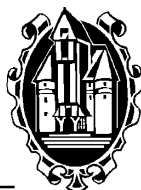

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The Corporate Governance Code for Polish Listed Companies

(final proposal)

POLSKIE FORUM
Corporate Governance

Egon Zehnder International *The translation of the complete version of the draft Code was sponsored by Egon Zehnder International*

Gdańsk, June 2002

The electronic version of this document is available on the website of the Polish Corporate Governance Forum – www.pfcg.org.pl

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The Corporate Governance Code has been drafted by Maciej Dzierżanowski and Piotr Tamowicz (eds.) – research fellows at the Gdańsk Institute for Market Economics[1]. The Code incorporates suggestions and comments elaborated in the wake of discussions conducted by a working group composed of the following capital market experts:

Grzegorz Cimochowski (*Elimar Brokerage House*),
Jarosław Dominiak (*Chairman, Association of Individual Investors*),
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Mariusz Grajek (*former Chairman of the OTC market*),
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Paweł Wojciechowski (*Chief Executive Officer, Allianz Poland Universal Pension Fund Society*)
Marek Żytniewski (*former Senior Vice President, Pioneer Investments*).

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[1] We also wish to acknowledge the excellent research assistance provided by Wojtek Popławski, Michał Przybyłowski, Marcin Porowski and Grzegorz Milewski.

Preamble

The draft Code – being presented – is an example of a bottom-up self-regulatory process, that addresses the problem of loosing confidence faced by the Polish capital market. The problem was caused by numerous cases of minorities` rights violations, ranging from transfer pricing and insider trading, to tunnelling and blocking effective exercise of corporate rights. It is now a common view among the domestic and international capital market community that regaining market confidence requires better protection of minority shareholders' rights. This will in turn contribute to a more effective and dynamic capital market, which the Polish economy needs. The draft Code, therefore, adopts the perspective of minority shareholders; at the same time it reflects cognisance of the fact that proper company development can only happen in the context of due balance of, and respect for, the rights of all stakeholders engaged in its operations, including controlling shareholders.

The draft Code principles and provisions address problems associated with both ownership structures dominated by a controlling shareholder (which is most common structure among Polish public companies) as well as dispersed shareholder base. It stresses the need of a stronger supervisory board *vis-à-vis* the dominant shareholder and the management. Thus it is recommended that at least two members of the supervisory board be independent. The draft Code also advocates more transparency in access to information through corporate websites, increased credibility of audits and restricted availability of anti-take-over defences.

The Code is based on a diagnosis of the most evident weaknesses of the corporate governance system in Poland. This analysis covered such issues as: the extent and sources of ownership and control concentration, control separation devices, cases of most evident shareholder right abuses, checks and balances between company governance bodies, disclosures to shareholders. Some examples of good corporate governance practices were found in Polish corporations, including independent board members and internal regulations addressing insider trading. All these cases were analysed and reflected in the provisions of the Code.

This draft of the Code was prepared following an extensive consultative process. Between December 2001 and April 2002, a series of open seminars were held. They brought together capital market consultants and advisors, scholars, institutional investors as well as representatives of publicly-listed companies. All comments, suggestions and recommendations were analysed in detail. Apart from the seminars, there were a number of individual meetings with persons willing to give us the benefit of their comments. The draft Code was also distributed among competent associations as a consultative document.

In its philosophy and particular solutions proposed, the draft Code adopts or refers to many principles, recommendations and codes of good practice issued in other countries or by international organisations. The most important benchmarks used

were: the OECD Principles of Corporate Governance, British corporate governance codes – mainly Cadbury (the prototype for many national codes) and Hampel, the EASD Corporate Governance Principles, as well as the recommendations and guidelines issued by Euroshareholders.

Implementation of the Code should be achieved by the way of including relevant provisions in the company's articles of association. The Code requires that companies report on compliance with its recommendations or on the reasons for non-compliance. The Warsaw Stock Exchange is empowered to put this obligation as a formal requirement for company share listing. Independently, to promote the implementation of the Code, the Polish Corporate Governance Forum – in co-operation with the Association of Individual Shareholders – intends to publish annually a corporate governance rating, with the Code serving as a benchmark. The first rating has already been published.

Principle I

The main objective of the company should be to operate in the common interest of all the shareholders, which is to create shareholder value.

Principle II

The composition of the supervisory board should facilitate objective oversight of the company and reflect interests of minority shareholders.

Principle III

The powers of the supervisory board and the company by-laws should ensure an effective supervisory board process and duly secure interests of all the shareholders.

Principle IV

The shareholders' meeting should be convened and organised so as not to violate interests and rights of any shareholders. The controlling shareholder should not restrict the other shareholders in the effective exercise of their corporate rights.

Principle V

The company should not apply anti take-over defences against shareholders' interests. Changes in the company share capital should not violate interests of the existing shareholders.

Principle VI

The company should provide effective access to information, which is necessary to evaluate the company's current position, future prospects, as well as the way in which the company operates and applies the corporate governance rules.

Principle VII

The appointment process of the company's auditor should ensure independence of the auditor's opinion.

Principle I

The main objective of the company should be to operate in the common interest of all the shareholders, which is to create shareholder value.

Recommendations:

1. The company should adopt and publish a declaration that sets the corporate objectives and defines the interests of the company and its shareholders.

2. The company boards should act in furtherance of the declared objectives as guided by the concept of shareholder value creation.

3. The company boards should ensure that the rights and interests of the company stakeholders, including employees, creditors, suppliers and local communities, are duly respected.

Principle II

The composition of the supervisory board should facilitate objective oversight of the company and reflect interests of minority shareholders.

Recommendations:

1. At least two members of the supervisory board should be independent. If they account for less than a half of the supervisory board, resolutions concerning issues that are crucial for the interests of minority shareholders should require a "yes" vote from at least two independent board members.

2. Detailed criteria for independence of supervisory board members should be set in the articles of association of the company. In principle, independent board members should not be linked to the company or its controlling shareholder. The independence criteria for supervisory board members should be met throughout the entire tenure.

3. Election and dismissal of independent supervisory board members should take place without any decisive influence of the controlling shareholder. In case a proper mechanism in this respect is not stipulated in the articles of association of the company, the controlling shareholder should abstain from voting.

4. The names of candidates for supervisory board members and their credentials should be published before the general meeting, in sufficient time as to allow shareholders to make an informed voting decision.

5. The number of supervisory board members should be regulated so as to ensure that a group of shareholders holding a total of 20 percent of the share capital has effective power to elect their representative in cumulative voting.

Principle III

The powers of the supervisory board and the company by-laws should ensure an effective supervisory board process and duly secure interests of all the shareholders.

Recommendations:

1. Transactions and agreements between the company and entities or individuals related to, or having direct or indirect influence on, the company should be subject to supervisory board approval. The relevant resolutions of the board should require a "yes" vote from at least two independent board members.

