preventive measures are accepted and who himself or other persons possess this property, it is carried out by a state executor in accordance with part 1 article 43^{6 ECP} of Ukraine in an order, statutory by Law of Ukraine „On executive realization” [18], on the basis of the proper economic court ruling which is an executive document.

As it has been mentioned above, the procedures which provide the observances of intellectual ownership rights are to be *equal and just* (part 2 article 41 of Agreement TRIPS), that is why preventive measures must be adequate. In our opinion, *adequacy of measure* prior to a claim, which is used by the economic court should be determined by its conformity to the requirements, to provide which it is used. The estimation of such conformity must be carried out by the court, in particular, taking into account correlation of rights (interest) protection of which a claimant sues, with the cost of property on which the arrest is imposed or property consequences of prohibition of a defendant to accomplish certain actions.

Therefore, an important guarantee of observance of legal titles and interests of person, against whom preventive measures are used and, simultaneously, a certain guarantee to prevent a claimant from abuse of procedural law is possibility to compensate the damage inflicted by the use of preventive measures .

For example, in accordance with article 4310 ECP of Ukraine in case of stopping of preventive measures or in case of waiver of a claimant of lawsuit, or in case when the

decisions on refusal from accepting a claim come into force ,a person to whom the preventive measures are applied , has a right on the compensation of damage inflicted by the use of these measures.

Should the claimant bring deposit to compensate the damage inflicted by the use of preventive measures , the compensation is carried out due to this deposit.

It seems that the compensation of damage must not be used automatically, as the author only suspects a certain person of committing civil offence. Moreover, for example, there are exceptions to a copyright (free use of works without the consent of the author and without payment to him a reward by libraries, educational establishments,etc.), that is why legitimacy of such exceptions will be established only during the legal proceeding of the case.

Availability of damage is to be well-proven exactly by the person, against whom were taken preventive measures . The damage is to be real , not probable and confirmed by proofs in accordance with section V „Proofs” of ECP of Ukraine, or by chapter 5 CCP of Ukraine.Compensation civil legal principles of responsibility are to cover these legal relationships in full measure.

In accordance with part 3 article 433 ECP of Ukraine after presentation of claim by a claimant *preventive measures operate as measures of security for a claim.*

Thus, it is possible to sum up that norm-creating activity of WTO directly influences on formation of legislation of Ukraine in the field of intellectual ownership rights protection. Temporary preventive measures used by courts in accordance with the orders of CCP of Ukraine and ECP of Ukraine, fully correspond to a norm and spirit of the European and world legislation.

In accordance with Directive of European Parliament and Council of Europe 2004/48/ of 29.04.2004 on provision of observance of intellectual ownership rights the circle of persons has been extended for whom a right must be determined on application of the proper measures, procedures and facilities. Apart from the subject of intellectual property rights, other persons who have the right to use intellectual ownership, organizations of collective

management, *professional organizations* whose right has been acknowledged in the set order are included here.

At the same time in accordance with Chapter 17 CC of Ukraine there always existed possibility for professional organizations to present interests of intellectual property subjects that could be carried out on the basis of regulation positions of such organizations or the institute of representative office.

From the analysis of article 7 of Directive of European Parliament and Council of Europe 2004/48/ of 29.04.2004 on provision of observance of intellectual ownership rights it is seen that it is based on positions of article 43 of Agreements of TRIPS and determines the necessity to provide the decision –making on demand of one of the parties about granting the proofs which have a substantial value for the case in violation of intellectual ownership rights, and are in possession of the other party without harm to protection of information confidentiality. Moreover, on the request of one of the parties the court can decree a decision about the transmission of bank, financial or commercial documents which the opposite party possess without harm for protection of information confidentiality.

Positions stated are likely to correspond to article 137 CCP of Ukraine and article 38 ECP of Ukraine as to obtaining proofs on demand. At the same time neither CCP of Ukraine nor ECP of Ukraine directly determines the proper mechanisms of maintainance of confidentiality of such proofs. Closed consideration of the case is allowed when it concerns protection of state, commercial or bank secret, or when the parties or one of the parties require reasonably proved confidential consideration of the case (article 44 ECP of Ukraine, part 3, article 6 of CCP of Ukraine). In relation to the obligations of the party which has learn the information containing a commercial or bank secret, in our opinion, it is expedient that the court should warn the parties of prohibition of such information distribution, as well as about responsibility for the illegal distribution of such secret. During the publication of court decisions on demand of one of the parties the information which contains a bank and commercial secret can be not published, but decision can be published partly.

As to the cognizance of the noted statements, it should be noted that jurisdiction of courts in relation to civil and commercial disputes is determined in accordance with the Brussel convention of 1968 [19] in accordance with the latter, if a defendant is not a domicile in the member- state, the jurisdiction is determined by a national law of every member-state. In relation to delict or quazi-delict ,according to article 5(3) of the Convention disputes are to be determined by the court of the place where the damage took place . This specified rule is an alternative for a plaintiff who in accordance with article 2 of the Convention can give a lawsuit in the court of the member-state where a domicile is defendant.

It should be noted that the maintainance of proofs in the version of Agreement TRIPS differs in contents from providing of proofs in CPK of Ukraine. For example, article 50 of Agreement TRIPS, has been developed in article 7 of the Directive of European Parliament and Council of Europe 2004/48/ of 29.04.2004 about observance of intellectual ownership rights. Under the maintainance of proofs this article means description with an exception or without the exception of standards, confiscation of goods , materials and instruments used in their production, documents related to them. Such actions are closer to the kinds of lawsuit provision specified by CPK of Ukraine. The only thing that coincides with such actions from the ways of proofs provision is inspection of proofs, including after their location. CPK of Ukraine determines at the same time, that the court can use other ways to secure the proofs which enables to make a decision about the withdrawal of samples, etc., however without granting of deposit or other guarantees by a plaintiff and without the compensation of damage by a plaintiff in connection with the groundless provision of proofs.

Besides, contradictory to article 50(4) of Agreement TRIPS, CCP of Ukraine does not provide for the immediate notification of the party, whose interests it concerns, about the adopted measures to provide the proofs, when a statement about providing of proofs is examined without the notification of the person in relation to whom providing measures are asked for.

It is expedient to complement article 151 „Ground for security of a claim” of CCP of Ukraine by position in relation to introduction of security for a claim in the cases of violations

prevention of intellectual ownership right . Such addition, on the other hand, would be realization of article 432 CC of Ukraine as to the possibility of the court to make a decision about application of immediate measures to prevent violation of intellectual ownership right in cases and order set by the law.

It is possible to conclude that the orientation of Ukraine to the law of EU and World Trade Organization becomes the substantial factor in the development of its legislation. In the process of harmonization of domestic legislation in the field of intellectual property right it is possible to determine the following directions: 1) harmonization in the direction of intellectual ownership right of EU; 2) harmonization in the direction of Worldwide organization of intellectual property; 3) harmonization in the direction of World Trade Organization.

The right to protect intellectual ownership on the object of copyright is an independent equitable civil right, which exists regardless of other equitable civil rights and is the measure of the settled conduct of the authorized person, which is expressed in the possibility independently or through jurisdiction organs to apply measures of influence in relation to the obliged person set in the law or in an agreement, with the purpose of removal of obstacles in realization of equitable right on work, its returning to the original state, as well as proceeding in a right or indemnification of the inflicted damage .Legal purpose of the right to protection is legislatively stated possibility of feasance of both actual and legal actions, directed on prevention or stopping of offence and in case of negative for the rights holders consequences, is renewal or indemnifications of the inflicted damage . The right to protection should not depend on the offensive occurrence .

Protection of intellectual ownership rights on the work as an object of copyright is a legitimate activity of proprietors of the personal and exceptional (property) rights on work within the limits of regulatory or protected civil legal relationship on unimpeded realization by stopping of direct or indirect offence or threat of such violation by the civil legal methods of protection.

Temporary preventive measures which are used by the courts in accordance with the orders of CCP of Ukraine and ECP of Ukraine fully correspond to the norm and spirit of the European and world legislation.

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Tomasz Gulla

“Report on insurance frauds in Poland (2009)”

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Mr. Gulla founded Printpol.pl, a legal-insurance website, and since 2008 he has served as its editor-in-chief. He has been interested in the field of insurance for eight years, and has conducted research on insurance fraud for four years. In Poland, he is the author of the first reports on: - “Insurance on the Internet” (2003); and “Insurance frauds – social aspects” (2007) – this report has been published during X International Conference “Insurance Offense” in Szczecin in 2007, in “Insurance Newspaper” and in a monthly magazine “Law Insurance Reinsurance”.

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Report on insurance frauds in Poland (2009)

(reprint in Gazeta Ubezpieczeniowa nr 17/2007 and PUR 5/2007)

Tomasz Gulla

Translation by Sławomir Witkowski

I. Introduction

As a result of the insurance market opening, new insurance companies are still arriving in Poland, along with their services, but unfortunately, so do the ways of illegal profiting from them. Globalization, beside its positive features for the national economy, brings about new procedures intended for illegal profiting from financial services.

Insurance frauds are not only an economic or legal problem but a social problem as well. The phenomenon of frauds in the insurance sector is not a new one, but taking into account an increase in importance of insurance activity in Poland, it is becoming a serious problem.

From my personal observations and appropriate research it can be concluded that this problem constitutes a taboo subject in Poland, including the insurance companies that fell victims to such frauds. The reactions of those companies are sometimes disproportionate to scope of the phenomenon. There are, of course, insurance companies which established special branches for discovering and counteracting the swindling of indemnities, but the majority of them do not wish to disclose such topics to the public for fear of damaging the company's image. There may be some logic in such attitude, because it is improbable that an average client would trust a firm that was defrauded, but on the other hand, does not this connivance of such illegal activities raise doubts concerning public trust for these institutions?

In the present elaboration I have put forward Polish legislation concerning legal protection of insurance market with particular exposition of penalty pertaining insurance frauds. (Chapter II) Chapter III depicts the scale insurance criminality occurrences in Poland., while in chapter IV of the said elaboration I included the results of my related research, which had been carried out by means of the Internet, where the poll appeared between 10th

November 2006 and 10th January 2007 on the Insurance Service Website “Printpol.pl”. The number of poll answers from polled persons amounted to 1023. The obtained group of respondents did not constitute any representative group, nevertheless the acquired results lay the foundation for an outline of the necessary measures which should be undertaken to continue such research in the future.

Taking into account the complexity of the problem as well as the necessity of continual improvements of research methods and relevant tools, such research, in their essence, act as pilot research, and, for this reason, the results could be interpreted as guideline data, only. The aim of the conducted research was the attempt to answer the question: which factors motivate the persons beguiling undue or illegally increased compensation from insurance companies, as well as the extent of the occurrence and its alleged acceptance among the said respondents.

