Enforcement of Corporate Governance Mechanisms in Transitional Economies –
Attainable Goal or Wishful Thinking?

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I. Introduction

Enforcement of corporate governance mechanisms is a topic that has been widely discussed recently. Nobody would argue that it is crucial to provide such legal provisions not only to have black-letter opportunities to effectively manage corporations, but also to have an opportunity to make a real use of them. This issue is particularly worth discussing since many aspects of doing business are already overregulated (namely there are many institutions in substantial law that are designed to control corporate governance of publicly held corporations) and thus there is no point in magnifying the volume of legal requirements to fill in by managers and corporate watchdogs. Rather, we need to look deeper than wider and work with what we have and make common effort not only to have good law in books, but also good law in action. And see its results and effects in everyday life.

This is particularly important nowadays, when more and more lay people invest their life savings into retirement plans and funds in order to have capital for their children education and their own retirement. This is all about our common wealth. Situation is particularly worrisome in emerging markets and transitional economies (however to different extent), where both investors and governments lack those years of experience of capitalisms, due to only relatively recently passed era of communism which lacked in real influence on their current financial situation.

At the beginning of this paper firstly the most important concepts are briefly discussed. We need to realize what are the most significant corporate governance mechanisms and what is their role in a „living body“, which every corporation is. Also types of enforcement are presented. Second, stress is put on transitional economies, their characteristics and particularities that may affect performance of companies incorporated in those countries. Next, the current state of law in transitional economies is briefly discussed and attention is paid to the most problematic issues. The next chapter covers the solutions
adopted in other important jurisdictions worldwide. As a follow-up, chapter six is mainly oriented on extracting "a lesson" from those countries. It is aimed to point out the solutions that may be applied to transitional economies with some changes necessary due to different economic and market history of those. The last chapter concludes.

An objective of this master thesis is to answer the question whether it is possible to improve enforcement mechanisms of corporate governance in transitional economies and what are the main barriers to a better management and functioning of corporations in this region.

The main thesis of this paper is that current state of law in transitional economies is detrimental to companies and investors. First, the corporate governance mechanisms exist, but are usually not very useful. Alternatively, that the stakeholders (even the investors) are not fully aware of tools which are in their hands. Wrong law means ineffective management and negative influence over all entities somehow dependent upon a given company.

The main objective is to provide a reader with the basic ideas on what changes should be made and in which particular aspects of corporate governance, in order to eliminate the biggest mistakes that were made on various levels of legislation and education of transitional economies’ societies.
II. Corporate governance mechanisms and their role in a company. Enforcement methods.

Every corporation is a body where meet the interests of many groups. We may encounter tensions at different dimensions and between different groups of people involved. This may happen not only between controlling shareholders and minority shareholders but also between shareholders and managers. At the same time the role and interest of other stakeholders cannot be overlooked (employees, creditors, society as a whole and customers).

An assumption that managers would simply work in order to maximize benefit of all those groups instead of thinking about their own profit is nothing more than a wishful thinking. Managers are more oriented on maximizing their own profit and looking for excessive executive compensation than creating value of a company to the benefit of all stakeholders. That is why the corporate governance mechanisms are essential for planning business of any type and no business can be conducted without them.

In the beginning of this chapter the most important corporate governance mechanisms are briefly described (II.1). Later, it is demonstrated why they are so important for every company and cannot be disregarded by anyone somehow involved in today’s business world (II.2). Third, different types of enforcement of corporate governance are pointed out (II.3). In the last subchapter, problems with practical application of enforcement mechanisms are addressed (III.4.)

1 It was observed in many corporate scandals that occurred in XXIth century, for example Parmalat scandal, http://www.larouchepub.com/other/2004/3102parmalat_invest.html, Disney-Ovitz case, http://www.bingham.com/Publications/Files/2005/08/Delaware-Court-of-Chancery-Decides-DisneyOvitz-Compensation-Case-in-Favor-of-All-Director-Defendants
1. Corporate governance – what does it really mean?

Corporate governance is a set of procedures and policies adopted by a company in order to provide internal and external stakeholders with proper protection of their interests\(^2\). It can be also described differently:

“Corporate Governance is the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies. The shareholders’ role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place. The responsibilities of the board include setting the company’s strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship. The board’s actions are subject to laws, regulations and the shareholders in general meeting”\(^3\).

That is how corporate governance should work in the perfect business environment. Unfortunately, due to the reasons pointed out above, this is not always the case and this definition needs to be adjusted to the reality.

Corporate governance is of particular importance for publicly held corporations, due to their size and complexity of structures and internal relations. It is easier to reach a compromise without compliance with

\(^2\) See for example Rafael La Porta, *Investor Protection and Corporate Governance*, Dartmouth College, Florencio Lopez de Silanes, Andrei Shleifer : “Corporate governance is, to a large extent, a set of mechanisms through which outside investors protect themselves against expropriation by the insiders”


http://www.law.uj.edu.pl/~kpg/images/stories/lad_korporaczad_og.pdf, p. 6. He also indicates that there are different approaches to this term, the wider and the narrower one.
corporate law and other codes that regulate corporate governance in smaller business entities. Without dwelling upon particular characteristics of every existing corporate governance mechanisms, it is worth mentioning that the main tools are: board of directors as a supervisory body, audits (very often provided by external auditing firms, normally conducted at least every year and very often this is mandatory before IPO) and balance of power (which is understood as divisions of tasks between different bodies within a corporation).

Recently, due to several financial scandals and also because of rapidly changing business world, there were several „amendments” and proposals of amendments to those mechanisms\(^4\). They are designed to improve the way in which common aims and goals within the corporations are to be reached.

2. **Role of corporate governance mechanisms**

First of all, one must be aware what are the primary supervisors and „watchdogs” who care about corporate governance compliance. They are, first, national courts (particularly important in transitional economies, but, at the same time, in those countries they are very inefficient and even in business-related cases the proceedings last far too long), capital market authorities, stock exchanges and other types of self-regulatory bodies as supervisors\(^5\).

First, it is obligatory to analyze why companies care about compliance with arbitrarily imposed rules (such as, for example, disclosure requirements, while not revealing those information may give a company a tactical advantage over

\(^4\) For example, Joseph A. McCahery, Erik P.M. Vermeulen, Masato Hisatake, *The Present and Future of Corporate Governance. Re-Examining the Role of the Board of Directors and Investor Relations in Listed Companies*, SSRN 2013.

its competitors). Of course, there are always economic reasons (threat of fines imposed by state authorities\(^6\)), but also pressure from other companies in particular industry, as well as clients and contractors. Sometimes compliance with some informal codes of best practices is required by the stock exchange. Without it, IPO is simply not possible. Consequences of non-compliance with good corporate governance standards are as following:

1. voting with feet by shareholders: if shareholders do not have confidence about company’s business future and prospective, they may sell their shares which leads to a decrease of company’s shares’ value;
2. lack of risk management within a company which leads to problems with making good decisions in corporate matters;
3. problems with raising capital.

Sometimes regulatory bodies or stock exchanges want corporate governance disclosures to be verified or even audited, especially when it is a part of annual report\(^7\).

While analyzing the corporate governance-related issues and their importance in modern business world, we cannot disregard corporate governance rating’s significance. This is the evaluation of companies (usually those listed on the stock exchange) in matters of compliance with the corporate governance codes and practices. According to the results of empirical research, including but not limited to those conducted by G. Kevin Spellman and Robert Watson, a high score (rating) of a company’s corporate governance is positively correlated with its financial results and dividend policy\(^8\). Therefore, ratings of


\(^8\) Corporate Governance Ratings and Corporate Performance: An Analysis of Governance Metrics International (GMI) ratings of US Firms.
corporate governance are used primarily by firms that manage the assets (including most of pension funds and investment).