2. The management board and the supervisory board should operate as regulated by relevant by-laws approved by the supervisory board and the general meeting, respectively. These by-laws, as well as the articles of association of the company, should be available from the company website.

3. The supervisory board should be provided with sufficient administrative support and be able to hire external experts at the expense of the company.

4. Members of the management board and the supervisory board should be obliged to disclose any conflicts of interests that may arise in relation to their duties.

5. The company should regulate trading in its securities and respective derivatives by its supervisory board members, managers and any other persons who have privileged access to information so as to prevent any violation of the interests of shareholders and investors, and in particular the right of equal access to information.

Principle IV

The shareholders' meeting should be convened and organised so as not to violate interests and rights of any shareholders. The controlling shareholder should not restrict the other shareholders in the effective exercise of their corporate rights.

Recommendations:

1. The venue, time and date of the shareholders' meeting should not hinder wide attendance by shareholders or their access to documents prepared for the meeting. To the extent possible, documentation prepared for the general meeting should be available from the company's website.

2. Prior to the shareholders' meeting the company should enable its shareholders to lodge questions on issues covered by the agenda. Information on the course of the general meeting, including answers to the questions tabled by shareholders, should be published – if possible – on the company's website.

3. Two independent supervisory board members should have the right to request the shareholders' meeting to be convened, and – if the request is not satisfied – to convene an extraordinary shareholders' meeting. The shareholders' meeting convened at the request of the independent supervisory board members or a qualified group of shareholders should take place on the date set in the request.

4. The company articles of association should set additional requirements to be met in order to postpone the shareholders` meeting convened at the request of qualified shareholders or independent supervisory board members, or to remove items proposed thereby from the agenda.

5. The chairman of the shareholders` meeting should satisfy the criteria of professionalism and impartiality so as to ensure efficient and unbiased course of the proceedings. The company articles of association may require that the chairman be independent from the company and its controlling shareholder.

6. Any amendments to the by-laws regulating the course of the shareholders' meeting should come into effect as from the next meeting, unless they are approved by a 9/10 majority of the votes.

Principle V

The company should not apply anti take-over defences against shareholders' interests. Changes in the company share capital should not violate interests of the existing shareholders.

Recommendations:

1. A voting cap – as defined in the company articles of association – should not apply to a shareholder, who commands more than 50 percent of the votes at the general meeting.

2. The company should not engage into acquiring of its own shares as an anti take-over defence.

3. The company should acquire significant packages of its own shares solely through a public tender offer addressed to all the shareholders.

4. A relevant resolution of the shareholders' meeting as well as the relevant provisions of the company articles of association concerning authorised capital should ensure that this facility is not employed as an anti take-over defence and duly secures interests of the existing shareholders in respect to the terms of the issue.

5. Shares issued for the purpose of management and employee stock option plans should not exceed 10 percent of the total number of the company shares over any five-year period. The issue price of such shares should not differ significantly from the market price.

Principle VI

The company should provide effective access to information, which is necessary to evaluate the company's current position, future prospects, as well as the way in which the company operates and applies the corporate governance rules.

Recommendations:

1. The company should ensure that the access to material information and company by-laws is easy, equal and provided at reasonable costs for the company. Relevant information and documents should be available from the company's website.

2. Every year the company should publish a report providing a detailed description of its corporate governance framework. It should include information on how the company achieves compliance with this Code or explain the reasons for non-compliance.

3. Every year the supervisory board should present a report to the shareholders on the position of the company, its prospects, functioning of its corporate governance framework, as well as the company's system of internal controls and information policy.

4. The company should provide access to basic information about members of its management board, including their professional qualifications, positions held with other companies and links to the shareholders. The available information on the forms and amount of managers remuneration should include such components as: base salary, bonuses, stock options, severance payments and other emoluments constituting a material cost item for the company.

5. The company should provide access to basic information about members of its supervisory board, including their professional qualifications, individual roles on the supervisory board (if any), links to the company or the controlling shareholder, positions held with other companies as well as the forms and amount of remuneration.

6. The company should disclose up-to-date information on its current ownership and control structures, including information on any arrangements causing disparity between the stake in ownership and the stake in control, as well as information – known to the company - on any agreements concluded by shareholders concerning voting in concert.

Principle VII

The appointment process of the company's auditor should ensure independence of the auditor's opinion.

Recommendations:

1. The company auditor should be appointed by the supervisory board or recommended thereby for appointment to the shareholders' general meeting. The relevant resolution of the supervisory board should require a "yes" vote of at least two independent board members.

2. When selecting the auditor, the supervisory board should consider the value of other services provided to the company by the potential candidate firms, as well as their subsidiaries and affiliates, over the last two financial years. The supervisory board should be able to perform a proper selection procedure.

3. The company should publish information on the value of other services provided by the auditor, as well as its subsidiaries and affiliates, in a given accounting year.

4. At least once every five years the company should appoint a new auditor. The new appointment should not coincide with a replacement of the management board.

5. The auditor of the controlling shareholder or the auditor who performed the regular audit of the company in the period named in the motion on the appointment of the auditor should not be appointed to serve as a special assignment auditor.

Commentary to the Corporate Governance Code

Principle I

The main objective of the company should be to operate in the common interest of all the shareholders, which is to create shareholder value.

Proper safeguards of shareholder rights and equal treatment of all shareholders are the fundamental OECD principles of corporate governance. A publicly listed company is one in which interests of all the shareholders, including minority shareholders, should be duly considered and respected. Otherwise the rationale of a public company as an institution is undermined and the capital market cannot take a desirable course of development.

For a company to operate in the common interest of all the shareholders implies that actions by the controlling shareholder should not violate interests and rights of the other (minority) shareholders. In terms of the total capital held, these other shareholders frequently account for the same, or even larger, stake as a single dominant shareholder. This situation arises in particular when the company applies arrangements providing for concentration of control in the context of a dispersed ownership of cash-flow rights (i.e. by issuing dual-class shares, non-voting shares, etc.). In cases of significant dispersion of both ownership and control of the company, the recommendation of ensuring proper safeguards for interests and rights of all the shareholders applies to the governance bodies of the company, in particular the management board.

Value creation for all the shareholders seems to be the best guiding principle for a public company operation. However, shareholder value cannot be grown at the expense of gross violation of the interests of the other company stakeholders, because in the long term success of any company and its shareholders can only arise from a well-balanced base of all stakeholders' interests.

1. The company should adopt and publish a declaration that sets the corporate objectives and defines the interests of the company and its shareholders.

A declaration of corporate objectives and a definition of shareholders' interests may serve as a very important signal for investors, in particular if the obligation upon the company governing boards members to act in the interest of the shareholders is also stipulated in the company articles. Company's boards members have a statutory duty to act in the interest of the company, which – according to the Code – should be understood as a long-term common interest of all the shareholders.