II. Insurance fraud in the Polish legal system

Unfortunately, the offences committed in the field of insurance fraud are not homogeneous, although in practise the action of obtaining compensation under false pretences attracts attention the most, also in the Polish criminal law, according to which insurance frauds are counted among the most important business frauds mentioned in the Polish Penal Code (Art. 298¹ of the Penal Code), while other offences against the insurance market are included in the Act of Insurance Activity².

The subject of the argument is still the content and scope of the definition of insurance crime itself. There is still no uniform definition in Poland, but there is a possibility to make use of materials, which were handed over to the Polish Chamber of Insurance by the European Insurance Committee (CEA) in Paris in 1994. According to the CEA an insurance

¹ „Art. 298 § 1 Whoever, in order to obtain compensation under an insurance contract, causes an event which provides grounds for a compensation payment shall be subject to the penalty of deprivation of liberty for a term of between 3 months and 5 years.

§ 2 Who had voluntarily prevented the payment of compensation, prior to instituting criminal proceedings, shall not be liable to punishment.

² See T. Oczkowski, *Frauds as property and economic offenses*, Cracow 2004, p. 168-169.

crime is a groundless claim for compensation or the receipt of compensation by way of fraud.

The CEA materials group the types of insurance crime into several categories:

- multiple insurance of one object in several insurance companies with the aim of claiming multiple compensations for one and the same damage;
- overinsurance, i.e. the amount of insurance exceeds the insured property's true value;
- withholding information – for various reasons, e.g. with the aim of paying a lower insurance fee;
- „backward insurance”, i.e. signing an insurance policy after damage has occurred (post factum);
- false damage, i.e. claiming compensation for damage that did not arise;
- causing damage by design;
- crimes committed during claims settlement, e.g. overstating the value of lost or damaged property;

Only the Trade Protection Act introduced the offence of insurance fraud into the Polish law in 1994, although attempts to introduce this offence into the Penalty Code were made already in 1932; eventually, the attempts were abandoned, although the offence appeared in the current Penalty Codes of the invaders.

Art. 298 of the Polish Penal Code states that all actions leading to the event of obtaining compensation under false pretences, thereby obtaining personal financial gain by disposing of an insurance company's property, to be criminal¹. The aim of this statement is to restrict the number of confidence games and protect potential victims from potential loss. All social and business insurances, compulsory or otherwise, made by a natural or legal person, now fall under legal protection.

The essence of the aspect of the offence as to the deed of insurance fraud is the act of

¹ See O. Gorniok, R. Zawlocki, The Penal Code – special part, comment, volume III, Warsaw 2004, p. 1195.

causing the event that is to be the basis of the insurance claim, as stated in the insurance contract¹.

A previously signed insurance contract is the necessary basis for bringing the culprit to justice for committing an insurance fraud.

According to the Polish legal system, the offence of committing an insurance fraud equals a substantive offence and is to be understood as such, due to the result of it being the causing of an event that is the basis of the insurance claim. The existence of such an offence is not dependent on the payment of compensation, or on the fact of making the demand for compensation.

The offence of committing an insurance fraud can fall, by convergence, under other regulations, usually under the regulations on protection of goods, to which events caused by the culprit aiming at claiming compensation on account of the contract pose a serious threat².

Legislator in the Article 298 paragraph 2 of the Criminal Code introduced special clause of active repentance, which guarantees perpetrator the impunity of committed act, but on condition that there is voluntary prevention from paying compensation before initiation of criminal proceedings. Active repentance has to be voluntary, if it is forced by circumstances or actions of other people, perpetrator is not eligible for impunity³. Such an example of prevention from paying compensation may be a withdrawal of the application for paying compensation or not taking the awarded compensation.

III. The scope of the phenomenon

The number of insurance crimes in Poland still has not been determined, in spite of such attempts, which have been intensified after year 2000. It concerns insurance companies and procedural authorities. Knowledge about mechanisms of cadging and deceiving is necessary, because only then can we speak about effectively counteracting criminal acts.

¹ See A. Marek, A comment to the Penal Code. Special part. Warsaw 2000, p.340.

² See K. Buczkowski, Economic offenses, Warsaw 2000, p. 41.

³ See Lech Gardocki, Crime Law, Warsaw 2002, p. 106.

The present proportions of this type of crime in Poland is difficult to estimate because, on the one hand, some cases not always can be classified as a crime or offence, on the other hand, the insurance company itself does not want to disclose this type of data. Another factor is the lack of relevant statistics, as well as detailed research on this subject. Some attempts at estimating this type of crime are made by, inter alia, the Polish Chamber of Insurance. It is estimated that in Western countries as many as about 15% paid compensations and about 8% paid benefits are independent benefits and compensations.

Estimations concerning the scale of insurance crime phenomena in Poland are discrepant and they reach from several to 50% paid compensations and benefits. Some Polish experts think that only 1% of frauds is disclosed.

Conducted analyses show that about 80% of disclosed crimes concern the motor insurance sector.

Figure 1. Art. 298 of the Penal Code – insurance offense

Year	2003	2004	2005
- instituted legal proceedings in general	236	208	148
- finished legal proceedings in general	201	197	188
- stated legal proceedings in general	178	125	162
- suspects	248	124	161

Source: Economic Crime Bureau in Polish National Police

Figure 2. Insurance offences committed between 2003-2004 with the division on the subject matter of offence and the perpetrator

Perpetrator	Type of an offence (type of insurance)	Number		Sum (thousand zlotys)		Average sum of offense (thousand zlotys)	
		2003	2004	2003	2004	2003	2004
Customers of the Insurance Companies	Motor insurance	2 791	1 700	16 741	15 457	6,0	9,1
	Collision coverage	853	896	11 151	14 450	13,1	16,1
	Insurance against fire and other elements	49	134	3 188	15 647	65,1	116,8
	Burglary insurance	109	47	8 779	6 188	80,5	131,7
	House insurance	29	29	386	538	13,3	18,6
	Agricultural insurance	33	106	159	901	4,8	8,5
	Other types of insurance	166	284	12 617	10 653	76,0	37,5
Employees or agents	Defalcation of insurance	319	150	19 340	4 388	60,6	29,3
	other acts	73	82	837	468	11,5	5,7
Total		4 422	3 428	73 198	68 690	16,6	20

Source: An analysis of information concerning disclosed offences in 2004 connected with the insurance companies' activity – members of the Polish Chamber of Insurance, Warsaw 2005

Contrary to what one may believe, police statistics do not fully reflect the actual state of matters. They only reflect certain phenomena, failing to show the “dark number” of crimes that according to estimates stands at over 66% of the crimes that are not reported to prosecuting authorities. In the EU, the figure does not exceed 50%.

In the Polish reality, one may notice the absence of forecasts regarding the development of insurance crime and it may be indirectly linked to the collapse of the system

fighting this type of crime. Therefore, it will be necessary to rely on the experience of countries with longer insurance traditions, as they have recognised the fraudulent obtaining of undue compensation as a grave problem and have systematically developed forms and methods of disclosing insurance fraud.

At present, developing a far-reaching strategy consisting of setting and defining tasks related to the prevention and detection of insurance crime is of prime importance. However, one may create certain general guidelines for insurance companies and other market protection bodies, which do not require changes in legislation and which will be of help in combating insurance crime. In my view, one should establish a centre that would coordinate activities of insurance companies and that would deal with the problem in a professional manner and, further, in all such companies one should create units implementing preventive measures and detecting fraud.

Insurance companies are businesses and not public entities and as such they are not obliged by law to prosecute economic crimes. Yet, they have the greatest potential to expose such crimes.

I believe that the most important factor that significantly affects the phenomenon under analysis is the atmosphere of social disapproval. Unfortunately, there is no research data and following my unreliable intuition only, I get the impression that some types of insurance crime are not socially stigmatised, and they are not even regarded as contemptible. Some representatives of public opinion believe that obtaining an unduly high or even an undue compensation payment is tantamount to “resourcefulness” rather than a criminal offence. Those who adopt this view seem not to understand that this “resourcefulness” translates also into higher insurance premiums that they have to pay.

We must underline the enormous role of signs indicating the possibility of the commitment of a crime in the process of detecting insurance crimes. Knowing the signs enables, from the outset, to properly classify information reported in an insurance claim, with a view to checking whether the procedure is not aimed at a fraudulent procurement of compensation or any other type of benefit.

Figure 3. The most common universal symptoms of insurance offense

Universal Symptoms
<ul style="list-style-type: none">- the raising of a claim shortly after the conclusion of the insurance contract or after the increase or change of its conditions;- disclosed material evidence does not confirm the losses reported by the insured;- the original documents submitted by the insured are considered to have been altered (specifically dates, descriptions or amount of money);- former assertion of similar claims concerning the occurrence of the same type;- the submitted bills (of examinations, repairs, treatment, etc.) considerably exceed the scope of the documented losses;- the pure submission of the photocopied documents in conjunction with the application for indemnity;- the submission of bills which confirms the purchase of lost objects or services carried out, prepared on the forms which a shop or a company do not use;- the demonstration of superaverage knowledge within the scope of insurance rules and the procedure of lodging claims, taking into consideration ineffectual documentary evidence concerning the application for indemnity;- the amount of the claim submitted to the insurance company is markedly different from the amount of losses reported to the police;- the expense of lost or damaged property which is the subject of the claim for indemnity, seems to exceed the financial capabilities of the insured within a period of the alleged purchase of this property;- the difficulties to answer routine questions connected with the application for indemnity submitted ;- the insured had previously asked his insurance agent numerous hypothetical and detailed questions regarding the occurrence similar to the one that has already been reported;- the aim of the insured to reach a prompt agreement with the insurer;- the existence of a motive, in other words financial difficulties (personal, marital or business problems).

Source: H. Kolecki, Warning signals (symptoms) indicating the possible cases of fraudulent claims for damages, „Law Insurances, Reinsurance – special edition 1998, no. 12

Figure 4. The most common specific symptoms of insurance offense

Specific Symptoms
<ul style="list-style-type: none"> - the lack of traces and material evidence showing that the security device of a room, object where the burglary took place has been overcome; - the bills submitted by the insured originating from the same place, are dated in different order than it is specified in the numbering of his/her bill or they are handwritten, while the handwriting and signatures coincide with the handwriting of the insured; - the price of the stolen object specified on the submitted bill does not correspond to its value specified in seller's price list; - the submitted list of objects stolen as a result of reported theft includes an extensive register of the recently purchased high-quality equipment, simultaneously the insured is not able to submit bills, invoices, operating manual or any other documents confirming the previous purchase of this equipment; - the amount of VAT specified on the bill submitted does not correspond to the price of the property or tax rate legally binding on the day the bill was issued; - the lack of standard stamps such as „paid”, „received” or other similar designation on the submitted bills, invoices, shipping documents, etc; - the statement of the insured that, as a result of the burglary, the damaged security device or property were thrown away, considering its uselessness, and where it was necessary replacing them – it is impossible to submit it to the appraiser who would then be able to appraise the motion; - the submission of the full and exhaustive list of all stolen objects on the day of the burglary or shortly afterwards as well as the report of a theft to the police.