For example, in Polish legal system PTE PZU uses services of corporate governance rating agencies\(^9\). This entity makes its decisions regarding investments/denial of investing in particular funds after taking into consideration recommendations prepared by Institutional Shareholder Services, Inc\(^10\). In Poland since 2011, assessment of corporate governance – PINK rating – and in-depth reports on corporate governance are conducted at the Polish Institute of Corporate Governance\(^11\). Therefore also from that perspective ‘corporate governance public relations” of a firm is significant to performance and prospective business development of a company.

What are the other reasons that make the enforcement of corporate governance so important? Partially, it is due to the fact that the European Union adopted complain-or-explain approach to some sensitive information that relates to corporate governance\(^12\).

Sometimes management/majority shareholders do not have interest in revealing particular information to the public. As a consequence, with detrimental effect to other stakeholders (minority shareholders or shareholders in general), they do not want to reveal particularly sensitive information. As a result one needs to face a serious agency problem. To cure this problem, legislation and codes impose specific sanctions on management or majority shareholders\(^13\). In addition, corporate governance is a set of rules and methods for ensuring the protection of investors’ best interest. Moreover, it helps to attract capital to firms that are the most promising and with real

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9 http://www.pzu.pl/grupa-pzu/pte-pzu
10 http://www.pzu.pl/grupa-pzu/pte-pzu/inwestycje-ofe
11 http://www.pink.waw.pl/
perspective for success in near future, and undertakings that guarantee security of invested money.

Therefore, compliance with state and “private” corporate governance codes is in self-interest of a company since it affects company’s business future.

As a follow-up, the next subchapter introduces and briefly describes the enforcement methods that are available for stakeholders to ensure compliance with corporate governance codes and best practices.

3. Enforcement methods.

Enforcement of corporate governance means that company’s stakeholders may take the real advantage of their rights and that those rights exist not only in the books, but also in practice\(^\text{14}\). The enforcement has also been defined as

\[
\text{“the basis for determining whether a violation of investor rights has occurred or might occur (whether or not expressly or explicitly covered by law or regulation) and an apparatus to translate these violations into regulatory sanctions or recovery for those harmed”}^{15}.
\]

Without proper enforcement methods even the best corporate governance code is useless. What’s more, it may be claimed that enhancing enforcement

\(^{14}\) What is more, “absent effectively enforced rights, the insiders would not have much of a reason to repay the creditors or to distribute profits to shareholders, and external financing systems would tend to break down”, Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, Robert Vishny, *Investor Protection and Corporate Governance*, p.6

\(^{15}\) Ira M. Millstein, on-traditional modes of enforcement, p. 3 in: *Enforcement and Corporate Governance: Three Views*. 
mechanisms is a key to a reform related to those issues in both emerging and transition economies\(^\text{16}\).

Proceeding to different types of enforcement mechanisms, we can divide them into two main groups. First of them is the one in which we have corporate governance rules and principles, some of them of obligatory, and some of them of voluntary nature. The second group consists of disclosure and transparency obligations, which concerns, especially recently, periodical publishing of financial statements and controlling the executive remuneration.

We also need to distinguish between \textit{private} and \textit{public enforcement}, which constitutes completely different division, based upon distinct criteria.

\textbf{Formal public enforcement} methods are judicial/criminal penalties and fines, administrative penalties and fines and remedial orders (courts, securities commissions, other government or regulatory agencies)\(^\text{17}\).

\textbf{Informal public enforcement} tools are the following: information requests, notice letters and norm-enhancing reprimands\(^\text{18}\).

On the other hand, there are \textit{private enforcement mechanism}\(^\text{19}\), particularly minority shareholder litigation and litigation initiated by some other group/government or regulatory agencies, namely class action and derivative

\(^{16}\) Ozden Deniz, \textit{Reforming Corporate Governance in Developing Countries and Emerging Economies}, New England Journal of International and Comparative Law 2012, p. 1

\(^{17}\) Erik P.M. Vermeulen, \textit{Corporate Governance & Private Enforcement}, (presentation for purposes of International Business Law Master Program, Tilburg University.

\(^{18}\) Eric Berglof, Stijn Claessens, \textit{Corporate Governance and Enforcements: Enforcement and Corporate Governance: Three Views}, p. 47. This author also indicates possibility of de-licensing of an entity.

\(^{19}\) Those mechanisms exist outside state legal systems and can be bilateral, multilateral and unilateral, see: Eric Berglof, Stojn Claessens, \textit{Corporate Governance and Enforcement}, p. 30, in Ira M. Millstein, Shri G.N. Bajpai, Eric Berlof, \textit{Enforcement and Corporate Governance: Three Views, Global Corporate Governance Forum}. 
suits\textsuperscript{20}. However, private enforcement methods still remain relatively rare. This is due to the numerous reasons, i.e. wrong incentives for shareholders\textsuperscript{21}, judicial review of the cases by non-specialists (judges that do not have much experience in commercial cases), the fact that proceedings, which arise out of those methods, are time-consuming. In addition, also using private enforcements methods creates much of business uncertainty that is very often non-acceptable for stakeholders\textsuperscript{22}.

As to the derivative suits, some scholars stress out that their main goal is to return to the company the benefits that were groundlessly taken away from it. At the same time even if no sum in turned back, litigation may cause pressure within company’s bodies to enhance corporate governance is such a way that similar abuses of law do not occur in the future\textsuperscript{23}.

As to the first group pointed out above, namely public enforcement, there is a question regarding the formal compliance with imposed requirements (“check the box”) or substantive one\textsuperscript{24}, which means true following of all formal standards and procedures. Checking the box equals compliance only in order to prevent imposing fines and penalties and to ensure good ratings for self-

\textsuperscript{20} As to clarify, other authors use different division. For example, in “The legal, regulatory and institutional framework for enforcement issues in Latin America: A comparison of Argentina, Brazil, Chile, 2009, the following types are listed: judicial process, sanctions and administrative procedures, self-regulation organizations and private enforcement (here, issues related to availability and feasibility of private arbitration must be addressed.

\textsuperscript{21} Shareholders very often are not aware of the nature of derivative suits and their role in corporate governance and their use it for their personal benefit, not in company’s best interest.


\textsuperscript{23} Scott H. Mollett, Derivative suits outside of their cultural context: the divergent examples of Italy and Japan, available at \url{http://usf.usfca.edu/law/academic/journals/lawreview/printissues/v43i3/Mollett.pdf}, p. 1.

\textsuperscript{24} In Study on monitoring and Enforcement Practices in Corporate Governance in the Member States, p.60 \url{http://ec.europa.eu/internal_market/company/docs/ecgforum/studies/comply-or-explain-090923_en.pdf} another division related to monitoring techniques was proposed. Accordingly, types of monitoring techniques are availability check, accuracy check and informative value check.
regulatory bodies. There is no doubt that from stakeholders’ point of view only substantive compliance can be at least somehow beneficial.

Another significant division is between different types of monitoring and enforcing bodies. Those can be assigned either to a market-wide group or to company specific one. In the former the following can be included: financial market auditors (provided that they have good reputation and care about maintain it and that those audit companies/individuals want to perform their tasks correctly), trade bodies, professional organizations, stock exchanges with their codes of best practices and finally, specialist financial press, analysts and scholars researching and writing about efficient corporate governance. In the latter there are boards of directors, auditors (both internal and external), shareholders and other stakeholders.

Also role of accounting and audit professionals is crucial. They are vested with possibilities to have good insight into company’s internal affairs and their approach, and least in theory, is neutral. They also present objective point of view, therefore their comments are more valuable. If accountants and auditors fulfill their obligations properly, they have good possibility to intervene when wrongdoings are spotted – even at very early stage. Therefore they activity can be called “inside enforcement” mechanism.