2. The company boards should act in furtherance of the declared objectives as guided by the concept of shareholder value creation.

Shareholder value creation is a universally accepted standard of public company management in the developed capital markets. The standard focuses on ensuring investors with the expected rates of return on the invested equity, in the form of growing stock prices and dividend pay-outs.

The minimum requirement to satisfy this recommendation is for the company to define precisely its financial objectives as regards the shareholder value and dividend policy targets. Maximization of shareholder value and setting precise corporate financial objectives are among the major corporate governance guidelines proposed by Euroshareholders.

3. The company boards should ensure that the rights and interests of the company stakeholders, including employees, creditors, suppliers and local communities, are duly respected.

Although any public company is owned by its shareholders, its proper long-term development can only be achieved if based on a balance of interests of all the company stakeholders. There are many factors of corporate success, including – to an ever greater extent nowadays – human capital. It means that "contributions" made into the company by various stakeholders should be properly rewarded. The supervisory board should expend particular concern and care to balancing the interests of various company stakeholders, and in particular to ensuring that the rights of such stakeholders as defined by law are duly respected. In its annual reports, the supervisory board should present information on actions taken to this effect.

In meeting this recommendation, the company may also develop and publish its policies in areas such as human capital management, environmental management, or internal codes of ethics. In order to develop its relations with the stakeholders (especially employees), the company may apply such arrangements as: employee representation on the supervisory board or the right to provide opinions on matters of critical importance for the company, employee stock ownership plans, etc. Such arrangements, however, should not infringe upon the rights of external shareholders of the company or reduce the accountability of its managers and supervisory board members (e.g. by eliminating the risk of a take-over).

Principle II

The composition of the supervisory board should facilitate objective oversight of the company and reflect interests of minority shareholders.

The supervisory board carries key importance as the guarantor of the interests of all the shareholders, especially in companies with high ownership and control concentration, whereby the mechanisms of the market for corporate control (i.e. the mergers and acquisitions market) cannot be freely applied. In such circumstances the supervisory board cannot exercise real control unless it is independent – at least partly – from the controlling shareholder. This purpose is served by including the so-called independent members in the composition of the supervisory board. As a result, a more impartial supervisory board process is ensured and the presence of minority shareholders in the company is duly reflected (however the Code does not advocate that the independent members be direct representatives of minority shareholders). In cases of significantly dispersed ownership and control structures, the independent members ensure that the supervisory board maintains its independence from the management board.

A greater scope of the supervisory board's impartiality and independence generates a number of benefits in terms of company management: it ensures more effective oversight and reduces the risk of failure in strategic decision making.

1. At least two members of the supervisory board should be independent. If they account for less than a half of the supervisory board, resolutions concerning issues that are crucial for the interests of minority shareholders should require a "yes" vote from at least two independent board members.

The fundamental and widely-accepted manner of enhancing the corporate governance role of the supervisory board is inclusion in its composition of the so-called independent members, and ensuring that they perform a material role in the functioning and decision-making of the board. At present, this solution has been introduced by only a few publicly listed companies in Poland.

The Code leaves to the market the role of defining the number of supervisory board members, and it lays down only the minimum requirement of two independent members. At the same time the Code recommends that the supervisory board decision-making procedures – as defined by the company articles – ensure that the "yes" votes of the independent members are sought on resolutions of critical importance for minority shareholders, such as:

- *transactions between the company and its parent entity or subsidiaries,*
- *setting the terms of share issues under the authorised capital,*

- *selection and appointment of the auditor.*

Thus there are two alternative arrangements which the company may choose from to secure full compliance with the Code: to ensure that at least half of the supervisory board members are independent members or to grant special prerogatives to a smaller number of independent supervisory board members.

The former solution seems to be the best systemic arrangement, in particular for companies with dispersed ownership and control structures. However, the solution may prove difficult to implement in practice, if not impossible in the short term. In particular, one should hardly expect the controlling shareholder to go along with losing control on the supervisory board, even if the Company Law provides for a direct appointment of the management board by the general meeting. The composition of the supervisory board with at least half of the members being independent should therefore be applied primarily in companies with a significantly dispersed shareholding base and in companies in which the state treasury is the controlling shareholder.

For the solution of having only two independent members on the supervisory board to be credible, the independent members must be furnished with at least the power to block decisions of the board on issues of critical importance for the interests of minority shareholders. To this end the company articles may require that supervisory board decisions on specific issues be adopted unanimously or by a sufficiently high voting majority. Granting decision blocking powers to the independent members of the supervisory board does in fact interfere with the collective character of the board and with the principle of the supervisory board being guided by the interests of the company, rather than the interests of individual groups of shareholders. However, this solution has already been used in practice: the first application of this Code recommendation is the supervisory board process as established by the articles of association of the Agora S.A. (Plc.) company. At the same time it should be noted that the institutional investor community strongly advocates the concept of special status of the selected supervisory board members who would not only be furnished with special blocking powers, but also be elected directly by minority shareholders as well as have the right of individual oversight and access to company documents.

The minimum degree of the independent directors' empowerment should be to ensure that the way they have voted on matters of critical importance for minority shareholders be published. In the case the independent members of the supervisory board have abstained or voted against a resolution, their justification of this action should be published as well. On the other hand, the company may go one step further than recommended by the Code and stipulate that the chairman of the supervisory board be independent.

2. Detailed criteria for independence of supervisory board members should be set in the articles of association of the company. In principle, independent board members should not be linked to the company or its controlling shareholder. The independence criteria for supervisory board members should be met throughout the entire tenure.

The development of good practice requires time and consensus. The Code, therefore, leaves the detailed independence criteria to be defined by companies and verified by the market and investors. Noteworthy, independence is not to be a complimentary category, but only represent lack of any links to the company or its

controlling shareholder. The substantive contribution made into the company's operations by the independent members on the one hand, and by the other members of the supervisory board on the other, is equally important. The independent supervisory board members should be just free from any commitments or relationships that could give rise to a conflict of interests in the context of acting in the interest of the company understood as a common interest of all the shareholders. The presence of independent members on the supervisory board should also facilitate more impartial oversight of the company affairs.

Corporate governance standards adopted by foreign capital markets usually require that the independent members of the supervisory board have no ties, including of family, personal or economic character, to:

- *the company and its subsidiaries,*
- *members of the company's management board, as well as the other members of the supervisory board,*
- *the controlling shareholder and its affiliates.*

The independence criteria may also specify the maximum tenure of service allowed on the company supervisory board (e.g. no longer than six years), and preclude earlier service on the company's management board. Independence may also be expressed in terms of the remuneration received: for example, the EASD recommendations preclude remuneration of the independent directors in the form of stock option plans.

For the independence criteria to be met over the entire tenure of the supervisory board service, the company's by-laws should require the independent members to re-validate their independence periodically. Furthermore, should the independence of a supervisory board member be compromised, the company should immediately inform the public thereof.