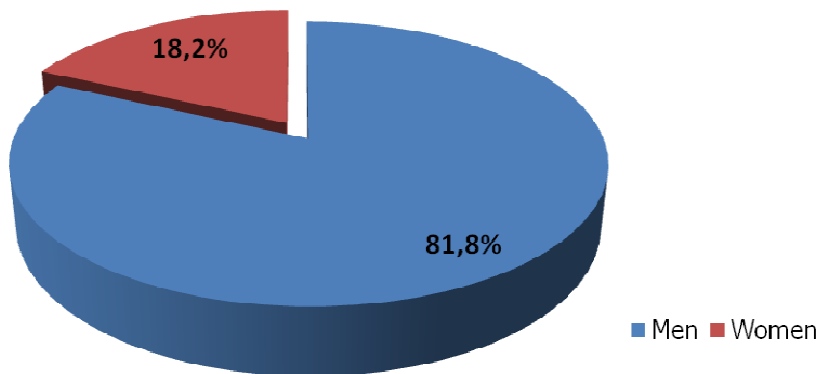
Source: H. Kolecki, Warning signals (symptoms) indicating the possible cases of fraudulent claims for damages, „Law Insurances, Reinsurance – special edition 1998, no. 12

IV. Results and analysis of the survey

1. Description of respondents

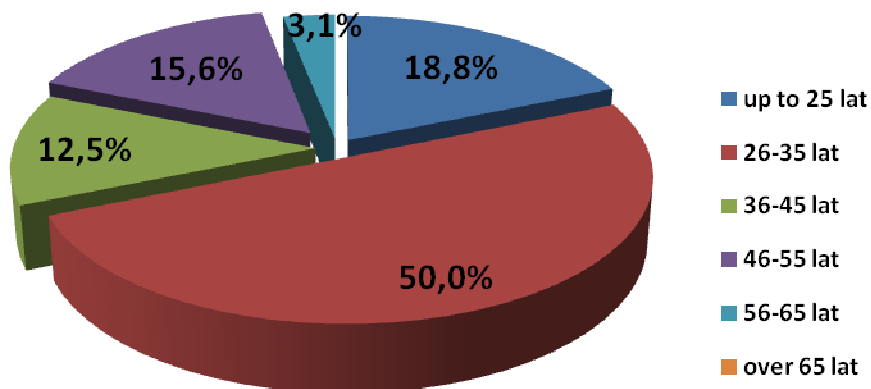
The survey was online in the period from 10th November 2006 till 10th January 2007 on the Printpol.pl website and concerned the population inhabiting the territory of Poland. The number of the respondents amounted to 1023 people. Men in the age from 26 to 35 were mainly the ones who took part in the survey (82 %). Below, there is a detailed sample distribution.

Diagram 1. Sex of respondents



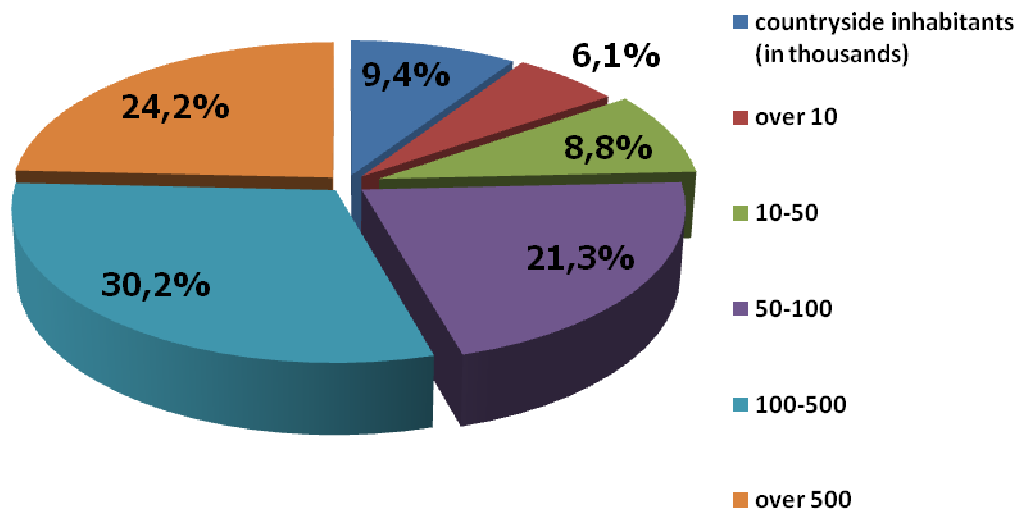
Source: my own elaboration

Diagram 2. Age of respondents



Source: my own elaboration

Diagram 3. Respondents' domicile



Source: my own elaboration

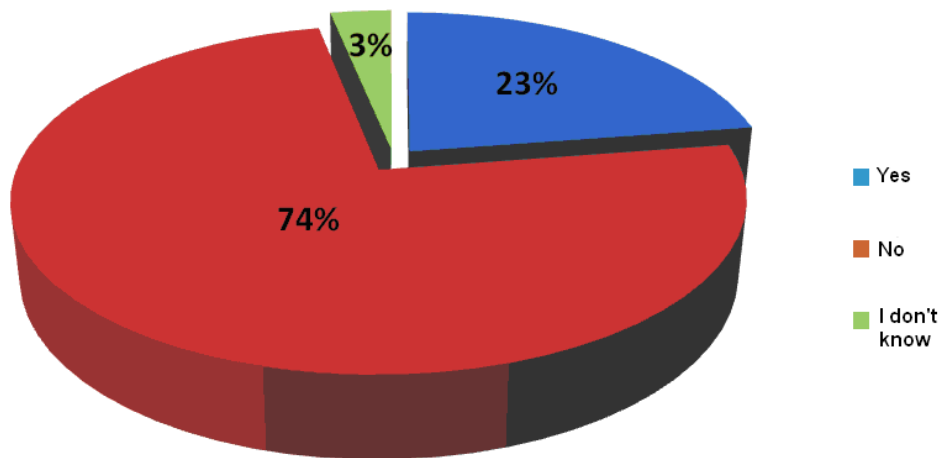
2. An analysis of studies

In the following report it is essential to quote the opinion of one of the respondents stating that „people are constantly deceived by insurance companies, the compensations they receive are underrated, they must struggle for their rights in courts. Additionally, the emotional aspect of taking revenge on the thief, who is the insurance company, comes into play. The deceiving to the deceiver, in the subjective opinion of the person who deceives, loses the traits of dishonesty”. These and other similar opinions appeared in the questionnaire frequently enough.

The majority of the respondents assessed the amount of the paid compensations to be on the medium level (60,6%), whereas $\frac{1}{4}$ on the low level, only 9,1% considered them to be high (diagram 5). The following question arises: whether the insurance companies, in fact, pursue the refusal policy or underrate the real compensation amount? If so, what influence does it have on the discussed occurrence? Unfortunately, on more than one occasion, I

encountered a lot of prerequisites which could confirm „de facto” such practices by some (if not the majority) of the insurance companies. Therefore ,in 2008, I performed the following studies, which focused this time on damage elimination process executed by insurance companies. The respondents (74%) point at the lack of objectivity while estimating the damage by the insurance company (draft 4).

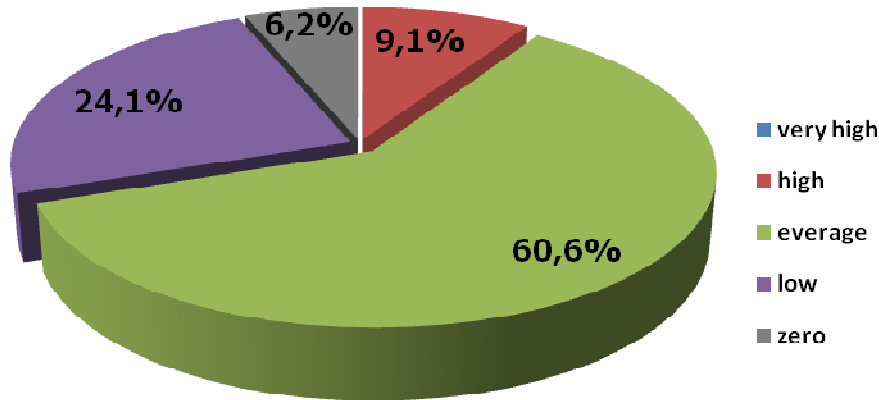
Diagram 4. Did the insurance company make an objective valuation of a damage?



Source: T. Gulla, „Report – process of damages liquidation in Poland”, 2009

The regular functioning of each economic system is based on mutual confidence of the entities creating this system. The appearance of deceptions causes everyone to be treated as a potential „deceiver” which after a while leads to the degradation of the whole social system. Thus, the possible pursuing of such a strategy by insurance companies may be the sign of losing confidence in their customers.

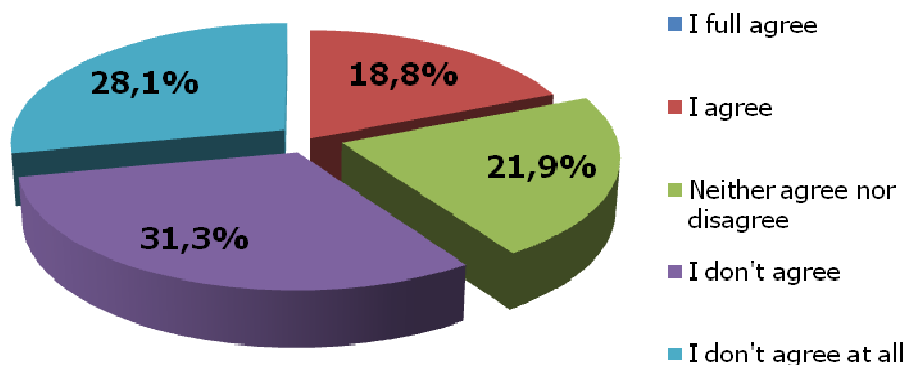
Diagram 5. An opinion of respondents about the amount of damages paid by insurance companies



Source: my own elaboration

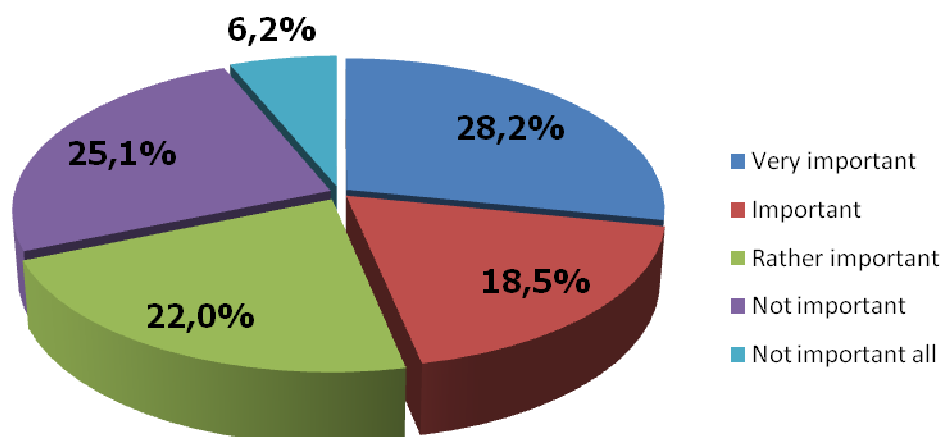
Although the majority of respondents, it is necessary to mention, do not associate the resourcefulness in obtaining inflated or undue compensation with a positive feature (graph 6). The majority of them claim also, that nevertheless, insurance companies care about reducing the insurance fraud phenomenon (graph 7).