Apart from the above general remarks, greater professionalism among financial advisors would be also beneficial. Their expertise and trustworthiness (which would particularly contribute to less tension between financial institutions and entrepreneurs) would prevent occurrence of multiple problems on many layers of business world.

Another key issue is what actions should be taken against members of boards of directors who are negligent or even incompetent, but whose actions cannot be counted into category of serious crime. Legislators shall ensure existence

of such soft tools as to make it feasible “to convince” wrongdoers not to commit particular abuses in the future.

Some authors proposed completely new and innovative approach to the issue at stake\(^\text{26}\). They sometimes underline how important are fiduciary duties and that in fact if a jurisdiction lacks proper legal framework to ensure them – the whole corporate governance structure suffer serious deficiencies and problems. To make sure this core duty is respected – it was, for example, proposed to use bilateral and multilateral contracts as a tool to implement good corporate governance between companies and investors\(^\text{27}\). These agreements may contain provisions concerning the following issues: mode of choosing board of directors, professional requirements for members of a board, anti-dilution provisions, accessibility of information, disclosure of material information, mode of dealing with related-party transactions (approval procedures and who is accountable for the ensuring of the proper way of caring about them), change of control rights.

However, as it was correctly pointed out\(^\text{28}\), effective enforcement forum is a prerequisite for usefulness of this method. Hence parties to those agreements shall also decide to oblige themselves to use an arbitration institution to resolve a dispute between them. In such an event, they need to be as specific as possible about arbitration rules that govern arbitration proceedings and choice of arbitration body that decide a case between them since pathological arbitration clause\(^\text{29}\) causes more harm than even the most obsolete and sluggish national courts\(^\text{30}\).

\(^\text{26}\) Ira M. Millstein, on-traditional modes of enforcement, p. 7, Enforcement and Corporate Governance: Three Views.
\(^\text{28}\) Ibidem, p. 8.
\(^\text{30}\) However, one has to bear in mind that usually arbitration agreement between two parties is not binding for all shareholders of a company. But recently Novo Mercado in Brazil introduced
One also cannot disregard the role of banks as one of the most important sources of capital for companies. Due to their significance they have self-enforcing powers, similar to stock exchanges, and they can enforce companies’ semi-voluntary compliance with good corporate governance. If a company refuses to do so – a bank may deny financing its projects. Therefore practical power of banks is significant and in practice it may occur that it is more efficient than other methods of enforcement.

The very last type of enforcing corporate governance is a “soft” one. In this group there are the following mechanisms: rating agencies and their reports concerning corporate governance, institutional investors and the media. When a company or a country has low rating – it simply deters potential investors. And as a result governments and companies’ authorities struggle to ensure better corporate governance.

Also role of newspapers, television and especially Internet cannot be disregarded nowadays. In some jurisdictions publication of information concerning corporate non-compliance and scandals have significant consequences for firm’s position among investors and stakeholders. Consequently, enforcement by media is related to a unilateral self-enforcing

provisions that allows binding power of arbitration provisions for third parties, see: ibidem, p. 11. Another key issue is that also professionals that take part in arbitration proceedings (i.e. Lawyers and judges) shall have relevant knowledge about particularity of capital market law and corporate governance, hence they need advanced training and courses, see: ibidem, p. 11.

33 See: Alexander Dyck, Natalya Volchkova, Luigi Zingales, The Corporate Governance Role of the Media: Evidence from Russia, http://www.nber.org/papers/w12525.pdf?new_window=1. The authors mention that media are used by institutional investors, especially hedge funds when they want to enforce particular behavior of a company in particular situations, for example when hedge fund want CEO to resign. The question remains whether using those types of tools in the most appropriate one and whether it ensures taking care of interest of other stakeholders, others than banks, hedge funds and VCs.
tool, namely reputation\textsuperscript{34}. Sometimes particular situation of a company is that all state-driven attempts to exert influence upon it are fruitless, and also shareholders and other stakeholders do not have sufficient incentives to take part in daily life of a company. In those situation some firms, especially the biggest and with the strongest position in the market, do care about how they are evaluated by customers and the market itself (and without looking at financial benefits\textsuperscript{35}).

4. Problems with practical application of enforcement mechanisms

Moreover, addressing the problem from a slightly different perspective, private and public enforcement mechanisms co-exist; no one can rely solely on one type. If private mechanisms fail to work in particular situation, public are supposed to fill in this gap, and vice versa. In addition, private tools need enforcing by public authorities, especially when it comes to derivative suits and class actions\textsuperscript{36}. As a result state and legislative initiatives to amend only one group of enforcement mechanisms in the end are deemed not to bring about changes that were foreseen.

Another key issue is that even if the parties to a dispute choose arbitration proceeding as a method of resolving their conflicts, state-driven legislation is still indispensable. An arbitration court may decide a case and order one party to comply with specific obligation or to pay significant amount of money, and this is enough if a losing party chooses to comply with this decision voluntarily.

\textsuperscript{34} Eric Berglof, Stojn Claessens, Corporate Governance... p. 41.

\textsuperscript{35} This is the case when we are talking about a company that for the time being does need outside financing by issuing more shared at a stock exchange, but it may have this will in the future.

\textsuperscript{36} Eric Berglof, Stojn Claessens, Corporate Governance... p. 40.
If not, involvement of a national court is needed in order to ensure taking real advantage of this decision. When national civil procedure regulates this issue in such a way that enforcement of arbitral awards is inevitable, business entities have powerful private corporate governance mechanisms in hands. If not, arbitration proceedings only prolong solving a problem and cause additional costs and waste of time for the parties involved. This example clearly shows how important is balancing and co-existence of the two big groups of enforcement mechanisms.

In addition, every state and self-regulating body needs to be careful about the issue of overregulation. More legal provision means more certainty in business environment, but at the same time they may hinder entrepreneurship and innovation by restricting freedom. Broader law equals greater room for maneuver, higher level of flexibility and ability to respond to market need quicker and more efficient.

In conclusion, all types of mechanisms described above and particular approaches to related problems have their advantages and drawbacks. Every actor involved in making those decisions needs to struggle with multiple tradeoffs and choose compromises. This task is particularly problematic in developing and transition countries, due to their young economies and lack of legal responses to practical issues.

In the following chapter brief description of those economies will be presented, as an introduction to the chapter that deals with the current state of law concerning enforcement of corporate governance.
III. Transitional Economies – how do they differ?

Due to WWII Europe had been divided into two parts that were subject to different types of influence and which followed different models of economy’s development. As it turned out, Central and Eastern Europe model imposed by USSR failed both politically and economically. Ultimately it led many countries and their nations to the edge of complete economic disaster. Since those countries were gradually freed from Soviet influence in late 80s and early 90ties, their economies are still recovering from this painful disease called communism. Formally countries in this region have underwent transition from communism model of the market, but in practice Eastern and Central Europe have still much to improve when it comes to conducting business successfully, which is particularly visible in good corporate governance.

Transitional economies\(^{37}\) in the meaning that will be adopted in this paper belong to civil law countries family of continental Europe. Their law is based upon German model or French model, due to common view that those jurisdictions provide law and particular institutions that are effective and that work properly.

In this context it is worth mentioning that sometimes it was argued that common law countries are more effective in protecting interests of investors and thus they have better corporate governance mechanisms and enforcement methods\(^{38}\). In general terms, however, one cannot decide whether some set of rules gives better results since those methods cannot be assessed without having in mind the bigger picture and whole perspective of a particular legal system, with its social and historical connotations. Simply,

\(^{37}\) In general, when an author uses the term „transitional economies“, s/he refers to other countries than those chosen to be analyzed in this paper, for example China and former Yugoslavia.