3. Election and dismissal of independent supervisory board members should take place without any decisive influence of the controlling shareholder. In case a proper mechanism in this respect is not stipulated in the articles of association of the company, the controlling shareholder should abstain from voting.

In the context of high ownership and control concentration – which is quite common in the Polish capital market – the simplest systemic solution ensuring true independence of a member of the supervisory board can only take the form of restricting the influence that the controlling shareholder may have on the election and dismissal of such a member. At the same time minority shareholders who have lost confidence in the independence of an independent director should have a real power to dismiss the director. In the context of dispersed ownership and control structures, the true independence of supervisory board members will be ensured by an effective market for corporate control and the requirement that the company refrain from the application of anti take-over defences.

A number of solutions may be devised to ensure that election and dismissal of the independent supervisory board members incorporates the spirit of this recommendation. The company articles may institute a special procedure of the independent member election, by deciding, for example, that such members be elected by the general meeting with a 9/10 majority, or that the voting disregards

the votes of the shareholder which holds over half of the votes at the general meeting in question. Furthermore, the independent supervisory board members may be elected by a separate body which represents exclusively qualified minority shareholders (the electoral college system). The company articles may also stipulate that the right to put forward candidates for the independent supervisory board members be granted exclusively to qualified minority shareholders.

As regards dismissal of the independent supervisory board members, the company articles may stipulate – by analogy – that such members be dismissed by the general meeting in a voting which disregards the votes of the shareholder which holds over half of the votes at the general meeting in question, or by a separate body which represents exclusively qualified minority shareholders. The company articles may also envisage that the dismissal of an independent supervisory board member at a motion of the controlling shareholder may only be possible due to material reasons, or that the relevant resolution require a 9/10 majority of the votes unless the dismissal motion has been tabled by minority shareholders. Another alternative is to institute a term of office of one year for all independent supervisory board members.

If the company articles do not provide for any specific mechanisms of independent director election and dismissal, the Code recommends that the controlling shareholder refrains from the exercise of its voting rights. The company may publish a relevant declaration of the controlling shareholder, or inform that the independent members of the supervisory board have been elected with the controlling shareholder having abstained from voting.

4. The names of candidates for supervisory board members and their credentials should be published before the general meeting, in sufficient time as to allow shareholders to make an informed voting decision.

Members of the supervisory board should have adequate education, qualifications, professional experience as well as personality, which can ensure the proper performance of their functions. However, the most straightforward way of arriving at the right composition of the supervisory board is to allow shareholders to make an informed decision. In making this decision, shareholders will always perform the best selection based on the criteria of merit, personality traits and ethics. Consequently, credentials information about candidates for supervisory board members should contain a description of the level of education, qualifications, professional experience and positions held in governance bodies of other companies. The requirement to disclose information about positions held with other companies aims at allowing shareholders to judge whether the candidate in question will be able to expend sufficient time on his or her duties on the supervisory board.

The Code strives to ensure a high level of professionalism in the supervisory board process by recommending that the board have access to advice of external experts at the expense of the company. Many foreign codes of best practice also recommend that companies provide proper training to members of their supervisory boards, in particular those members who are just starting up their assignment with the company.

The company should define proper procedures of proposing candidates for supervisory board members. In case a shortlist of candidates must be drawn up, the list should be compiled by the supervisory board or a competent committee

thereof, on which the independent members should form a majority. Relevant by-laws of the company may also require that candidates proposed in the course of a shareholders' meeting be considered only if the candidates proposed prior to the meeting have been rejected.

5. The number of supervisory board members should be regulated so as to ensure that a group of shareholders holding a total of 20 percent of the share capital has effective power to elect their representative in cumulative voting.

Cumulative voting (or voting in groups) is an emergency procedure which ensures that a qualified group of shareholders may introduce at least one representative to the supervisory board, who is automatically furnished with individual oversight powers. Pursuant to the Company Law, any shareholder or shareholders holding 20 percent of the share capital have the right to table a motion for election of the supervisory board by the way of cumulative voting. However, if the supervisory board is composed of three members – as is now allowed by the new Polish Company Law – an election of a member by such a group may be problematic, as the required effective majority to elect one member is 33.3 percent of all votes represented at the shareholders' meeting. Hence the company articles should stipulate that the supervisory board be composed of five members or more if a specified number of the supervisory board members are not elected directly by the general meeting (e.g. a representative of the employees or of the Treasury).

The number of supervisory board members may be fewer than five (which might be justified for smaller companies), provided that the requirements regarding the membership of independent members are satisfied and the company articles stipulate that in the case of a motion having been tabled by a qualified shareholder or shareholders to elect the supervisory board in cumulative voting, the prescribed number of supervisory board members shall be set at five or more, as appropriate.

Principle III

The powers of the supervisory board and the company by-laws should ensure an effective supervisory board process and duly secure interests of all the shareholders.

Pursuant to the Company Law, the supervisory board exercises on-going oversight of the company's operations in all strands of its business. However, for the supervisory board to perform a real role in corporate governance, it must not only enjoy relative independence, but also be furnished with adequate prerogatives and resources needed for effective exercise of oversight and control functions.

The supervisory board should be particularly concerned about securing shareholder interests against opportunistic behaviour of the company managers or the controlling shareholder, whose positioning within the company may incline them to undertake actions that are designed primarily to cater for their own interests. In particular, company managers or the controlling shareholder may strive to derive greater benefits than those resulting from their contracts or shares possessed, respectively, i.e. to transfer value from the company, which violates the interest of all the shareholders. The internal mechanisms of corporate governance should serve as an effective shield against such situations, including timely disclosure of potential conflicts of interests on the part of company managers and supervisory board members.

Pursuant to the Code recommendations, the management board or the controlling shareholder should not take advantage of their positions to derive any benefits above those resulting from their contracts or shares possessed, respectively, in a manner which violates the interests of all the shareholders.

1. Transactions and agreements between the company and entities or individuals related to, or having direct or indirect influence on, the company should be subject to supervisory board approval. The relevant resolutions of the board should require a "yes" vote from at least two independent board members.

Transactions and agreements between the company on the one hand, and entities and persons being related to, or having a direct or indirect influence on, the company on the other, carry the risk of additional benefits being realised at the expense of all the shareholders or of minority shareholders (as well as the company creditors). In this recommendation the Code refers in particular to transactions and agreements between the company and:

- *the controlling shareholder and its affiliates,*

- *the company subsidiaries or affiliates, as well as significant clients or suppliers,*
- *members of the management board and the supervisory board, as well as entities related thereto.*

Pursuant to the Code, such transactions should be subject to additional control exercised by the supervisory board. The Company Law stipulates that the company articles may require the management board to seek an approval of the supervisory board prior to taking certain actions as specified in the articles of association. The terms of such transactions and agreements should be on an arm's length basis, and any supervisory board members involved therein should not participate in the decision making.