Diagram 6: An opinion of respondents about the statement – ‘One who gains inflated or independent damage is a resourceful person’.



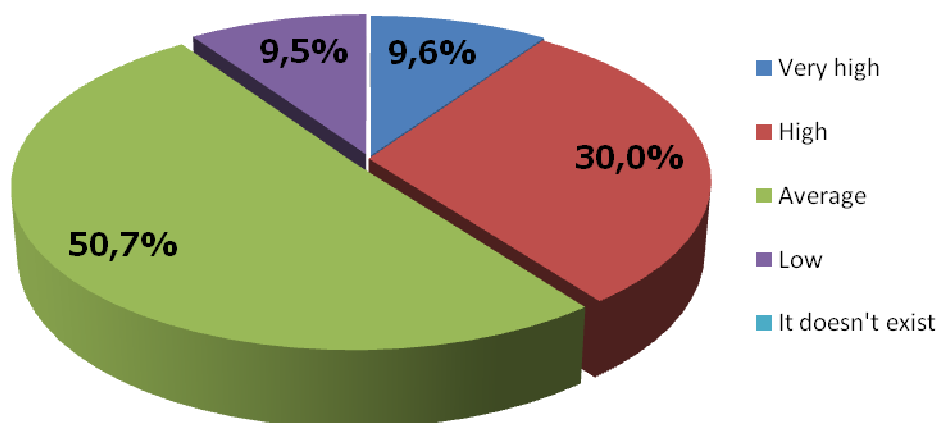
Source: my own elaboration

Diagram 7. The limitation of the problem of damages beguilement by insurance companies according to the opinion of respondents.



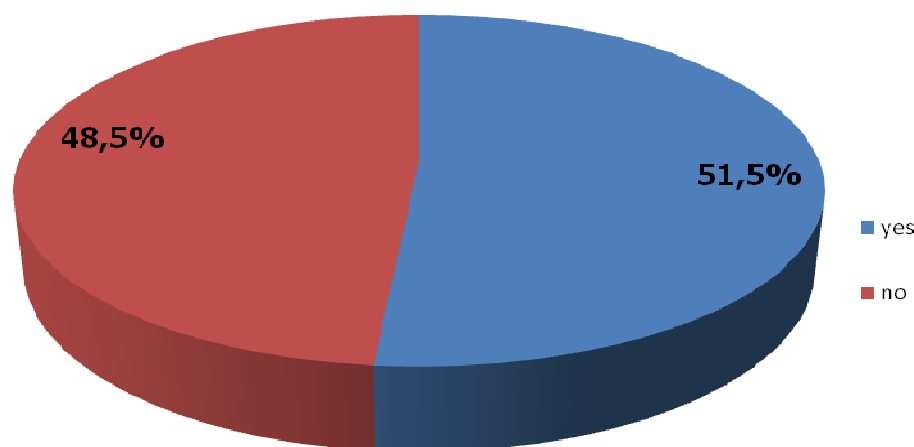
Source: my own elaboration

Diagram 8. The problem of occurrence of insurance offenses in Poland according to respondents' opinion.



Source: my own elaboration

Diagram 9. Percentage of people who confirmed that they know a person who wheedled damage from an insurance company.



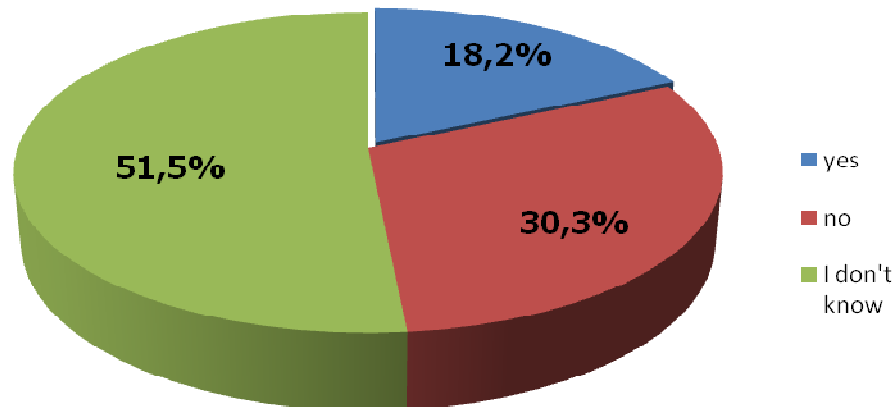
Source: my own elaboration

Another alarming observation appearing after the analysis of the collected data (graph 10) is the group of 51,5 per cent of people who do not present any opinion concerning informing certain organs about the act of beguilement of undue compensation. Only 18,2 per cent of people would inform about this fact: the victim - the insurance company (63,3 per cent); the penal prosecution agency (31,6 per cent) or both penal prosecution agency and insurance company (5,1 per cent) (graph 11).

Can we then consider the Polish society a passive one against the manifestation of breaking the law? Actually, it is difficult to answer the above question, even concerning the criminological investigation, since we react differently to violation of norms in case of a crime, and differently in case of a misdemeanor. Another factor, which may affect such passive attitude of the society is the victim, who is - by the perpetrators - always associated with a great financial institution dealing with millions of zlotys. For such institutions a loss of several thousand zlotys is hardly noticeable.

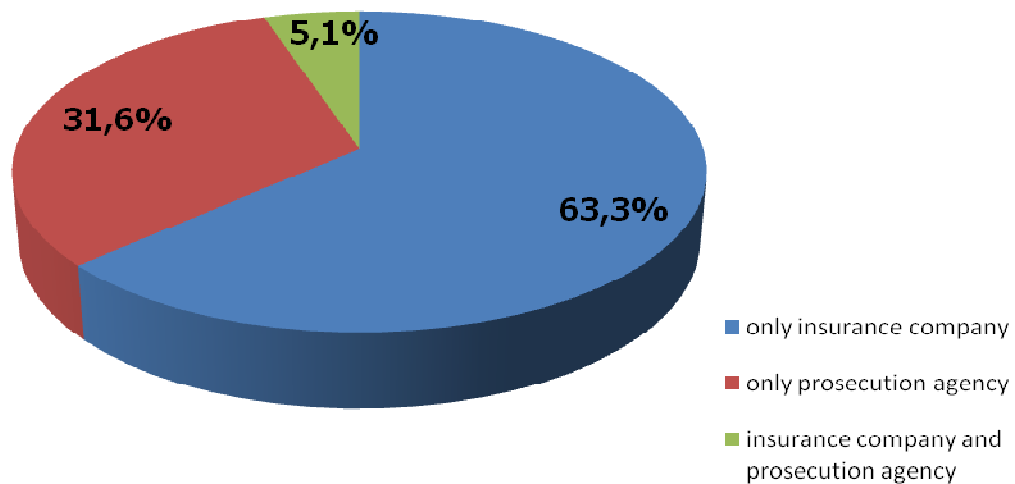
In my opinion, the act of insurance fraud is perceived by the society as an act of little importance. On its own, it does not deserve such active opposing like - among other things - informing appropriate authorities.

Diagram 10. Percentage of people who informed appropriate authorities about the damages beguilement.



Source: my own elaboration

Diagram 11. Institutions which the respondents would inform/notify when having information about a possible insurance offense.

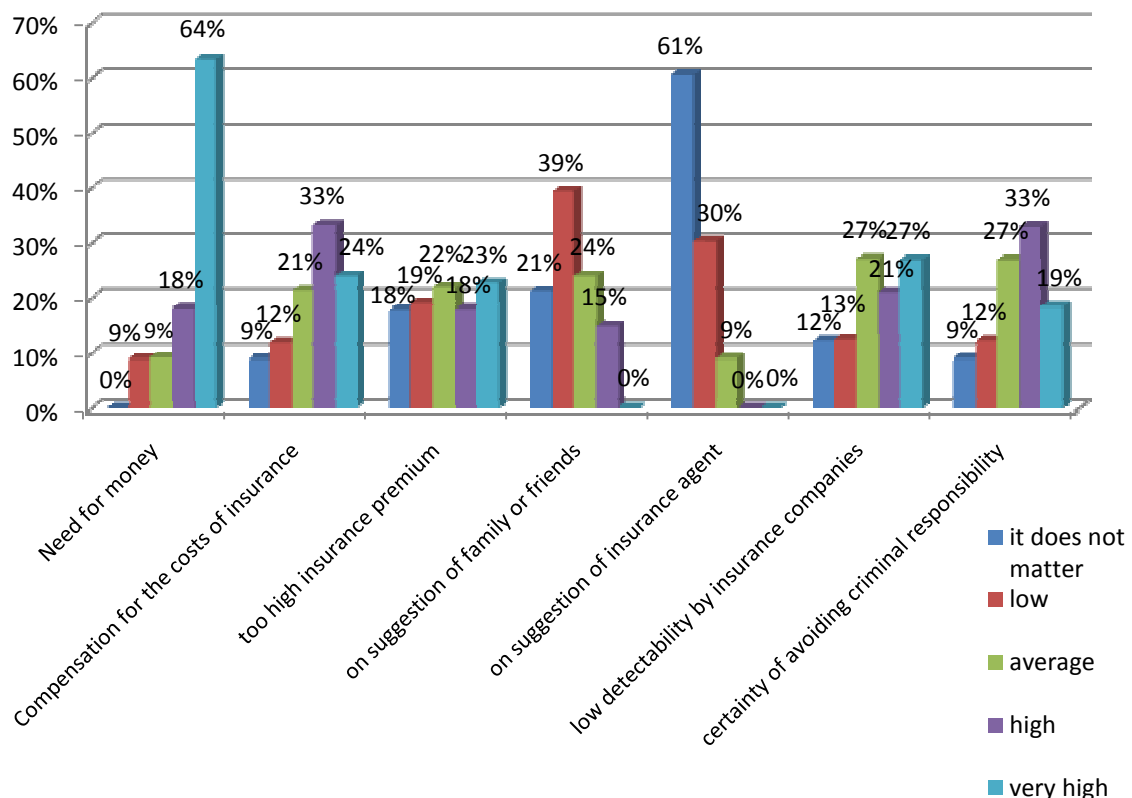


Source: my own elaboration

The most common reason for obtaining inflated or undue compensation is the economic aspect, which is seen in either the need of money or insurance charges

compensation (graph 12). Relying on dependence exchange theory¹ we can classify - as one of the factors conditioning taking up obtaining inflated or undue compensation - the relation between the scale of possible punishment (an act of insurance fraud is liable to a penalty of 3 months to 5 years imprisonment, according to paragraph 298 section 1 of the penal code) and the expected reward. Almost 50 per cent of the respondents account the low level of detection rate of such actions for important and causative action. The sense of impunity may stem from two reasons: the conviction of high effectiveness of one's actions and, consequently - from the helplessness of social control systems. It is confirmed by only 18 per cent of respondents who declared the willingness to inform the victim – the insurance company or prosecution agency about the insurance fraud.