\(^{38}\) For more see: Reforming Corporate Governance…p.4.
different solutions work differently in different countries\textsuperscript{39}. At the same time, sometimes deficiencies are so obvious that they need to be eliminated since lack of this intervention may impair development of business environment and evolution in the right direction in a particular country.

Since there is no point in presenting legal situation and environment in every single state from Central and Eastern Europe, only three of countries from this region, which will be also subject to further scrutiny of their legal system, will be briefly described. First of them is Poland, second Czech Republic, and third Romania. This choice is not random. Each of those countries differs when it comes to actors by which their corporate governance systems were created\textsuperscript{40}. It is obvious that Czech Republic and Poland are more developed than Romania\textsuperscript{41}, therefore also business and legal environment in those two countries varies from the one that exists in Romania.

Approaching this topic from a different perspective, it is also important that corporate governance has become a subject of more detailed research in Poland relatively recently, namely in the end of XX century and the beginning of XXI\textsuperscript{42}. As a result, Polish doctrine lack abundance and variety of sources that is available in other European countries.

In addition, research in this field was conducted by researchers from different fields of science separately (legal practitioners, economists) and therefore not complex nor covering every emerging problem comprehensively. Due to this fact it is impossible to present historic stages of development of approach to

\textsuperscript{39} One sentence particularly shows essentials of this problem: „Without ensuring complementarities between the new law and preexisting legal institutions, harmonization distort rather than improve the domestic legal framework.“, Katharina Pistor, *The Standardization of Law and its Effect on Developing Economies*, 50 Am. J. Comp. L. 97, 97-130 (2002).

\textsuperscript{40} See chapter IV.

\textsuperscript{41} Human Development Index: in Czech Republic 0,973, in Poland 0,821, in Romania: 0,786 http://hdrstats.undp.org/en/indicators/103106.html.

\textsuperscript{42} Krzysztof Oplustil, *Instruments Nadzoru Korporacyjnego (Corporate Governance) w Spółce Akcyjnej*, C.H. Beck 2010, p. XXII.
corporate governance. The only field of research available is entrepreneurship in private sector in the last two decades. This troublesome issue is common for all three countries.

Another key issue is ownership concentration in transitional economies, since it influences an answer to the question of what is the most efficient method of enforcing good corporate governance in a particular jurisdiction\(^\text{43}\).

In the following parts of this paper Polish legal system will be scrutinized, and the other countries related issues will be signalized or deeper touched upon, depending on their importance.

\(^{43}\) Eric Berglof, Stojn Claessens, *Corporate Governance*…, p. 31.
IV. Current state of law related to corporate governance and enforcement mechanisms in transitional economies

In this chapter the current state of law regarding enforcement of corporate governance is presented. First, it is described which enforcement methods prevail currently in Poland and what are the most acute problems that should be resolved. (IV.1). Second, the situation in Czech Republic is covered (IV.2). Third, the most important solutions applicable in Romania are touched upon (IV.3). Finally, focus is on extracting the „common denominator” existing in all those jurisdictions and on spotting the most significant differences (IV.4).

At the beginning, one needs to observe that both Romania and Czech Republic show “high compliance” of their laws with OECD Principles of Corporate Governance, whereas Poland is a medium compliance country\(^44\). It clearly indicates that in broad terms Poland falls behind the other two countries, despite being more developed than Romania. It brings a question what are the reasons for it, which will be answered later.

Before detailed analysis of corporate governance enforcement in the chosen countries, it is recommended to briefly address the issue of implementation of Directive 2006/46/EC by the Member States. According to this directive EU countries differ in respect to method of implementation of this directive into their legal systems. Poland and Romania chose the implementation by listing rules\(^45\), and Czech Republic by state law\(^46\).

\(^{44}\) Commercial laws of Romania. An assessment by the ERBD. 2012, p. 9
\(^{45}\) http://ec.europa.eu/internal_market/company/docs/ecgforum/studies/comply-or-explain-090923_en.pdf, p.28
\(^{46}\) Ibidem.
1. Poland

Of course it is not possible to touch upon all corporate governance mechanisms and enforcement methods under Polish law; however, in general, Poland does have detailed law that regulates multiple potentially problematic issues within corporate law. A problem that may emerge is more related to overregulation and complexity of provisions that shall be applied and the fact that stakeholders often lack relevant knowledge and experience than to deficiency of laws.

Before detailed analysis of corporate governance structure and enforcement methods, one shall take a closer look at sources of corporate governance in Polish legal system. Those are the following:

1. Corporate law, i.e. the law of limited liability companies and joint stock companies, including Commercial Companies Code, the Banking Act, the Act of 05.07.2009 on auditors and their government (Article 85 - the audit committee), the Act on Commercialization and Privatization of 1996 (eg Art. 12-18), the Law on Public Offering of 2005 (cf. art. 80-80d, Art. 82-86);

2. Capital Market law: the Act on Trading in Financial Instruments (2005), the act on Public Offering, Conditions Governing the Introduction of Financial Instruments to Organized Trading and Public Companies (2005);

3. Accounting Act of 1994, the Act on Auditors in 2009;

4. Bankruptcy and reorganization law, procedural law (Act of 2009, an investigation claims in group proceedings, the Polish derivative suits).
Corporate governance in Poland is a term that exists in many official legal documents, but interestingly does not in Commercial Companies Code. However, Commercial Companies Code provides multiple provisions that regulate corporate governance.

In Poland limited liability companies and publicly held corporations are two types of legal persons that may exist and those are to be analyzed in this paper. It shall be also borne in mind that publicly held companies are subject to different requirements when it comes to mode of conducting of day-to-day affairs of a company.

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47 Polish equivalent: „ład korporacyjny”
48 art. Paragraph 49. 2 Section 8 of the Act on Accounting (report of activities of the Company listed on the regulated market must contain the information “about corporate governance”, § 91 paragraph. 5 Section 4 Ministry of Finance regulation on 19.2.2009 on current and periodic information (“statement of corporate governance”)
49 According to Polish Companies Code, there are of course other types of companies that are available to potential entrepreneurs. However, those forms do not have legal entity and may cause problems to their founders (for example in case of insolvency). At the same time it is easier to create them and requirements to fulfill before founding them are less burdensome than those existing when somebody would like to establish Limited Liability Company or publicly held corporation.
50 For example: the form of convening of general meetings (Article 402.1 - 402.3 CCC), rules for determining the legitimacy of shareholders to participate in the GMS (art. 4061 - 4064 CCC), exclusion of voting privileges (Article 351 § 2 sentence. 2 CCC), Higher minimum number of Member of the supervisory board (Article 385 § 1 of the Commercial Companies Code), postal vote (art. 4111 - 4112 CCC), Specific rules regarding proxy voting(Article 4121 § 2-6, art. 2-4 § 4122 Code of Commercial Companies), shorter deadlines for appeals against resolutions (Article 402 § 2, Art. 425 §2 CCC), different regulations concerning the quorum and majority required to take certain resolutions (eg Art. 431 § 3a, Art. 445 § 3, Art. 506 § 2, Art. 541 § 3 of the Commercial Companies Code) a requirement for a formation of an audit committee (Article 86 of the Act on Auditors), special rights and obligations of shareholders provided for in the Act on Public Offering (Articles 82-86), compulsory redemption and repurchase of shares, minorities the right task for the appointment of auditor special, regulations concerning major holdings, information obligations (Articles 69-71), purchasing shares through a public tender offer (Article 72 -81)
Polish model of corporate governance is based upon German law\textsuperscript{51}. In corporation, the board of directors is obligatory and clear demarcation between competences of managers and board of directors exists. In Polish joint stock companies the highest governing body is the general meeting of shareholders. Its powers are constitutive for a company, both during foundation process and during its operation. Competences of a general meeting are vast, infinitely greater than competences of the supervisory board. Due to the substantive nature of these rights, they can be divided into decisions on financial matters (for example resolutions on the transfer of the undertaking or property of the company, acquisition of own shares by employees of a company, redemption of shares and reduction of share capital or resolutions on distribution of profit) and decisions regarding organization of a company and its structure (e.g., appointment and dismissal of members of a management board or supervisory board, discharge of the members of management board and supervisory board, approval of financial statements for the previous financial year, approval of conclusion of a contract by management of the subsidiary by the parent company, adopting a resolution to significantly changing the objects of the company and resolutions relating to existence of the company, if the balance sheet prepared by the board shows a loss exceeding the amount of capital and reserves and one-third of the share capital). Most of the powers of the general meeting have been specified in art. 393 - 429 of Commercial Companies Code.