According to the Code recommendations, the company articles should define a procedure of decision-making applicable to such transactions and agreements, which ensures that approval of at least two independent board members is obtained. At the same time, the articles may include stipulations waiving the requirement of supervisory board approval for transactions and agreements, which represent small value, or else are of routine or typical character. However, the company should be required to provide periodical information on the total value of such transactions and agreements.

2. The management board and the supervisory board should operate as regulated by relevant by-laws approved by the supervisory board and the general meeting, respectively. These by-laws, as well as the articles of association of the company, should be available from the company website.

The by-laws of the management board process and the supervisory board process may contain important points of order which have an impact on the functioning of internal corporate governance mechanisms. In order to avoid abuse of the by-laws, as well as to ensure proper conditions of the supervisory board process, the Code recommends that the by-laws be approved by the competent oversight body. The by-laws and the company articles should be published and easily available, so that investors can verify and evaluate the institutional arrangements in the company. The company website seems to be the best vehicle of such information.

3. The supervisory board should be provided with sufficient administrative support and be able to hire external experts at the expense of the company.

For the sake of efficient functioning, the supervisory board needs to receive proper administrative support. Furthermore, to be effective, the supervisory board need not only represent a high level of professionalism of its members, but also hire external experts. The company should therefore make formal arrangements to provide the supervisory board with such a support and allow the board to hire external experts at the expense of the company.

The rules of hiring external experts should be stipulated in the company articles or the relevant by-laws. The company may publish information about the supervisory board budget, rules of hiring external experts and the value of advisory services

purchased. The information may be included in the annual corporate governance report of the company.

Many foreign corporate governance codes also recommend that specialised training be provided to the supervisory board members, in particular those starting up their assignment with the company.

4. Members of the management board and the supervisory board should be obliged to disclose any conflicts of interests that may arise in relation to their duties.

Conflict of interests disclosures by company managers and supervisory board members represent a crucial corporate governance mechanism. Conflicts of interests are part and parcel of business practice, but, importantly, they must be disclosed and properly taken account of in the supervisory board's decision making processes.

Company supervisory board members and managers should be obliged to disclose conflicts of interests to the competent company governance body. If a conflict of interest arises for a management board member, this information should be notified immediately to the supervisory board. In warranted cases the supervisory board may decide to make the conflict of interests information public.

Proper internal regulations and conflict of interests disclosures should enhance the credibility that the supervisory board and the management board may enjoy among shareholders.

5. The company should regulate trading in its securities and respective derivatives by its supervisory board members, managers and any other persons who have privileged access to information so as to prevent any violation of the interests of shareholders and investors, and in particular the right of equal access to information.

As a result of their functions in the company, members of the company governance bodies and other managers enjoy privileged – relative to the shareholders – access to information that may be securities price sensitive. This inevitable asymmetrical advantage creates opportunities for company managers and supervisory board members to derive additional benefits, and gives rise to conflicts of interests in the context of the requirement to immediately notify any material information to the shareholders.

As a result of opportunistic insider trading, shareholders may lose confidence as to whether the company ensures equal access to material information. In some circumstances, especially when directors and managers hold large share packages, the scale of transactions involving those share packages may have an adverse effect on the company share pricing.

The Code recommends that the company institutes internal regulations defining the rules of trading in company securities and respective derivatives. Those regulations should restrict the possibility of engaging into such transactions prior to the relevant material information going public, and define precise disclosure requirements related to such transactions. Furthermore, the regulations may recommend a minimum lock-up period on the shares.

Such internal regulations should enhance investor confidence. Proper notification of transactions involving company directors, managers, and other persons having access to confidential information, allows shareholders to verify whether the company has been diligent in providing information to shareholders and ensuring that all shareholders have equal access to information. Unfortunately, public companies applying such arrangements are still difficult to find in Poland. The first Polish company, which has instituted internal insider trading regulations was Agora S.A.

Principle IV

The shareholders’ meeting should be convened and organised so as not to violate interests and rights of any shareholders. The controlling shareholder should not restrict the other shareholders in the effective exercise of their corporate rights.

The shareholders’ meeting is a place of important decisions for the company and its governance bodies. It is also where the interests of shareholders focus and clash. Unfortunately, in the past a number of cases were noted in which the institution of a general meeting was manipulated as to restrict minority shareholders in the effective exercise of their corporate rights. In particular, such cases involved attempts to restrict the participation of minority shareholders in the general meeting, as well as to prevent certain items from being put on the agenda or discussed by the meeting. There were also attempts to postpone the date of the general meeting in order to restrict the possibility of changing the composition of the supervisory board, including election of minority shareholders’ representatives to the board.

The Code recommends that no actions violating the rights of minority shareholders be taken, and sees the general meeting as a platform for seeking compromise-based solutions in good service to the company and all the shareholders. To this end, the general meeting should be a place of discussions and communication among shareholders, as well as among the shareholders, company governance bodies and the auditor.

The management board and the controlling shareholder should also refrain from restricting the other shareholders from effective exercise of their corporate rights, such as the right to convene a general meeting, the right of all shareholders’ to participate in the general meeting, as well as the right to put items on the general meeting agenda or elect minority shareholders’ representatives to the supervisory board.

1. The venue, time and date of the shareholders’ meeting should not hinder wide attendance by shareholders or their access to documents prepared for the meeting. To the extent possible, documentation prepared for the general meeting should be available from the company’s website.

To participate in the general meeting is an inalienable right of any shareholder and should not be restricted. Hence the time and venue set for the general meeting should be feasible for all shareholders that may be reasonably interested in taking part. This recommendation gains special importance in Poland, where

participation in the general meeting by the way of voting by correspondence or by audio-visual means is not allowed.

Unrestricted participation in the general meeting and minimisation of participation costs should encourage shareholders to exercise their voting rights and – by that token – to develop long term relationships with the company. Otherwise the only recourse left to shareholders is to vote with their feet, which makes the company more vulnerable to a hostile take-over. The company may also consider measures to stimulate or furnish mechanisms of voting by proxies.

Effective shareholder participation in the general meeting also requires that shareholders have access to relevant documentation (the agenda, draft resolutions, reports). The Code recommends that those documents be available from the company's website.

2. Prior to the shareholders' meeting the company should enable its shareholders to lodge questions on issues covered by the agenda. Information on the course of the general meeting, including answers to the questions tabled by shareholders, should be published – if possible – on the company's website.

In order to facilitate the communication between the company and the shareholders, the Code recommends that the company invite shareholders to table questions to the management board, the supervisory board and the auditor prior to the general meeting. The company should also ensure that those persons, including a representative of the auditor, may participate in the general meeting.

Information about the course of the general meeting, including answers to the shareholders' questions, should be published, also – if possible – on the company's website, in compliance with the restrictions stipulated by the Public Trading in Securities law.