Diagram 12. The significance of reasons which have influence on committing insurance offenses.

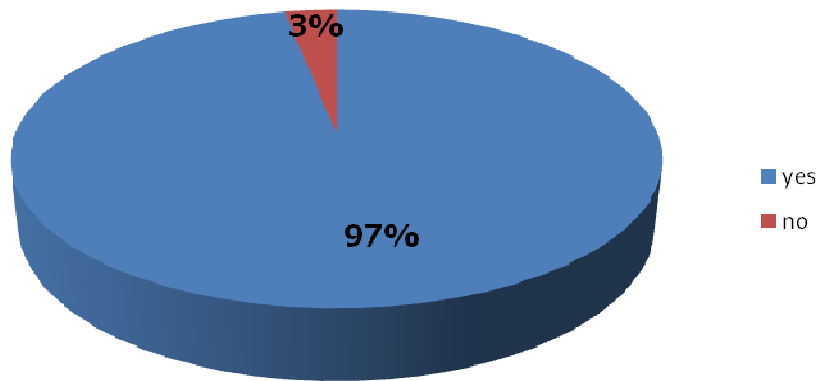


Source: my own elaboration

¹ B. Hołyst, Criminalistic psychology, p.467, Warsaw 2006.

What is surprising is the fact that 3% of poll respondents stated that an insurance offense is not a crime.

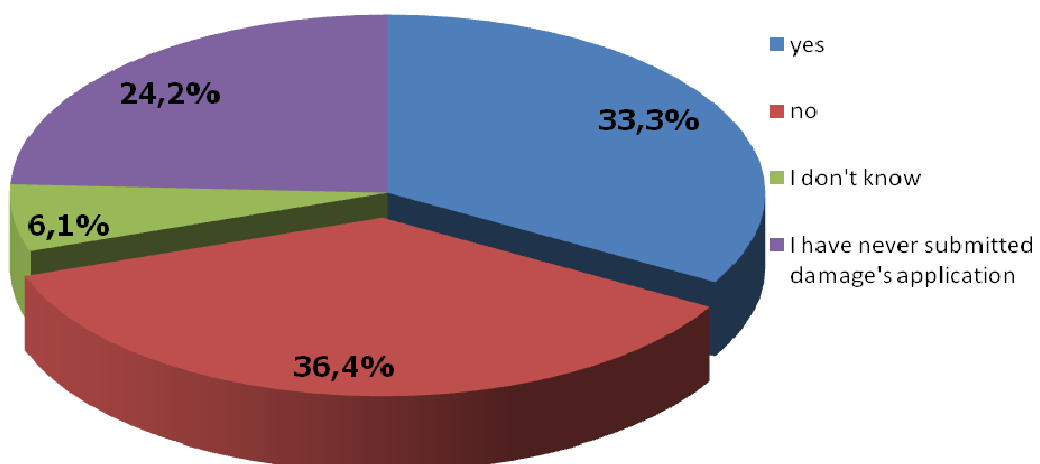
Diagram 13. Respondents' opinion about the question: Is insurance offense a crime?



Source: my own elaboration

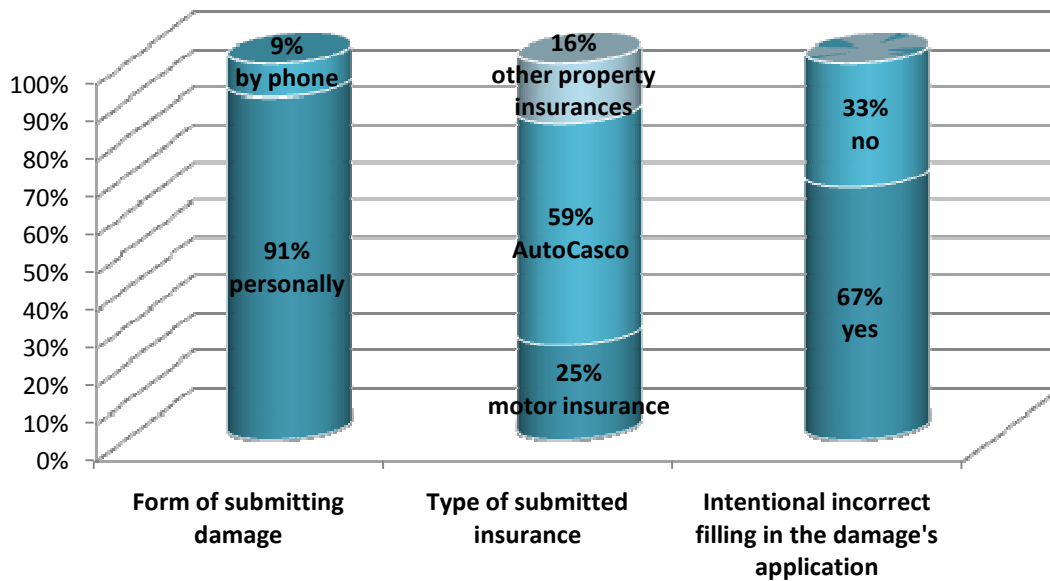
Although respondents know that by committing an insurance offence one can be punished (diagram 14), 24% of them admitted to the purposeful misleading the insurance company when reporting damage which concerned mainly motor insurances (motor insurance [OC] and collision coverage[autocasco]).

Diagram 14. Truthful filling of application forms when reporting a damage.



Source: my own elaboration

Diagram 15. Detailing the scope of submitted damages by people who filled the application forms incorrectly.



Source: my own elaboration

V. Summary

The aim of this report was to depict the phenomenon of insurance crime in Poland with emphasis put on the beguilement of undue compensation being one of the most serious problems affecting insurance companies nowadays. Among the factors that had significant influence on this trend were the development of market economy and the appearance of many insurance companies which, through their passive attitude, indirectly contribute to the increase of insurance crime in Poland. Even though some of the companies have already commenced the fight against insurance crime and achieved success, it will be impossible to win this war without consolidating the whole milieu.

In the future, more sophisticated methods of beguiling undue compensations may gradually be expected, as may the significance of organized international criminal groups. Since this is the case, a question of when insurance crime is going to be finally treated

seriously may arise and it was partially answered by the hereby pilot study concerning social acceptance of the aforementioned phenomenon.

Insurance crime ought to be counteracted through the increase of social awareness of the fact that insurance fraud does not stand for the resourcefulness of a person beguiling undue compensation, but a crime threatening both the interest of a given insurance company as well as its clients’.

Finally, we ought to bear in mind that social approval or even tolerance for this type of economic crime creates a social climate which will be difficult to change afterwards.

Student notes

Marta Flis

**“Institution of The Crown Witness In Poland On The Basis Of
The Crown Witness Act of June 25 1997”**

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Institution of The Crown Witness In Poland On The Basis Of The Crown Witness Act of June 25 1997

Marta Flis

Genesis of the crown witness institution.

The process of a political transformation, initiated in Poland in 1989, was marked not only by the increase of social consciousness as well as deep social and economic transformations, but also by a sudden development of pathological phenomena, especially of organized crime. Rapid and high rise in the unemployment, mass arrivals of foreigners, facilitated access to arms, developing mobile and internet communication created favourable conditions for this situation. Unfortunately, at that time, Polish law enforcement bodies did not have a proper equipment or experience at their disposal and, most importantly, no appropriate legal solutions allowing an effective fight against those phenomena functioned. However, quite soon a series of organizational and legal actions have been taken, which allowed an effective fight against a pathology of this kind. Inter alia, the police has been vested with powers to practice controlled purchase, bribe and delivery¹; an amendment to the Penal Code has been introduced; the Code of Criminal Procedure has been amended and an institution of an incognito witness has been introduced²; the Customs and Internal Revenue Service have been vested with the power to take operation character actions. Moreover, on June 25 1997 the Crown Witness Act³ has been passed, effective September 1 1998. Initially, the act was supposed to be temporary in character and to be in force until September 1 2006, but the Act of July 22 2006⁴ has extended its effect indefinitely. In the justification of the draft amendment to the Crown Witness Act it has been stated that, inter alia, the previous practices of the law enforcement bodies and of the courts have demonstrated the usefulness of

¹ Dziennik Ustaw (Journal of Laws) No. 104 of 1995, item 515

² Dz.U. No. 126 of 1996, item 444

³ Dz.U. No. 114 of 1997, item 738

⁴ Dz.U. No. of 2006

the crown witness institution for combating organized crime. Thanks to this institution, numerous gangs have been broken up and their leaders, as well as members, have been sentenced, which previously was not possible due to the conspiracy of silence and the criminal solidarity.

Definition of the crown witness

The early articles of the Act contain the definition of the crown witness, being the accomplice in a crime defined enumeratively in Art. 1 of the Crown Witness Act, who is simultaneously the suspect, towards whom a ruling on levelling the charges has been issued (or without issuing such a ruling, a charge in connection with setting about the interrogation has been levelled – Art. 71 § 1 of the Code of Criminal Procedure¹), who shall be admitted to giving testimony in the capacity of witness against other accomplices, in return for exempting him from being liable to punishment for the committed crimes, which he took part in, and which he, as the crown witness, revealed according to the rules determined in the Act.

Positive and negative prerequisites for granting the status of the crown witness.