Proceeding to specific methods of public enforcement, the most important one is Financial Supervision Authority\textsuperscript{52} that took over the powers and obligations of Polish Securities Exchange Commission. Its existence is regulated by an Act that has much broader scope than only actions taken by this authority. It has broad competences that are not confined to Polish capital market, but cover also pension system and insurance system. Four organizational units are responsible for matters related to capital markets: Department of Infrastructure Investment Firms and Capital Market, Department of Investment

\textsuperscript{51} \url{www.egospodarka.pl/60956,Polski-model-ladu-korporacyjnego,1,20,2.html}

\textsuperscript{52} \url{http://www.knf.gov.pl/index.html}
Funds, Department of Corporate Marketing, Department of Public Offering and Financial Information. Financial Supervision Authority may impose fines for non-compliance with obligation provided by different Acts, for example not revealing material information required by the law.

As to private methods of enforcing corporate governance in Polish companies, it is worth noticing activities undertaken by Stock Exchange in Warsaw. There are several projects intended to enhance corporate governance among companies listed on Stock Exchange in Warsaw and NewConnect (alternative system of securities trading).

On 21th of November 2012 new Code of Good Practices was adopted (in force from 1st of Jan 2013). This Stock Exchange not only adopted the said Code, but also, in the preamble it obliged itself to benefit those companies that have decided to follow best practices. It may lead to increased level of compliance with solutions proposed in this document and it also may constitute a better incentive for companies to comply with this Code than punishment and fines that are imposed by state authorities according to Commercial Code Law and other legal acts. Overall, Warsaw Stock Exchange has multiple competences that provide it with power to influence performance and undertakings of corporations listed on it. However, due to lack of interest in those matters by politicians corporate governance compliance is not particularly impressive here.

The next key issue is that resolutions of a general meeting shall be subject to judicial review, which means that any resolution 1) contradicting a statute of a company or of morality or 2) detrimental to the interests of a company and which is aimed at harming even a single shareholder may be appealed to the court by an action for annulment of the resolution (Article 422 § 1 of the Commercial Companies Code and art. 425 § 1 of the Commercial Companies Code).

54 http://corp-gov.gpw.pl/about_us.asp
56 Eric Berglof, Stojn Claessens, Corporate Governance…, p. 60.
Code). What does the interest of a company really mean? According to the judgment, the Supreme Court of 5th Nov 2009 (I CSK 158/2009) interest of the company is to reflect the interests of all groups of shareholders of the company, which are in economic terms its “owners”. The concept of “interests of the company” is the general statutory formula, which requires consideration of a compromise between different function of beliefs, aspirations and behaviors of all groups of shareholders, determined according to the best and the most suitable common goal of a company taken as a whole. Adoption of the concept of “interest of the company” leads to the inadmissibility of identifying it only as the interests of the majority shareholder, as well as to excluding the recognition that the minority shareholder action defense is always dictated by the interests of the company and shall be perceived as the tool for ensuring of the best interest from objective point of view.

Reassuring the main point of this discussion, the right to bring such an action is in hands of board of directors and the supervisory Board, or alternatively the individual members of those bodies; shareholder who voted against the resolution, and after its adoption demanded to record objection; shareholder who unjustly did not participate in the general meeting; a shareholder who was not present at the general meeting – in the case of the convening of a defective or adoption of a resolution on a matter not on the agenda (Article 422 § 2 of the Commercial Companies Code).

It is worth noticing that in 2009 Poland was one of very few Member States of European Union that did not require in its law the disclosure of remuneration policy. What is more, Polish law does not require disclosure of performance criteria upon which remuneration is decided. Those two deficiencies taken together may constitute significant disadvantage of Polish corporate governance model in comparison to those implemented in other countries. Lack of this type of by-laws may lead to improper level of knowledge of

57 http://ec.europa.eu/internal_market/company/docs/ecgforum/studies/comply-or-explain-090923_en.pdf, p.40
58 http://ec.europa.eu/internal_market/company/docs/ecgforum/studies/comply-or-explain-090923_en.pdf, p.41. Also Czech Republic and Romania lack those types of provision.
shareholders about internal situation of a given firm and, as a result, lack of their intervention even if there is a need to do so (by initiating proceedings before a national court or arbitral tribunal).

In Poland, the most common methods of enforcement are criminal sanctions and administrative fines. According to the Polish Commercial Companies Code, Title V („Penal provisions“), Articles from 585 to 595, company officers (i.e. members of a board, managers, liquidators, even other people indirectly involved in business affairs of a particular company) are subjects to various penalties and fines, ranging from fines to imprisonment up to 1 year. Those are of criminal nature and they differ from those described above which are imposed by the Financial Supervision Authority.

Another problematic issue is a courts’ involvement in ruling in cases related to business disputes. Theoretically, there are divisions of courts both of first and second instance that are designed to decide such cases, but their judges in most instances do not have above-average knowledge in this field of law. It seems that the core problem in Poland is created by the fact that every judge, no matter in which branch of law he/she is specialized, obtains the same training. Even worse, judges do not have any previous experience as practicing lawyers. Especially in the lowest courts this problem is particularly acute and it leads to lengthy proceedings, for which Poland is famous.

Also arbitration as private enforcement tool is still not regulated in such a way as to ensure its proper usage in corporate-related disputes. In Poland it

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59 For example, according to art. 592 of Company Code, manager who allows issuance of certification of being an owner of company stock which are underpaid, or does it before registration of a company, may be imposed a fine or even imprisoned.

60 However this drawback is common in civil legal system.

61 Due to official governmental information duration of civil proceeding before a court of the lowest type varies from about 3 months in smaller regions to even 11 months in Warsaw, capital city. This is particularly strange, because of the number of corporations that are incorporated in a place, which is under jurisdiction of this court. It is also worth noticing that legal tools were implemented to fight lengthy proceedings before civil courts after the case Kudla v. Poland, www.hfrpol.waw.pl/precedens/images/stories/kudla_p._polsce.doc
occurred due to lack of awareness of investors and shareholders of advantages of alternative dispute resolution. Another problematic issue is use of arbitration in resolution of disputes between a corporation itself and their shareholders.

Another crucial issue is that currently a statement regarding compliance with Corporate Governance rules is obligatory part of any annual report of the issuer of securities admitted to trading on a regulated stock market (the main market). Its content shall include (according to Minister of Finance cf. § 91. 5 points 4 Reg MF, 19.2.2009):

- an indication of the corporate governance rules of the issuer;
- an indication of the provisions of the set, from which the Issuer did depart and explanation of the reasons
- a description of the main features of the issuer's internal control and risk management systems in relation to the process preparation of financial statements
- identification of shareholders owning directly or indirectly significant shareholding
- indication of the holders of any securities that give special control rights and a description of these rights.