3. Two independent supervisory board members should have the right to request the shareholders' meeting to be convened, and – if the request is not satisfied – to convene an extraordinary shareholders' meeting. The shareholders' meeting convened at the request of the independent supervisory board members or a qualified group of shareholders should take place on the date set in the request.

In cases of utmost importance the supervisory board may wish to communicate with the shareholders by the means of an extraordinary general meeting. Among the prerogatives that the Code proposes to grant to the independent supervisory board members is the right to demand that an extraordinary general meeting be convened. This prerogative corresponds to an analogous right stipulated by the Company Law for shareholders representing at least 10 percent of the share capital. This is how the independent supervisory board members may effectively substitute a dispersed shareholder base in active exercise of their oversight role. The demand for a general meeting should be made by at least two supervisory board members, which means that a minimum scope of prior consensus must be achieved, preventing this prerogative from being abused. The solution

recommended by the Code has already been reflected in the articles of a few public companies in Poland (e.g. Agora S.A.).

At its own initiative, the company may also decide to institute a facility allowing a smaller group of shareholders to demand a general meeting than the minimum share capital representation defined by the Company Law (e.g. 5 percent of the share capital).

In order to eliminate the practice of postponing the date of a general meeting, the Code recommends that the date requested by the minority shareholders or the independent supervisory board members be strictly observed.

4. The company articles of association should set additional requirements to be met in order to postpone the shareholders` meeting convened at the request of qualified shareholders or independent supervisory board members, or to remove items proposed thereby from the agenda.

General meetings usually adopt resolutions with a simple majority, which privileges the controlling shareholder, allowing it to exercise significant influence on the course and agenda of the general meeting.

Pursuant to the Code, the controlling shareholder should not use its position to postpone a general meeting against the will of the other shareholders who requested the meeting, or to remove from the agenda items proposed by minority shareholders or independent supervisory board members. In order to preclude such situations, the company articles may, for example, require a 4/5 majority to effectively postpone the date of the general meeting or remove items from its agenda.

5. The chairman of the shareholders` meeting should satisfy the criteria of professionalism and impartiality so as to ensure efficient and unbiased course of the proceedings. The company articles of association may require that the chairman be independent from the company and its controlling shareholder.

Recent years' experience shows that a chairman of the general meeting elected with the controlling shareholder's voting majority may have a significant negative impact on the course and results of the meeting: the chairman may be biased in resolving procedural questions, and restrict, or even prevent, minority shareholders from tabling questions. In order to eliminate such practices the Code recommends that the election of the chairman of the general meeting should involve a minimum evaluation of the person's credentials to perform this function. It is also recommended that the company define minimum criteria to be met by the general meeting chairman, including his or her independence from the company and the controlling shareholder. The chairman election procedure should be construed so as to prevent the controlling shareholder from blocking the effective election of the chairman.

6. Any amendments to the by-laws regulating the course of the shareholders' meeting should come into effect as from the next meeting, unless they are approved by a 9/10 majority of the votes.

The general meeting should proceed according to transparent and well-known prescribed rules. The Code therefore recommends that the possibility to make on-going amendments to the general meeting by-laws be restricted, so that the general meeting process is not used to restrict rights of shareholders. Any amendments to the by-laws effected in the course of the general meeting may only pertain to purely technical questions, and shall be approved by an overwhelming majority of the shareholders.

The general meeting by-laws should be publicly available, including – if possible – from the company's website.

Principle V

The company should not apply anti take-over defences against shareholders' interests. Changes in the company share capital should not violate interests of the existing shareholders.

Mergers and acquisitions are an important control mechanism of the capital market. Such transactions are particularly useful and effective in the context of dispersed shareholding and control structures. The risk of a take-over may stimulate company managers and supervisory board members to manage the company better and maximise shareholder value. A permanent gap between the company economic and market values, which – from the shareholders' perspective – reflects inefficient management, will always lead to a take-over and replacement of the company managers and supervisory board members.

In keeping with the OECD and EASD best practice guidelines, the Code also recommends that companies not use instruments with the view to eliminate the risk of a take-over entirely. It is recommended that any application of such instruments should be subject to shareholder oversight. Anti take-over defences can be allowed over a limited period of time, and only if they are in the interest of the company and its shareholders, and have been approved by the latter. In specific circumstances, a tangible risk of a take-over may halt the management board back in taking risky but justified long term investment decisions.

Securing the interests of existing shareholders in the context of changes in the company share capital is only partially related to mergers and acquisitions. The company may issue new shares under the authorised capital as an anti take-over defence – addressing them to friendly parties and diluting the stakes of existing shareholders, thus reducing the risk of a take-over. Pricing of such a share issue may also harm the interests of the existing shareholders, as may a share issue addressed to company managers and employees. On the other hand, similar risks arise from transactions in which the company engages into redemption or buy-back of its own shares.

1. A voting cap – as defined in the company articles of association – should not apply to a shareholder, who commands more than 50 percent of the votes at the general meeting.

The Company Law institutes the so-called voting cap, i.e. a restriction of an individual shareholder's voting rights to no less than 20 percent. This facility may be used to defend the company against a take-over, i.e. against replacement of ineffective managers and directors. The risk of a hostile take-over is a strong factor stimulating managers to better performance. Hence it is recommended that the

available voting cap be not applicable to the shareholder which has exceeded the threshold of 50 percent of the votes in the general meeting. A more far-reaching solution is to stipulate that the voting cap applies for a limited period only (e.g. in order to eliminate the risk of a take-over when the company engages in risky investment projects). Any extension of such a period would then be subject to a new approval by the shareholders.

2. The company should not engage into acquiring of its own shares as an anti take-over defence.

The Company Law stipulates some possibilities of acquisition of company's own shares, which may be used as an anti take-over defence. Under the total limit of 10 percent of all the shares issued, the company may buy back own shares in order to prevent a potential severe loss to the company, as well as to offer the shares to the company employees. Financial institutions (e.g. a bank or a national investment fund) may also buy back own shares on their own or customer's account for the purpose of future re-sale.

The draft Code recommends that the company fully refrains from such transactions being performed directly or via subsidiaries. Unfortunately, the practice of the Polish capital market has seen quite many undesirable examples of public companies being controlled by insiders who acquired the control as a result of the company shares having been purchased by its subsidiaries (i.e. when the greater scope of control over the company has been paid for from the remaining shareholders' money). Public companies also should not engage into cross shareholdings, which restricts the controlling rights of external shareholders.

3. The company should acquire significant packages of its own shares solely through a public tender offer addressed to all the shareholders.

The buy-back of own shares should be performed in the open, as in some circumstances such transactions may result in value transfer to selected shareholders. Hence the Code recommends that buy-back transactions guarantee the same selling terms to all the shareholders, which is best catered for in a public tender offer procedure. The company may choose not to follow the procedure if it has been approved by the shareholders (i.e. a relevant resolution on, for example, share redemption, has been adopted by the general meeting). Shareholders who believe that the buy-back procedure stipulated by the relevant resolution harms their interests may always appeal against the resolution. The company should notify the reasons and terms of own shares buy-back in due advance.