Positive prerequisites for granting one the status of the crown witness have been enumerated in Art. 1 of the Crown Witness Act by means of giving a closed catalogue of crimes, in the combating of which, in the opinion of the legislator, the institution of the crown witness might have applications. Those crimes are, inter alia, homicide, assassination of a president, causing a fire or a disaster, slave trade, criminal coercion, theft with assault, illegal possession of firearms and many others. Art. 3 of the Crown Witness Act formulates two subsequent prerequisites that are compulsory in character and that have to be fulfilled altogether, namely: 1) upon giving an explanation, the suspect–future crown witness – has to give to the law enforcement body specific information, which can contribute to revealing the circumstances of the crime, uncovering the rest of the offenders, revealing further crimes or

¹ Dz.U. No. 89, item 555

preventing them, and also 2) he/she has to undertake to give true and in-depth testimonies in court. Furthermore, only optionally can one demand that this person undertakes to return the profits achieved from the crime or to repair the damage caused by this crime¹.

However, the negative prerequisites have been comprised in Art. 4 of the Act, saying that no person who 1) has attempted to commit or has committed the crime of homicide or has cooperated in committing such a crime; 2) has urged other people to commit a prohibited act, determined in the abovementioned Act, in order to point the criminal proceedings against those people; 3) has been leading an organized group or gang aiming at committing a revenue offence; can apply for being granted the status of the crown witness.

Procedure for allowing the evidence from the crown witness' interrogation

Only the prosecutor, personally conducting the investigation or inquiry, or supervising the preparatory proceedings in a case, in which there are grounds for applying the institution of the crown witness, with the National Public Prosecutor's prior consent, is the subject entitled to submit to the district court, proper in terms of the place of conducting the preparatory proceedings, a motion on converting the trial status of the offender. In the cases liable to the military courts' judicature, the articles of the analyzed Act are appropriately applicable, in addition to which the permission for putting forward a motion is granted by the Chief Military Prosecutor².

Only when positive prerequisites are fulfilled, with a simultaneous lack of any negative prerequisites, can the prosecutor submit a motion to allow the evidence from the witness' testimonies.

Apart from the requirements that every written statement of claim shall meet, the prosecutor's motion to allow the evidence from the witness' testimonies has to contain arguments for the need for allowing the evidence of this kind in a given case. The prosecutor is also bound to prove that he/she has fulfilled the prerequisites enumerated in Art. 1 and 3 of

¹ Ewa Kowalewska-Borys, *Świadek koronny*, Zakamycze 2004, p.97

² Bolesław Kurzępa, *Świadek koronny*, Toruń 2005, p.131

the Act, namely: 1) to divulge the evidence for accepting the suspect's participation in committing even one of the crimes listed in Art. 1 of the Act, committed in an organized group or gang; 2) to hand over the record of the suspect's interrogation, in which the suspect has given the information that can contribute to disclosing the circumstances of the crime, to uncovering the rest of the offenders, to disclosing further crimes or to preventing them; 3) to hand over the record containing the suspect's commitment to give in court in-depth testimonies, concerning the people taking part in the crime and other circumstances of the crime; 4) to hand over the record with the suspect's commitment to return the benefits achieved from the crime and to repair the damage caused by this crime. The motion shall be accompanied by complete files of the preparatory proceedings.

The decision to allow or refuse to allow the evidence from the crown witness' testimonies is taken by the district court on a sitting, in a composition resulting from Art. 329 § 2 of the Code of Criminal Procedure, in connection with Art. 25 of the Code of Criminal Procedure¹, and, thus, single-person. There is also a possibility for the offense attorney to be present, if it is demanded.

The judicial inspection in the subject of allowing the evidence from the crown witness' testimonies proceeds in two stages, each of which constitutes a state secret until the evidence from the witness' testimonies is allowed. Stage one consists in the court's carrying out the inspection, on the basis of the motion and the materials gathered in the case, to check whether positive prerequisites occur with a simultaneous lack of any negative ones. The conditions of the admissibility of the evidence from the crown witness' testimonies have to be fulfilled altogether, therefore the failure to meet even one of them results in issuing the court's ruling on dismissing the motion. However, if it turns out that all the conditions required in Art. 1, 3 and 4 of the Act are fulfilled, then the court sets about the second stage of the inspection². At stage two of the proceedings the court interrogates the suspect. "The content of such explanation should be information that has previously been put forward to the body

¹ Dz.U. No. 89, item 555

² Ewa Kowalewska-Borys, *Świadek koronny w ujęciu dogmatycznym*, Zakamycze 2004, p.217-223

conducting the preparatory proceedings, and that can contribute to disclosing the circumstances of the crime, to uncovering the rest of the offenders, to disclosing further crimes or to preventing them. At this stage, it is also the suspect's duty to take a stance on the previously undertaken commitment, concerning the reimbursement of the benefits achieved from the crime and the reparation for the damage caused by this crime. The information put forward by the suspect-candidate for crown witness has to be characterized by an extremely high level of probability that it may lead to sentencing the rest of the offenders.”¹ At the request of the crown witness, the court hears the case at non-public sitting. The judicial inspection ends with issuing a ruling, in the subject of allowing the evidence from the crown witness' testimonies, within 14 days from the date of the court's receiving the prosecutor's motion. Only the prosecutor is entitled to an appeal against the ruling. On the discussed matter, only two kinds of the court's decision are possible: the ruling on refusing to allow the evidence from the crown witness' testimonies or the ruling on allowing the evidence from the witness' testimonies. In case the court issues a ruling on refusing to allow the evidence from the crown witness' testimonies, the suspect's explanation put forward to the body conducting the preparatory and judicial proceedings shall not constitute an evidence, and the actions conducted on the bases and according to the procedure determined in the present Act are recognized as non-existent and the documents are liable to being destroyed. In case the court issues a ruling on allowing the evidence from the crown witness' testimonies, the prosecutor duplicates the materials concerning the person indicated in the court's ruling and they become the basis of separate proceedings, which is then suspended. The suspension of the proceedings lasts to the moment of the legally valid conclusion of the proceedings against the rest of the offenders, or to the moment of its obligatory undertaking by the prosecutor, in case: the crown witness has given false evidence as for the essential circumstances of the case, during the proceedings, or has refused testifying in court; has committed a new crime or a revenue offence, acting in an organized group or gang aiming at committing a crime or a revenue

¹ Bolesław Kurzępa, *Świadek koronny*, Toruń 2005, p.133

offence; has concealed his/her wealth and the wealth he/she is familiar with, belonging to other perpetrators of the crime or a revenue offence; it has turned out that the court has allowed to the role of the crown witness a suspect, towards whom the application of the Crown Witness Act's articles is excluded, on the basis of Art. 4 of this Act. The prosecutor can also undertake the proceedings optionally, the moment the crown witness has committed a new intentional crime or an intentional revenue offence, or has not carried out the commitment to repair the damage or return the benefits achieved from the crime, within the time appointed by the court. However, the court may extraordinarily commute the offender's sentence.

Dismissal of the proceedings against the person, who appeared in the trial as the crown witness

The essence of the crown witness institution has been contained in Art. 9 Sect. 1. This Section constitutes an exclusion of the punishment's application towards the perpetrator of a crime, committed in an organized group or gang aiming at committing crimes in a situation, in which, during the criminal proceedings, he/she had decided to give the information that can contribute to revealing the circumstances of the crime, uncovering the rest of the offenders, revealing further crimes or preventing them¹. The exclusion of the application of the punishment, determined in Art. 9 of the Act is the sole stimulus able to motivate the suspect to break the conspiracy of silence with the accomplices, and to obtain from him/her valuable information on dangerous crimes and criminals. Making do solely with the mitigation of the punishment would not bring the desired effect, because, while serving the commuted sentence in the penitentiary, the suspect would be afraid of the vengeance of his accomplices or their hirelings.

In accordance with Art. 9 Sect. 2, the prosecutor issues a ruling on dismissing the proceedings within 14 days from the date of rendering final and binding the ruling that closes

¹ W. Jasiński, D. Potakowski, *Świadek koronny – nowy instrument w walce z przestępczością zorganizowaną*, MP 1998, No. 7

the proceedings against those offenders, whose participation in the crime has been revealed by the crown witness and against whom he has testified. Yet, the crown witness shall be wary of committing further crimes because, within 5 years from issuing a ruling on the dismissal, regardless of Art. 327 § 2 of the Code of Criminal Procedure, the prosecutor resumes the previously dismissed proceedings in a situation that: 1) the crown witness has committed a new crime or revenue offence, acting in an organized group or gang aiming at committing a crime or a revenue offence; 2) the circumstances, proving that the crown witness has intentionally concealed his/her wealth and the wealth he/she is familiar with, belonging to other perpetrators of the crime or a revenue offence, have been revealed, or 3) he/she has not carried out the commitment to return the benefits achieved from the crime or revenue offence, and to repair the damage caused by those crimes; 4) any of the negative prerequisites, listed enumeratively in Art. 4 of the Act has been revealed.

The prosecutor also undertakes the proceedings optionally, the moment the crown witness, within 5 years from the date of rendering final and binding the ruling on dismissing the proceedings on the basis of Art. 9, has committed a new intentional crime or an intentional revenue offence. However, the court may extraordinarily commute the offender's sentence. The crown witness is entitled to lodging a complaint against the ruling on resuming the proceedings to the district court, proper in terms of the place of conducting the preparatory proceedings.

Protection of the crown witness

The consequence of using the evidence from the crown witness' testimonies in the criminal trial is not only exempting him/her from the responsibility for the committed crime, but also ensuring him/her protection against the retaliation of the accomplices. By no means does the protection of the crown witness have to take place in every case, in which his/her testimonies have been used. This protection can include not only the crown witness, but also the suspect, who is only applying for being granted the status of the crown witness. First of all, it is granted at the request of the crown witness and of the people closest to him/her, and

routinely, after obtaining the consents of people, whom it is supposed to concern. According to Art. 115 § 11 of the Penal Code¹, the closest person is the spouse, ancestor, descendant, siblings, relation of the same line or degree, adopted person and his/her spouse, as well as a life partner. Apart from the motion on the application of the protection, people entitled to receive it also have to file a commitment to obey the rules and instructions pertaining to the provided protection, and also to perform the duties resting on them on the basis of the Crown Witness Act. The decision in the subject of applying the protection is taken by the prosecutor and it takes the form of a ruling. In an issued ruling, the prosecutor may decide on providing the entitled person with protection or help solely, but he/she can also grant both the protection and help.