Last, dualistic model of corporate governance adopted in Poland visibly loses its importance worldwide 62. There are numerous voices that Polish law should be changed and it should allow for implementing monistic system of governing a company (France) 63, or even impose obligatory monistic system (Scandinavian countries).

In conclusion, as it was presented above, Polish enforcement system is too complex, multidimensional and bureaucratic. It imposes many obligations on corporations and shareholders and in addition creates difficult procedures to

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conduct for national authorities. In order to make Polish legal system modern and able to compete with others in Europe there is need to amend the crucial legal provisions.

2. Czech Republic

In Czech Republic a system of corporate governance is driven by public actors, thus the role of private bodies and parties to business transactions is insignificant. It may create problems with flexibility of corporate governance and its enforcement in rapidly changing business world, since undoubtedly private actors may respond to market needs faster than state authorities.

First of all, in Czech Republic companies are unwilling to establish corporate bodies that are not obligatory. In addition, many companies do not create those bodies despite of suggestion of it in Czech Corporate Governance Code. The most common measure that is introduced in this country is Internal Audit. The second one is implementation of informal Code of Ethics. Lack of very basic corporate governance system and only soft methods of enforcing introduction of them creates lower security of market players and it impairs Czech Republic attractiveness for foreign investors.

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64 http://ec.europa.eu/internal_market/company/docs/ecgforum/studies/comply-or-explain-090923_en.pdf, p.25
65 Legislation process is also heavily influence by political legislation cycles, see: ies.fsv.cuni.cz/default/file/download/id/17142
66 Deloitte corporate Governance Centrum, Czech Institute of Directors, Report on the State of Corporate Governance in the Czech Republic in 2012, p. 5. Also, Compensation Committee, Nomination Committee and Audit Committee in 2012 were less common than in 2009. In the report it was explained that this is due to the financial crisis and looking for savings opportunities.
67 Ibidem, p. 5
68 Ibidem, p.6. Almost 77 % of companies decided to have this kind of control in a company.
69 Ibidem, p.6.
One of big problems seems to be lack of mechanism that provide for smooth change of board members. Period of rapid changes within a company always is also one of most dangerous; therefore especially during it every company shall have ready-to-use solutions that may ensure fast “succession”. When taking into consideration standards that exist in western Europe, it is clear that this issue shall be improved.

As to the composition of the board of directors, in majority (60 %) of companies its members are elected by the general meeting. In fewer instances this decision is in hand of the supervisory board.

As to the supervisory board, in approximately 25 % of companies their members are elected completely outside, namely not from the company itself or its parent company. It means that all the rest in this regard acts not with compliance with OECD recommendations. It brings the question of what would make the companies and their statutory bodies to comply with best practices provided by international organizations.

Similar problem exists when it comes to independency of directors of a company. Only 15 % of all companies in Czech Republic in 2012 had completely independent directors. Czech law does not provide for effective mechanisms to ensure existence of this corporate governance tool and that may be detrimental (but may not) for company’s public relations with stakeholders.

Another interesting fact to consider – legal requirement to establish and audit committee exists for approximately 50 % of companies in Czech Republic, but only 42 % of surveyed companies indicated that they have audit committee.

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70 Ibidem, p. 7. According to the Report, in about 97 % of companies lack formal procedures that shall be applied when there is a need for a new board member.
71 Ibidem, p. 8
72 Ibidem, p. 8
73 Ibidem, p. 9.
What is more, state authorities do nothing to change this situation – they do not have appropriate legal tools to enforce those requirements. Audit committee itself has significant responsibilities concerning enforcement of corporate governance within a company; its key areas of activity are financial statements, assessing work done by an external auditor and investigating functioning of internal system control\textsuperscript{75}.

The next impediment to effective enforcement of corporate governance is that in more than half of companies the internal audit is subordinate to CEO, in more than 20 % to the Board of directors\textsuperscript{76}. The best possible solution to this problem would be to make internal audit-related entities supervised exclusively by non-executive bodies functioning within a company.

As to enforcement matters, in Czech Republic companies apparently are not afraid of being held criminally liable for misconduct within a company\textsuperscript{77}. It may suggest that imposing sanctions of that type on companies is deemed to fail in this certain jurisdiction.

\section*{3. Romania}

In Romania the system of corporate governance is driven solely by private actors\textsuperscript{78}. Main act concerning corporate governance in Romania is the Companies Act\textsuperscript{79}. It says that companies may choose between one-tier and two-tier board system, which makes Romania flexible and friendly environment.

\textsuperscript{75} Ibidem, p 14.
\textsuperscript{76} Ibidem, p. 16.
\textsuperscript{77} Ibidem, p. 19. The answer provided by companies in the Report indicated that 10 % on companies decided to change their behavior in certain areas somehow after introducing criminal liability of legal entities.
\textsuperscript{78} http://ec.europa.eu/internal_market/company/docs/ecgforum/studies/comply-or-explain-090923_en.pdf, p.25
\textsuperscript{79} Commercial laws of Romania. An assessment by the ERBD. 2012, p. 8
Romania is a country, which has its corporate governance, based upon system of internal control\textsuperscript{80}, therefore it is important to design corporate governance in this country as to ensure that rights of various stakeholders are taken care of by relevant corporate bodies. When analyzing the case of Romania, one cannot disregard significance of privatization process and its consequences for entrepreneurship.

The next thing is that corporate governance as a key issue for functioning of companies was spotted there recently\textsuperscript{81}. Bucharest Stock Exchange introduced first code, based upon OECD Principles, in 2001, but it was perceived too vague and soft when it came to its interpretation. In addition, it was applicable only to companies listed at the “Plus Category”, which meant that they were obliged to comply with additional transparency requirements. As a result, only one company had to act in accordance with the Code\textsuperscript{82}.

As a result, the new Bucharest Stock Exchange in 2008 has implemented new Corporate Governance Code. From the perspective of enforcement mechanisms its key feature is that, nonetheless the code is voluntary, companies are obliged to reveal the reasons why they decided not to comply with it (“comply or explain”)\textsuperscript{83}. However, so far companies have been reluctant in reveling required information in those obligatory statements\textsuperscript{84}.

Moreover, although revealing of executive and members of board of directors’ remuneration is mandatory in the said Code, in 2011 some industrial

\textsuperscript{80} Laura Giurca Vasilescu, Corporate governance in developing and emerging countries. The case of Romania, 2008, http://mpra.ub.uni-muenchen.de/10998/1/MPRA_paper_10998.pdf

\textsuperscript{81} Ibidem.

\textsuperscript{82} Niculae Feleaga, Liliana Feleaga, Voicu Dan Dragomir, Adrian Doru Bigoi, Corporate governance in emerging economies. The case of Romania, http://store.ectap.ro/articole/632.pdf, 2011, p. 10

\textsuperscript{83} Ibidem.

\textsuperscript{84} Commercial laws of Romania…, p. 9
companies were scrutinized and as it came out, none of those firms published the data.\(^{85}\)

It shall lead to a conclusion that, generally speaking, this type of soft enforcing method is not particularly effective in Romania. And it shall be perceived in the light of research conducted by Maier\(^{86}\), where he claimed that an average percentage of disclosure of remuneration in companies from 24 countries was about 84 %. The reason why there is such a huge difference between Romania and other countries may be due to transitional character of its economy.

Corporations apparently do not care a lot about their public relations with media and an opinion that other companies and potential clients may have about them.

### 4. Common denominator for all three jurisdictions

Although enforcement systems in Poland, Czech Republic and Romania were presented from different perspectives and different problematic issues were indicated, one need also to realize what are the common issues that occur in all of them. In this subchapter all three jurisdiction are described as a whole, without specification which remarks fill in with a particular country directly.