4. A relevant resolution of the shareholders' meeting as well as the relevant provisions of the company articles of association concerning authorised capital should ensure that this facility is not employed as an anti take-over defence and duly secures interests of the existing shareholders in respect to the terms of the issue.

The authorised capital concept has been introduced to increase the flexibility of the company in raising funds relative to the market conditions. In this sense it is undoubtedly a very useful and needed institution. However, it also carries certain

inherent risks. For example, shareholders have no recourse to court, because the relevant share issue decisions are taken by the management board and the supervisory board, rather than by the general meeting. Authorised capital may also be used as a hostile take-over defence, and terms of the share issue may violate interests of the existing shareholders.

In particular, a resolution of the general meeting and the relevant provisions of the company articles should specify what circumstances allow the management board to issue shares under authorised capital (e.g. execution of an approved investment programme), and what situations preclude such an issue (e.g. defence against a hostile take-over). In case the shares issued under authorised capital are to be sold in a private placement, a resolution of the general meeting should specify the selection criteria for entities to which the offering will be addressed. The decision to issue shares under authorised capital without pre-emptive rights, to offer the shares to a specific entity or a group of entities, as well as the issue price decision should be approved by the supervisory board, including endorsement of the independent members thereof. If the pre-emptive rights of the existing shareholders are excluded, a relevant authorised capital resolution of the general meeting should also specify the criteria of pricing the issue, as well as clearly obligate the management board to take reasonable measures to achieve the best available issue price. Except for special circumstances (e.g. execution of a long-term investment programme), the company articles should stipulate a one year time horizon for the authorised capital competencies of the management board, so that the extension of this period for another year requires a new approval of the shareholders.

Proper precautions regarding the application of the authorised capital provisions by the company seem to be of critical importance in the case of companies being floated for the first time, as their articles of association may contain authorised capital provisions dated prior to the public offering, i.e. accepted without the approval of new external shareholders.

5. Shares issued for the purpose of management and employee stock option plans should not exceed 10 percent of the total number of the company shares over any five-year period. The issue price of such shares should not differ significantly from the market price.

Stock option plans are useful and should be applied more frequently. However, such plans should not cause any significant dilution of the existing shareholders' stakes or constitute a gross incident of value drawing from the company. One specific type of risk is value transfers in the context of the company managers holding significant share packages, or the major owner being concurrently a manager of the company.

Principle VI

The company should provide effective access to information, which is necessary to evaluate the company's current position, future prospects, as well as the way in which the company operates and applies the corporate governance rules.

A public company should primarily satisfy all the statutory information disclosure requirements, and in particular immediately notify to the public any information that may have a significant impact on the price or value of its securities. Furthermore, the company should also provide access to relevant information on its operations and investment risks, including internal arrangements in the area of corporate governance, as well as the ownership and control structure of the company. This information should be extensive enough to allow investors to evaluate the corporate management system from the viewpoint of its effectiveness and due protection of shareholder interests, including the interests of minority shareholders.

1. The company should ensure that the access to material information and company by-laws is easy, equal and provided at reasonable costs for the company. Relevant information and documents should be available from the company's website.

A majority of publicly listed companies in Poland have websites. However, the degree to which the Internet is used for active investor relations is still small in spite of the fact that the web is the simplest and cheapest way to distribute information to shareholders as well to communicate actively with the company shareholder base (e.g. by inviting shareholders to put questions to the company).

The Code therefore recommends that public companies make a greater use of the web in investor relations. The company website should cover not only current information about the company and obligatory periodical reports, but also the relevant information as required by this Code. The Internet home page should also provide access to such documents as: annual reports, the articles of association and the by-laws of the company governance bodies (including the general meeting), the regulations pertaining to trading in the company's shares by its directors and managers as well as by other persons having access to insider information.

To the extent possible, the website should also offer a minimum scope of information in the English language.

2. Every year the company should publish a report providing a detailed description of its corporate governance framework. It should include information on how the company achieves compliance with this Code or explain the reasons for non-compliance.

Observance of corporate governance principles will enhance the company's credibility among investors. Disclosure of the relevant information should therefore come as natural. However, the recommendations of the Code are voluntary, and the company may provide a reasonable explanation of why it does not follow some of those recommendations. As well, the company may wish to highlight the effective implementation of other solutions proposed by the Code, and designed to cater for shareholder interests.

From the shareholders' point of view, comprehensive information is highly desirable; otherwise, shareholders would have to review all company documents and regulations on their own. For the information to be credible, however, it should be approved – if not prepared – by the supervisory board.

The draft Corporate Governance Code lays down guidelines, which may – but need not – be followed by companies. Most importantly, companies should strive to capture the spirit, rather than the letter of the Code recommendations. To this end the Code recommends that companies publish up-to-date reports on their corporate governance arrangements, in which they should not only report compliance, but also describe how this compliance is achieved.

3. Every year the supervisory board should present a report to the shareholders on the position of the company, its prospects, functioning of its corporate governance framework, as well as the company's system of internal controls and information policy.

An important objective of the Code is to enhance the corporate governance role of the supervisory board, as well as to strengthen the board's accountability to the shareholders. The role of the supervisory board process is important in Polish companies, yet reporting by supervisory boards is still a rare practice.

The Code recommends that the supervisory board present a report on its activities as well as an evaluation of the company's current position and future prospects. Given its special role, the supervisory board should also present its evaluation of the corporate governance process, the internal controls system and the information policy of the company. The board may choose to present its evaluation of other strands of the company's operations as well, including human capital management, or environmental management policy.

4. The company should provide access to basic information about members of its management board, including their professional qualifications, positions held with other companies and links to the shareholders. The available information on the forms and amount of managers remuneration should include such components as: base salary, bonuses, stock options, severance payments and other emoluments constituting a material cost item for the company.

Comprehensive information about the management board members, including precise details if a member of the management board is a significant shareholder of the company or is related to such a shareholder, should be available from the company's website.

The form and amounts of company top manager remuneration is also relevant to the shareholders. This information allows shareholders to judge how well the management board is motivated to provide effective management performance and shareholder value. Remuneration information should include details of the base salary as well as performance-related bonuses, including the bonus award rules.

The information should identify the individual components of manager remuneration, such as stock options, pension insurance, insurance policies, severance payments, and other emoluments constituting a material cost item for the company or the shareholders – financed both by the company and its subsidiaries.

The amount of top manager remuneration should be given at least as an aggregated amount for the entire management board.

5. The company should provide access to basic information about members of its supervisory board, including their professional qualifications, individual roles on the supervisory board (if any), links to the company or the controlling shareholder, positions held with other companies as well as the forms and amount of remuneration.