The basic condition that justifies providing with protection the crown witness, the suspect- future crown witness and people closest to them is life or health hazard. “Since the crown witness, on account of his/her role of a traitor, informer or, finally, a criminal, who will avoid criminal responsibility for his/her offense, is in the state of a constant life or health hazard. Being the most important human source of evidence in the cases of great weight, with the lack of other evidential basis, the crown witness’ life and health are particularly in danger. There is also no doubt that the people closest to him/her, his/her family, can be a subject to various pressures (for instance, oral and written warnings, threats, destruction of property, violence, assaults) [...] Due to such a manifold risk, the crown witness loses his/her “liberty”, freedom of getting about, of action, of earning capacity and the previous style and standard of life”². Therefore, it is so important to protect such a witness and the people closest to him/her also against possible role as the main prosecution witness in the trial

The kinds of protection have been determined in Art. 14 Sect. 1 and 2 of the Act. The protection may assume the form of: 1) a personal protection; 2) help pertaining to the change of the whereabouts or of the employment; 3) in exceptionally substantiated circumstances, one can rely on issuing the documents, allowing to use the personal information other than

¹ Penal Code

² Ewa Kowalewska-Borys, *Świadek koronny w ujęciu dogmatycznym*, Zakamycze 2004, p.257-258

someone's own, including the documents that entitle one to cross the border; 4) conducting a surgery, removing the characteristic elements of the appearance, or a plastic surgery; 5) a financial assistance to cover the costs of obtaining health services; 6) a financial assistance, in case it is not possible to employ the crown witness or the person closest to him/her.

In case the person, provided with the protection, intentionally breaks the rules or instructions pertaining to the protection, or persistently evades carrying out the duties, the Chief of Police or the Managing Director of the Correctional Service submits a motion to the prosecutor conducting the proceedings, on withdrawing the protection or help. Having consulted the Chief of Police or the Managing Director of the Correctional Service, the prosecutor conducting the proceedings may issue a ruling on withdrawing or ending the protection or help also routinely, or at the request of a person, who has been provided with protection or help. The people concerned are entitled to lodging a complaint to the superior prosecutor, against the ruling in the subject of withdrawing or ending the protection or help.

Then, on the basis of Art. 21 Sect. 1 and 2 of the Act, in case the dismissed criminal proceedings are assumed or criminal proceedings resumed, the prosecutor may routinely oblige the witness or suspect-applying for the status of the crown witness, to repay the equivalent of the benefits, received as part of the help, to the proper body. If the help has consisted in issuing documents, this person shall be also obliged to return those documents. The prosecutor may also oblige the suspect-applying for the status of the crown witness, to repay the equivalent of the benefits, received as part of the help, to the proper body, if the prosecutor has not submitted a motion on allowing the evidence from the crown witness' testimonies, or if the court has issued a ruling on refusing to allow the evidence from the crown witness' testimonies. In case this person evades carrying out the duty to return the equivalent of the provided help or the issued documents, the articles on execution proceedings in the civil service are applied.

Conclusion

In spite of many doubts and controversies that the institution of the crown witness has risen since it has come into existence, it shall be stated that it has considerably contributed to uncovering and breaking up many organized gangs and, what probably more important, than sentencing and imprisoning their members in penitentiaries.

The comments made on excessive costs generated by the functioning of the crown witness protection system, endangered values, rules of law and of the criminal procedure¹, as well as moral doubts about the criminal's impunity² seem to be pushed into the background, in comparison with numerous profits derived from the introduction of this institution to our legal system, such as: getting to know the operation of the gangs, the increase in the safety not only of the Polish citizens, but also of the citizens of neighboring countries, as well as the decrease in losses that the State Treasury suffers as the result of the activity of organized gangs.

¹ Stanisław Waltoś, *Spór o świadka koronnego w Polsce(w:) Prawo karne i proces karny wobec nowych form i technik przestępczości*, Białystok – Rajgród 1995, p.429

² Stanisław Waltoś, *Świadek koronny obrzeża odpowiedzialności karnej*, PiP 1993, p.16

Agata Kochman

“Poland as a part of the Eurozone. Currents problems and discussions”

Author: Ms. Kochman studied law at the University of Wrocław, the Faculty of Law, Administration and Economy. During her studies, she was a member of the Student Penal Law Club at the University of Wrocław and she participated in the international student organization, The European Student’s Law Association (ELSA).

Ms. Kochman is interested in criminal law. She was awarded a scholarship allowing her the opportunity to study for one semester in Iceland in The Lifelong Learning Program Erasmus for European Union student. She defended her master degree in executive criminal law; masters degree was based in Psychology and psychiatric exams carried out on prisoners serving a sentence of life imprisonment.

Poland as a part of the Eurozone. Currents problems and discussions

Agata Kochman

“A common currency has been a long time dream of many people in Europe. The civil and economic development of western Europe after World War II, the strategic German-French partnership, the cooperation between the Benelux countries, the new Italian government, the Marshal Plan, all helped establish a European community.”¹ Poland, with almost 40 million people, is the biggest of the new member states. Poland lost an opportunity to adopt the euro right after in joining the European Union .

Poland is developing rapidly, the economic rates are positive and the Euro might even accelerate this economic growth. Unfortunately, the idea of joining the Eurozone actually requires some serious consideration. The current global economy and growing crisis does not create a good environment for such a huge change in our country. On the other hand, if Poland does not join the Eurozone, we can only expect foreign investment to find better business conditions in Lithuania, Slovenia, or Slovakia which made this step at the beginning on this year. In general, we do know that the Euro exists. Euro-awareness is apparent among entrepreneurs, people with higher education, students and people who travel frequently. Most Poles do not know in which countries the Euro is valid. Unfortunately, there is no ‘Euro education’ or governmental campaign to show, as simply as possible, the advantages and disadvantages of entering the Eurozone. The government did take care to provide good advertisements and especially TV information to prepare Polish people to become part of European Union, but the Eurozon subject did not receive the same level of importance in education. It became apparent that it was more useful in political battles between the parties. In this situation we can say that Pole do not want to switch Zlotys for Euros. We can notice that it is a Polish tradition to dislike what we do not understand. We are opportunists. And of

¹ “Euro in Poland... what, where and why”, Stefan Wyszynski, Movement for Supporting Initiatives towards International Education, Wrocław

course the lack of knowledge is used by populist politicians, who are openly arguing against the Euro, ipso facto creating people's views on the subject. It is a great pity that such dilettantes, without basic economic knowledge, are building public opinion on such an important matter. This is a chance for us to see the acceptance of this currency by our neighbors, nations that are mentally close to us. Maybe this will convince Polish people to accept the Euro.¹

Generally, people in Poland believe that the prices will rise rapidly after the acceptance of the Euro and that everything will become expensive, just as expensive as in Germany or France. This is a repeat of a situation that has happened before Poland's accession to the European Union. I remember people saying that the goods in the shops would grow expensive and that nobody would be able to afford them anymore. The opposite of this is that earnings will remain the same. I am not surprised at hearing opinions like this because then there is reason for not having the new currency. Like every nation we too will have to go through this process, which at the beginning will cause prices to go up. I could notice in Italy when in 2000 I spent the summer there and from the start of the year they switched to the Euro. In this case my winter trip definitely cost more. There is natural process, but the changes are not big at all.²

On the other hand the benefits of changing to the Euro are enormous. Beside the economical benefits, the most common one is the easier way to travel. No more the last minute hunt for a currency exchange to change money before a trip. No more worries of getting the best price and doing it on the day when the currency is the cheapest. Changes like this will cause so much less stress for travelers.

Besides it would reduce currency risks for importers and exporters. It would help to cut costs of risk protection and make trade profits more predictable. Predictable profit stimulates investment. About two years ago there was a rule, saying that export is profitable

¹ "Euro in Poland... what, where and why", Stefan Wyszynski, Movement for Supporting Initiatives towards International Education, Wrocław

² "Euro in Poland... what, where and why", Stefan Wyszynski, Movement for Supporting Initiatives towards International Education, Wrocław

when the Euro costs 4.10 Zloty. 6 month ago the Euro costs about 3.80 Zloty and the exporters were counting their losses. Now the price went to 4.80 Euro for 1 Zloty and a lot of companies are close to bankruptcy. Above all the unpredictable changes are keeping away investors. With the Euro, international trade would become easier within the European Union for sure! But the most interesting aspect of the Euro is the way to get the right to join it – the convergence criteria.

We have noticed a sudden increase in support of euro currency in our country. According to GfK Polonia's survey among 500 Poles, 65% of respondents want the new currency. That is 20% more than 6 months ago. Moreover there are less opponents of this idea (16% less than 6 month ago). 70% of Polish people think that we should agree to change our currency to the euro, by holding a referendum. That is 9% less than in September 2008 but it is still too big of a number. 59% of respondents say that the new currency may have very positive consequences for our country (36% 6 months ago).¹

Actually “the euro may be the shelter Poland's government seeks from Eastern Europe's currency storm, but residents here are basking in the weakness of the one it has now: the zloty. This has helped the Tatra Mountain region in Poland's south, which borders on Slovakia, a country that adopted the euro this year. Whereas the traditional traffic has been of Poles to Slovakia to ski and buy inexpensive alcohol, now Poles are relishing an influx of bargain-hunting Slovaks. Last month at more than 2,000 makeshift stalls in a muddy field just outside the Polish town of Nowy Targ, Slovaks comprised about 80 percent of customer”²

There is no doubt that the euro will be very beneficial. There would be more investments; it would make life easier for exporters, as well as importers, who must battle currency volatility now. It would also mean bigger access to capital, which would be very positive for consumers.

What we have to do to have the Euro?

In the first place, we have to decrease the financial deficit. It may not exceed 3% of the

¹ “Many Polish People want the Euro Currency”, M. Zamojski, translator D. Góra

² “Slovaks discover cross-border shopping as Polish currency dives”

<http://www.iht.com/articles/2009/03/02/business/zloty.php>

Gross Domestic Product (GDP). This is the largest problem for the Polish economy. Nowadays, it seems to be impossible. In the second place, the ratio of the gross government debt may not exceed 60% of the GDP. And the Polish government is not even able to count it properly. Thirdly, our nominal long - term interest rate may not exceed with more than 2 percentage points that of the three best-performing member states. Fourthly, we must participate in the exchange-rate mechanism of the European monetary system without any break during two years. In addition to this, we may not devalue the Zloty on our own initiative during the same period of two years. Lastly, our inflation rate may not be on a right level.

On February the country's current currency, the Polish zloty, hit its highest level since the country joined the EU. According to the central bank, entering the ERM-II phase - a two year process which tests the stability of a currency before entering the eurozone - would be hard to support at this stage. Since the beginning of 2009, the zloty has fallen 14 per cent against the euro and has been placed under increasing pressure by the hesitation of the central bank. Fears have grown over strict levels of lending in Poland if our country's finance the deficit in current accounts. The country is also heavily export dependent, which in the current sudden global growth slowdown means there is likely to be further concerns over the Polish economy.¹

Prime Minister Donald Tusk's centre-right coalition has signaled it is ready to take Poland into the European Exchange Rate mechanism (ERM-2), the waiting room for euro adoption, in the first half of 2009 even without a constitutional amendment. There is still a long way to go, through political distaste and economic problems. But we should do it as soon as possible. It will be easier for Poland and it will be easier for the rest of the European Union when we too have the Euro. We are a part of the European Union and we have to cooperate with our partners for a better future, for common European welfare.