Generally, judicial review by non-specialists that exist in all the countries pointed out above proved to be time consuming and inefficient. Another key issue is that the companies still must face business uncertainty as to the costs of judicial proceedings. Also the “loser pays” principle cannot encourage shareholders to intervene in situation that are not 100 % clear.


\(^{86}\) Referred to in ibidem, p. 14.
There are also problems with private enforcement mechanisms. It is true that using them reduces agency costs, but on the other hand they may be abused by minority shareholders without real need for this intervention. There are of course certain thresholds that are supposed to exclude this threat, but they are not able to fully eradicate abuses.

The next type of enforcing method also creates numerous problems, especially in transitional economies, namely class action. First, corporations have face enterprise liability and issuer-funded settlements. Derivative suits also are not fully adopted into legal systems of Eastern Europe. Those jurisdictions so far have not resolved uncertainties related to ownership thresholds, lack of incentives (no contingency fees, the fact that it does not benefit shareholders directly, requirement to advance court fees). Therefore very often those two enforcement methods remain useless.

One can easily spot that also decision or nullification suits tool is not flawless. Sometimes in firms act predatory shareholders, whose aim is to harm interest of a company to the benefit of its competitors on the market. Some of them may be even called “professional plaintiffs”. They are supported by low-tier law firms, more often in transitional economies than in countries in Western Europe, which help to bring boilerplate complaints, driven by possibilities of lucrative settlements. This type of practices is disruptive to business and even if settlements are relatively low – they engage company’s time and attention.

Opting out of seemingly inefficient legal provisions also seems as a solution to adopt to improve corporate governance in transitional economies and make them more attractive for foreign investors. The question remains to what extent those contracts are allowed in particular countries and whether can be enforced before local courts.\footnote{More broadly this issue was addressed in Ozden Deniz, Reforming Corporate Governance in Developing Countries and Emerging Economies, New England Journal of International and}
As it was pointed out above, in all three economies investors and stakeholders face an issue of dispersed ownership. Due to this fact all private enforcement mechanisms are more costly and less efficient. As a result, there is a need to rely to a higher extent on other enforcement methods, within national legal systems, and only those in which the state acts as a prosecutor. It is obvious that also the board involvement and significance in corporate governance is lesser when ownership is concentrated since in practice “the biggest” shareholder decides who serves at a board.

The same problem emerges with executive compensation. Many corporations in this region are not forced by law to reveal information concerning executive payments plans. Therefore no public pressure is exerted upon management and board of directors. Investors very often fear waste of their money on salaries of inefficient managers.

In conclusion, transitional economies, despite their progress in terms of efficient enforcement of corporate governance, still shall revise their judicial systems and legal acts that apply to corporations. They need to learn from more developed countries from Europe and North America. Some foreign solutions are presented in the next chapter.

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Comparative Law 2012, p. 2., where it was discussed in a section related to “firm level reforms”.

88 Eric Berglof, Stojn Claessens, Corporate Governance…, p. 34.
V. Enforcement mechanisms in other jurisdictions

In order to find proper solutions for transition economies, there is a need to analyze some ideas that were proposed or implemented in other jurisdictions. Because of limited volume of this paper, only selected of them are presented.

Of course one needs to realize that every country has its own history and general approach to business, which was presented above. Therefore no idea fits all the countries all over the world. Moreover, a structure of law, and as a consequence, enforcement methods is different in common law and civil law countries. Foremost, civil law is more oriented on black-letter rules, and common law pays attention to open-ended solutions. Each of these models has it advantages and disadvantages. Civil law approach means more certainty and easier access to complex legal regulations. Common law approach entails flexible solutions and adaptability do fast-changing business requirements, but at the same time there is more room for looser interpretations. This does not improve certainty as to the content of law.

As a consequence of this demarcation, there are two main models of corporate governance throughout the world: Anglo-American model and German model. The former is an “outsider based”. In this system the crucial role is vested in with an independent board of directors that is obliged to monitor performance of various corporate bodies. One cannot disregard importance of active capital market and hostile takeovers that occur relatively often in countries with those approach to corporate governance. The latter system is and “insider” one. Significance of capital market is lesser and a company tends to take care about interest of numerous stakeholders, i.e.

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89 Ira M. Millstein, on traditional modes of enforcement, p. 3 in: Enforcement and Corporate Governance: Three View.
90 Laura Giurca Vasilescu, Corporate governance in developing and emerging countries. The case of Romania, 2008, http://mpra.ub.uni-muenchen.de/10998/1/MPRA_paper_10998.pdf
91 Ibidem.
banks, employees. Some claims that this approach boosts innovation and development of companies\textsuperscript{92}, but it may also depends on other factors, for example condition of the whole economy.

Criminal and administrative sanctions exists in almost every country in the world\textsuperscript{93}, however, this method of enforcement lack flexibility. In addition, very often fines and penalties imposed constitute only a very small share of an amount of money that was illegally taken away from a company by managers and directors. Collateral damage also cannot be disregarded\textsuperscript{94}. It is extremely difficult to impose monetary fines in such a way not only a company and particular insiders itself will have to pay for a wrongdoing. Very often other stakeholders and company’s clients are the ultimate “victims”.

In the U.S., the private ordering very often serves as an incentive to implement particular law related to an issue that causes conflict within a corporation\textsuperscript{95}. Of course, Poland, Czech Republic and Romania are civil law countries and therefore a course of action and relation between case-by-case problems and implementation of public law resolving those issues is different than in U.S., however national authorities cannot disregard signals that private actors provide.

In Western Europe and America ownership structure is more concentrated, therefore shareholders have more incentives to properly monitor managers and directors. Shareholders are more educated and aware of their powers and rights, thus able to exercise them correctly. As a result any form of private enforcement mechanisms is more efficient than in Western and Central Europe.

Also arbitration as a method of resolution of intra-corporate disputes is more popular than, for example, in Poland. This is partially due to the fact that in

\textsuperscript{92} Ibidem.

\textsuperscript{93} For example SEC in the U.S., http://www.sec.gov/

\textsuperscript{94} See Citibank case and KPMG case.

\textsuperscript{95} Eric Berglof, Stojn Claessens, Corporate Governance…p. 62.
France, Great Britain and United States of America there are virtually no restrictions on arbitrability of corporate disputes. In Poland exists very obsolete regulation of this matter that prohibits commencement of arbitration proceedings in a case of non-pecuniary disputes\textsuperscript{96}. Legislators explained this by pointing out that some disputes cannot be decided upon by other body than a court because of public policy-related significance.

What is symptomatic, in western jurisdictions companies do value their position at the market and what their competitors and potential clients think about them. As a result, corporations, especially those listed on stock exchanges are more willing to reveal information without being forced to do so\textsuperscript{97}.

In conclusion, in the “other” legal systems both public and private enforcement methods are present, however companies and their stakeholders seem to be more eager to cooperate and taking advantage of private tool. It has several benefits, for example hiding intra-corporate problems from public view. As a result, problem within a firm cannot affect a company’s position and shares’ price detrimentally. Therefore transitional economies shall take a closer look at solutions adopted abroad since those regulations may enhance competitiveness and reduce vulnerability to economic crisis. In the next chapter some important improvements are suggested.

\textsuperscript{96} Art. 1157 and 1163 of Code of Civil Procedure.

\textsuperscript{97} For example, after IPO of Facebook and following drop in the price of share, Mark Zuckerberg made some official statements that were intended to calm investors. He also revealed Facebook plans for the future, which is usually crucial for shareholders’ decisions regarding buying/selling their shares.
VI. What are the best ideas to extract from other jurisdictions and how to apply them to legal environment of transitional economies?