Information about the independence of a supervisory board member, or alternatively his or her links to the company or the controlling shareholder, should be an important part of this report. Independent supervisory board members should be obliged to re-validate their independence on a periodical basis. Should the independence status of a board member be lost – the company should immediately inform the public thereof.

The amount of supervisory board member remuneration should be given at least as an aggregated amount for the entire supervisory board. If the remuneration for individual members vary, the company should report separately on the remuneration of the independent members of the supervisory board.

The company should provide information about the form and amount of remuneration awarded to the supervisory board members needed to evaluate whether the remuneration may restrict the impartiality and views of the independent directors.

6. The company should disclose up-to-date information on its current ownership and control structures, including information on any arrangements causing disparity between the stake in ownership and the stake in control, as well as information – known to the company - on any agreements concluded by shareholders concerning voting in concert.

Information about the company ownership and control structures is an important variable determining shareholder investment behaviour. It allows shareholders to decide about increasing their respective stakes or – if material risks have been judged to emerge – about selling the stake off. The Code recommends that up-to-date data on the ownership and control structures include, inter alia, information about shares (stakes in capital and control) held by members of the management board, the supervisory board, and founders of the company, as well as their respective subsidiaries and subsidiaries of the company.

The company should disclose any arrangements causing a disparity between the respective stakes in capital and the number of votes held (i.e. about the number of preferred shares, etc.). Whenever the company is aware about agreements concluded by shareholders regarding voting in concert, the company should publish this information. This requirement complements the stipulations of the Public Trading in Securities Law which obliges shareholders to disclose such mutual agreements only when they refer to a purchase or sale of shares resulting in the statutory stake limits being exceeded.

Principle VII

The appointment process of the company's auditor should ensure independence of the auditor's opinion.

The corporate governance role of the auditor is crucial – the auditor shall ensure that the relevant reports and the accounting conventions used by the company give a true and fair view of the company's affairs and financial position. However, the auditor may not be able to escape conflicts of interest, which may restrict the independence of their opinion. Hence the Code provides for some additional safeguards of shareholders' interests, including minority shareholders, in the company – auditor relationship.

1. The company auditor should be appointed by the supervisory board or recommended thereby for appointment to the shareholders' general meeting. The relevant resolution of the supervisory board should require a "yes" vote of at least two independent board members.

A conflict of interest on the part of the company auditor arises frequently whenever the auditor is appointed by the management board of the company. The procedure of direct auditor appointment by the management board is relatively rare among Polish public companies. However, the appointment approval given by the supervisory board is often a formal validation of the earlier choice already made by the management board. According to the Code, the auditor should be selected at least by the supervisory board, whereby the board should be able to perform a proper selection procedure. The company articles should stipulate that the relevant auditor appointment resolution of the supervisory board be endorsed by the independent members. As an absolute minimum requirement, the company should publish what votes were cast by the independent members when selecting the auditor.

The supervisory board may establish an audit committee, composed mainly of the independent members of the board. The committee is responsible for monitoring the financial situation of the company and its accounting system. In doing so, the committee communicates with the company auditor.

If the company is a part of a multinational capital group, whereby the auditor is actually imposed by group-wide rules, the supervisory board should ensure that the chartered auditor responsible for auditing the company is not accountable to, nor a member of, the audit team for the parent company or the capital group.

2. When selecting the auditor, the supervisory board should consider the value of other services provided to the company by the potential candidate firms, as well as their subsidiaries and affiliates, over the last two financial years. The supervisory board should be able to perform a proper selection procedure.

A conflict of interest on the part of the company auditor may also arise whenever the auditor firm or its subsidiaries and affiliates (e.g. affiliated law firms) concurrently provide other services to the company (e.g. consulting services) as contracted by the management board. At present the trend is to eliminate the practice of concurrent provision of advisory and auditor services by one and the same firm or a group of related firms. In this respect the Code only requires that the supervisory board consider such links of the potential auditor to the company when deciding upon the appointment. Elimination of this type of a conflict of interest also prevents the candidate firm from competing on the grounds of a lower audit fee to be compensated for in the form of fees for other services contracted by the management board.

The company's internal regulations should allow the supervisory board to conduct a proper auditor selection procedure (including questions to the potential auditor, invitation of price quotes, etc.). The company management board should be obliged to take adequate measures to provide to the supervisory board information about the value of other services delivered to the company by the candidate auditing firms.

The supervisory board should also inform the public of whether it has effectively verified the auditor's independence, as required by the spirit of this recommendation. Information on the auditor selection and appointment procedure should be given in the annual corporate governance report.

3. The company should publish information on the value of other services provided by the auditor, as well as its subsidiaries and affiliates, in a given accounting year.

Usually the full auditor selection and appointment procedure is performed once every two or three years. It seems advisable therefore to periodically verify the links that the auditor firm may have developed to the company as a result of other services provision. It is also important information for the shareholders, allowing them to evaluate the effectiveness of the supervisory board process in this respect.

Relevant information should include the value of the other services provided by the auditor firm and its affiliates, in relation to the value of all consulting services purchased by the company and the audit costs. Prior to publication, the information should be presented to, and approved by, the supervisory board.

4. At least once every five years the company should appoint a new auditor. The new appointment should not coincide with a replacement of the management board.

Too long a tenure of an auditor with the company may compromise its independence (e.g. restrict impartiality due to excessive routine). Although appointment of a new auditor may involve additional expenses, the cost seems justified by long term shareholders' interests (especially in view of the much higher potential costs of insolvency; cf. the Enron case).

The Code adopts a general recommendation in this respect, with the view to cater for a flexible development of the auditor rotation practice. The company may opt for instituting a term of office allowed to any one auditing firm, and restrict the

number of successive terms to two. Alternatively, the company may resolve to change the auditor at least once within one management board term of office.

Instead of appointing a new firm as the auditor, the company may seek assurance from the incumbent auditor that the entire audit team shall be replaced in pre-defined intervals.

5. The auditor of the controlling shareholder or the auditor who performed the regular audit of the company in the period named in the motion on the appointment of the auditor should not be appointed to serve as a special assignment auditor.

A special assignment auditor is a relatively new concept introduced by the recent amendments to the Public Trading in Securities Law. The new institution has been designed to protect the interests of minority shareholders in companies with a controlling shareholder (which may be used in emergency situations by minority shareholders). Pursuant to the Law, any shareholder or a group of shareholders representing at least 5 percent of the share capital may move for a special assignment auditor to be appointed.

In practice, however, the concept of a special assignment auditor calls for additional safeguards of the auditor's independence, as the controlling shareholder may exercise effective influence upon its appointment. The Code addresses this point with this recommendation, which may be translated into relevant stipulations of the company articles. The recommendation is a more precise wording of the provisions of existing law, which may need to be amended in the future.

Appendix 1

We wish to thank the following persons for comments submitted in writing or at consultative meetings.

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Piotr Kozarzewski (CASE)

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Krzysztof Szwarc (BRE Bank)

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