Some economists have cautioned that the zloty might come under attack from speculators exploiting the political uncertainty if it enters ERM-2 -- where it trades in a fixed

¹ Currency in Poland Falls Amid Eurozone Fears www.whichwaytopay.com/money-latest-news-article.asp?articleid=1504 February 17

range against the euro -- before the constitutional change.

Worried by the global crisis, Poland's central bank (NBP) on Monday January 16 weighed the costs and benefits of planned entry in the eurozone in 2012, the NBP's head said of an official report published Monday.¹

"When we began work on our report two years ago, it seemed we would find a clear answer on the costs and benefits of integration with the eurozone," NBP president Slawomir Skrzypek said.²

As all candidates for the eurozone, Poland is required to spend two years in the ERM II exchange rate mechanism to prove the stability of its currency, the zloty. The stability of Poland's currency the zloty has been challenged since the onset of the crisis. Despite a recent European Commission forecast predicting Poland will avoid recession and could score two percent GDP growth this year, the zloty plummeted to 4.78 to the euro in morning trading on Monday, the lowest level for five years and a 43-percent drop compared to exchange rates in July 2008. Eurozone candidates must also respect the EU's Maastricht criteria regarding low inflation and public spending deficits in order to become eligible for monetary union. Poland committed itself to joining the eurozone and replacing its currency, the zloty, with the euro as part of its 2004 European Union entry agreement. No deadline for the switch was set.³

Poland's Prime Minister Donald Tusk may delay the 2012 target set by his liberal government for a currency switch to the euro to avoid a referendum on the matter demanded by the opposition. The reports come a day after Tusk met with European Central Bank (ECB) President Jean-Claude Trichet in Frankfurt. Quoting an anonymous source close to the prime minister, Poland's leading daily, the Gazeta Wyborcza broadsheet, reported the ECB would rather Poland make the necessary constitutional amendment for euro adoption prior to entering the exchange-rate mechanism known as ERM-2 that Warsaw wants to happen in

¹"Poland's central bank questions euro", <http://www.eubusiness.com/news-eu/1234800122.97/>

² "Poland's central bank questions euro", <http://www.eubusiness.com/news-eu/1234800122.97/>

³" Poland's central bank questions euro", <http://www.eubusiness.com/news-eu/1234800122.97/>

2009.¹ Also Poland's constitution must be amended to allow eurozone entry. It has to be done before it can replace the zloty with the euro but needs opposition backing to do so.

The constitution says:

Chapter XII AMENDING THE CONSTITUTION

Article 235

- 1. A bill to amend the Constitution may be submitted by the following: at least one-fifth of the statutory number of Deputies; the Senate; or the President of the Republic.*
- 2. Amendments to the Constitution shall be made by means of a statute adopted by the Sejm and, thereafter, adopted in the same wording by the Senate within a period of 60 days.*
- 3. The first reading of a bill to amend the Constitution may take place no sooner than 30 days after the submission of the bill to the Sejm.*
- 4. A bill to amend the Constitution shall be adopted by the Sejm by a majority of at least two-thirds of votes in the presence of at least half of the statutory number of Deputies, and by the Senate by an absolute majority of votes in the presence of at least half of the statutory number of Senators.²*

The opposition leftists back a government plan to adopt the euro in 2012 but believe it will be delayed by conservative resistance to required constitutional changes."We agree to 2012 (for euro adoption). This is a good moment and a great chance for Poland. Just like joining the European Union was a great chance for us, euro zone membership would be a civilisational leap for us," Wojciech Olejniczak, leader of the leftists' parliamentary group said. The eurosceptic right-leaning main opposition Law and Justice (PiS) party has refused to back the 2012 target date, saying it is too early. Wojciech Olejniczak, leader of the leftists' parliamentary group, told Reuters in an interview Poland should only initiate the lengthy process of adopting the euro after the next parliamentary election, due in 2011.

¹ "Poland may delay 2012 target for euro adoption 14 November 2008" <http://www.eubusiness.com/news-eu>

² "The Constitution of the Republic of Poland" OF 2nd APRIL, 1997: As published in Dziennik Ustaw No. 78, item 483. Konstytucja Rzeczypospolitej Polskiej, Dziennik Ustaw

Any amendment, however, requires support in parliament from the opposition Law and Justice (PiS) party to muster the needed two-thirds parliamentary majority. Led by Jaroslaw Kaczynski, the identical twin of conservative President Lech Kaczynski, the PiS has made Poland's euro adoption -- and therefore its support for a constitutional amendment to this effect -- conditional on its approval in a public referendum. To change the constitution cooperation is necessary between the government and the Kaczynski brothers. On the other hand the Prime Minister Donald Tusk has arrived at the conclusion that a referendum would be too risky."¹

Poland committed itself to adopting the euro as part of its 2004 EU accession agreement but no date was set for the switch. Tusk is equally determined that there is [no need for one](#) because Poland has already committed itself to adopt the Euro when it joined the EU. We have presidential elections in 2010 and parliamentary ones in 2011 – we will see if that changes the scenery.

On January 1, 2009, Slovakia will become the second post-communist country after Slovenia to enter the current 15-state eurozone. Poland will stick to its target of adopting the euro by 2012, a goal which will help mark its economic health despite the global financial crisis, Finance Minister Jan Rostowski said Thursday. "Our goal is ambitious, but realistic," Rostowski told lawmakers as he presented the liberal government's draft 2009 budget to parliament. Poland's Prime Minister Donald Tusk had announced for the first time in mid-September that Poland wanted to adopt the euro in 2012.. Rostowski said that Poland could enter the ERM-2 in mid-2009 to put its currency, the zloty, to the test. In mid-2011 we will ask the European Commission to confirm our readiness to join the eurozone and to fix the final exchange rate between the zloty and the euro," he added. "I am convinced that on January 1, 2012, the official switch to the new currency will take place," Tusk said.²

¹ "Currency in Poland Falls Amid Eurozone Fears" www.whichwaytopay.com/money-latest-news-article.asp?articleid=1504 February 17; "Poland may delay 2012 target for euro adoption" <http://www.eubusiness.com/news-eu>

² <http://eupolitics.einnews.com/news/poland-euro-currency>; "Polish government approves road-map for 2012 euro adoption" <http://www.eubusiness.com/news-eu>

Poland joined the European Union in 2004 along with nine other nations, mostly from the former communist bloc. Of those countries, Slovenia began using the euro in 2007 and Cyprus and Malta adopted the common currency this year. This year, Slovakia becomes the 16th member of the 27-nation EU to adopt the euro. Rostowski added that the government's euro drive was part of a "strategy aiming to seize the opportunity created, paradoxically, by the international financial situation". Reaffirming Poland's 2012 target amidst global market turbulence can only mean a "double bonus" for the country, which is enjoying an economic boom, he said. "Firstly, it will allow us to mark out the exceptionally robust state of the Polish economy compared with those of other countries and, secondly, it will underline the determination of the government, which will help reduce the impact of the difficult external economic situation," he explained. Over recent days, Rostowski and other Polish government ministers have given repeated assurances about Poland's financial health, with their stance backed by most analysts.¹

A Polish official said the country has started official talks with the European Central Bank on joining a fixed exchange-rate program that is a stepping stone to euro adoption. But few analysts believe the beleaguered Polish economy will meet the common currency's entry criteria anytime soon. Poland's currency, the zloty, has lost some 19% of its value against the euro this year as investors flee Eastern European markets, which are perceived as risky. Adopting the euro, now shared by 16 European nations from Ireland to Slovakia, would likely shield Poland from such volatile currency swings.

Talks between Poland and the European Central Bank about Poland entering a two-year exchange-rate program that is a prerequisite for adopting the euro "are official and started several days ago," said Zbigniew Chlebowski, head of the parliamentary caucus of the governing Civic Council platform party. A Polish Finance Ministry spokeswoman said she couldn't comment. A European Central Bank spokesman also declined to comment. Analysts believe Poland is unlikely to enter the two-year waiting room for euro adoption this year, in

¹ "Polish government approves road-map for 2012 euro adoption" <http://www.eubusiness.com/news-eu>

part because the economic slowdown will make it difficult for the country to meet the currency's strict adoption criteria. Wednesday's comments are "part of a package of comments from policy makers aimed at trying to stem their currency losses," said Neal Shearing, an economist with Capital Economics in London. Before the Polish official's comments, most economists believed Poland would enter the two-year euro anteroom next year or in 2011 and adopt the euro by 2013 at the earliest. The zloty rallied 3% Wednesday, its biggest one-day bounce this year. Any decision to begin talks on entering the euro's two-year anteroom run counter to the opinion of Poland's central bank, which said Monday the program is too risky in view of the zloty's weakness. The program, which is mandatory for euro aspirants, would require that Poland keep the zloty from moving more than 15% above or below an accepted level against the euro for two years. The Polish government's plan calls for entering the program by the middle of this year and adopting the euro by 2012. Prime Minister Donald Tusk recently suggested the plan could be flexible due to the zloty's vulnerability.

Business leaders have welcomed the government's commitment to bring Poland into the euro zone in 2011. "The adoption of the euro will make life much easier for entrepreneurs, especially those who do business with the euro zone," said Andrzej Arendarski, head of the Polish Chamber of Commerce (KIG). "They will no longer need to constantly monitor exchange rates and incur costs associated with currency exchange. The risk of losses caused by exchange rate changes will also disappear once the single currency is adopted." The Association of Polish Exporters says an early entry to the euro zone would make Polish exports more profitable and competitive. Business Centre Club experts say the benefits of adopting the euro for Poland would include faster economic growth, easier handling of increased tourist traffic and more efficient preparations for the Euro 2012 soccer championships.

While Poland is still dreaming about adoption of the Euro in 2012, eight years after joining the EU, its tiny-weeny, titchy-witchy neighbor to the south, Slovakia, is using the Euro as of Jan 1 2009. The even smaller nations of Slovenia, Cyprus and Malta have also

joined in the last year or two. For Poland of course, meeting all the criteria is just a side-show compared to the political bickering and in-fighting that needs to go on around the subject.

So we have a country that is, as far as I can tell is an absolutely ideal candidate for joining the Euro at the earliest opportunity and yet is taking far too long to do so thanks, in the most part, to its leadership sacrificing the countries needs for the sake of their own egoistic bickering.

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