Since there is possibility of unilateral implementation of best practices and voluntary compliance with corporate governance codes, why government should even think about amending law? The answer is simple – everything made on national level may bring greater results than “private reforms”\(^{98}\), understood as putting particular obligations into contracts between particular actors within a corporation. What’s more, usually investors first look at national, hard law, and only after it at private regulations. Thus good enforcement law may attract more capital to a country.

At the beginning here is a need to realize that although direct transplantation of legal provisions from one country to another is the most common method of amending particular legal solution\(^ {99}\), the question remains whether this is the most effective one. Of course there are some countries in which the legal system is perceived as a model jurisdiction\(^ {100}\) and other countries, especially developing, tend to implement solutions from them directly. Nowadays transitional economies are developed and they do not need to copy and paste whole legal systems without analyzing them, but they may try to implement particular legal provisions that not necessarily fit.

In this chapter, first the greatest problems that occurred in “enforcement environment” in transitional economies are touched upon, and second, ideas already used in other jurisdictions that would be are useful in Central and Eastern Europe are pointed out.


\(^{100}\) Curtis J. Milhaupt, Katharina Pistor, Law and Capitalism; What Corporate Crisis Reveal about Legal Systems and Economic Development around the World 207 (2008)
As it was indicated above, there are some common issues that emerge in all three transitional economies that have been chosen. First, in all of them there is an urgent need to have better trained judges, especially in capital markets issues, which area of law is very often neglected in law schools in Eastern and Central Europe. It would be welcome if judges have real business experience and advanced knowledge about practical aspects of functioning of corporate governance in listed companies.

Second, and this issue is directly linked to the previous one, national authorities shall introduce special courts for capital markets. Greater experience and narrower field of specialization means better fluency and proficiency in solving that type of problems. Good example to follow is Delaware Court of Chancery\(^\text{101}\), which is well renowned for their skillful judges and fast proceedings. Probably it is not possible to introduce this type of court in every country, and therefore European initiative in this issue would be welcome.

Third, appeal process lasts undoubtedly too long. As a result, it equals to denial of justice, since business life is very fast and hectic and deciding upon particular issues many months after underlining events is pointless. What can be done to shorten this period? First of all, judges and courts shall work more efficiently. Second, the issue of lack of knowledge about corporate matters also prolongs trials and appeals processes. If judgments are better drafted, parties are less willing to appeal.

As it was mentioned above, also approach to arbitrability of corporate disputes is perceived differently in other jurisdictions than in Poland. Arbitrability, being a core element of arbitration, may constitute a significant obstacle, if not regulated correctly. For example, in the U.S., the question of arbitrability never has been widely discussed by scholars. Importantly, according to U.S. law shall be governed solely by the general provisions on arbitration. First of all, an arbitration clause shall be treated as an ordinary

\(^\text{101}\) http://courts.delaware.gov/chancery/
contract between parties concerned. Second, both in the United States and in other common law countries is widely accepted that if the law does not directly provides for lack of arbitrability of a given category of disputes, it should not be deprived of this feature.

Then, it should be noted that the so-called. "non-arbitrability doctrine" has lost its previous importance in recent years, particularly in matters relating to international relations\textsuperscript{102}. Therefore, it must be accepted that virtually all pecuniary disputes may be subject to the jurisdiction of an arbitration court. In addition, it should be noted that in the United States is not possible to appeal against resolutions of shareholders meetings of public companies to court\textsuperscript{103}, what is possible under for example, Polish law. It should also be borne in mind that in the United States, arbitration is well established, and the general approach of state and federal law requires the adoption of its "pro-arbitration" rule (the federal policy favoring arbitration)\textsuperscript{104}. It is advisable to broaden a category of disputes that may be subject to arbitration since artificial narrowing of the scope of arbitrability in corporate law does not seem to serve any particular national of social interest.

Another question to answer is whether transitional economies are developed enough to have even a slightest possibility of existence of effective enforcement procedures. The key prerequisites for effective private and public enforcement are the following\textsuperscript{105}:

\begin{quote}
„1. central level of market maturity and sophistication;"
\end{quote}

\textsuperscript{102} P. Bowman Rutlege, R. Kent, C. Henel, [w:] Practitioner's Handbook on International Arbitration, p. 890
\textsuperscript{105} The list according to „Corporate Governance in Emerging Markets – Enforcement of Corporate Governance in Asia. The unfinished agenda.”
2. the awareness of managers and directors of their duties, and shareholders of their rights;
3. transparency and discipline;
4. the presence of enforcing institutions;
5. the integrity and efficacy of regulatory agencies and the court system;
6. a supportive legal framework;
7. a complete set of corporate and financial law”.

It is clear that markets in all three countries lack maturity and such level of development that is necessary to efficient functioning of corporate governance. Second, one of the greatest problems lays in awareness of managers, directors, shareholders of their rights and obligations that they owe to a company. Enforcing institutions are present, however very often their existence remains without measurable effects.

Especially the court system is obsolete and need amendments. Appropriate legal framework exists, however sometimes it was copied directly from equivalent legal acts from more developed countries, which caused that they are not adapted to reality of transitional economies because of lack of knowledge of entrepreneurs, business actors and attorneys.

On the other hand, it is obvious that even the most developed countries in the world cannot fulfill all the obligations listed above and they still struggle with some problematic issues within those major points. Therefore it is possible to have sufficiently efficient enforcement systems provided that at least two types of enforcements mechanisms are designed reasonably and with good recognition of business realities.
VII. Conclusion

In the light of the above it is reasonable to conclude that despite significant development of Central and Eastern Europe, there is still room for many improvements of corporate governance in transitional economies. As it was demonstrated, companies in Poland, Czech Republic and Romania still have to face many serious problems that may obstruct their day-to-day business, but also their development and expansion, and as a result, competitiveness in comparison with companies not only from Western Europe and America, but also from fast developing Asia.

One of the key issues is the way in which national courts operate. Specialized business courts, with faster and less bureaucratic procedure would be welcome. Second, speedy and pragmatic solutions should be implemented not only at national level, but also when it comes to private enforcement methods, for example arbitration.

Stress should be put also on court-conducted and court initiated settlements. Both entrepreneurs, members of companies’ bodies and legislators must use broad research and papers on efficient corporate governance in Western Europe and other countries. At the same time they need to try to amend those solutions in such a way as to make them the most suitable for business reality and legal environment of a particular country.

One possible solution also cannot be disregarded and national authorities have to become aware of it if a company is particularly dissatisfied with corporate governance and enforcement mechanisms: it may use „cross-listing” in order to enhance its relations with investors\textsuperscript{106}. This may cause problems for countries with poor corporate governance since companies have an alternative to being listed in their initial country. However, beforehand it has to be allowed by national law, as it was done by, for example, Korean

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\textsuperscript{106} Ozden Deniz, Reforming corporate…
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Financial Supervisory Commission\textsuperscript{107}. At the same time, it cannot be seen as a permanent solution to all problems permeating corporate law, and amending national law regarding this field may bring greater benefits than allowing cross-listings\textsuperscript{108}.

One of the most puzzling issues to be addressed in transitional economies is, unfortunately, not related to pure legal issues. Stakeholders and society, not only lay persons, but also business people are not properly informed about possibilities they are granted by law to seek compliance with corporate governance practices. And even if they are only partially informed, very often the law does not address particular problems in a way that is desirable from a point of view of a prospective investor.

Answering the question posed in the title of this paper, efficient enforcement of corporate governance in Poland, Czech Republic and Romania is possible, but the whole legal systems need several changes, not only from purely legal perspective, but also social and economic one. The most important problem is not law, but a way of how it is used by stakeholders, or more precisely, lack of knowledge that particular powers may be exercised.

\textsuperscript{107} Ibidem.