

Don't hit the wall: how to deal with (and prevent) default in real estate projects

Real Estate and Insolvency Commissions

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National Report for Poland

Anna Wyrzykowska

WKB Wiercinski, Kwiecinski, Baehr Sp. k.

ul. Polna 11

00-633, Warszawa, Poland

Tel: +48 22 201 00 72

anna.wyrzykowska@wkb.com.pl

1. Construction Contracts

1.1. Defending Employer's interests

1.1.1. Before entering into a construction contract, how can the employer¹ check the financial standing of the contractor²? Is credit/financial information publicly available in your jurisdiction?

In Poland, in order to find information about the bankruptcy of an entity you are interested in, you should visit the website of the Ministry of Justice and download and print a current excerpt from the National Court Register. It is also possible to obtain information about the submission of a bankruptcy petition of this entity. For this purpose, publicly available registers in the registry court can be reviewed.

There is no national authority that would provide credit/financial information for entrepreneurs. According to the Act on Disclosure of Business Information and Exchange of Economic Data, a private entity, after fulfilling certain conditions, may collect, store and share economic data about individual and corporate debts. The activity of business information bureaus is supervised by the Minister of Internal Affairs. Currently, there are four business information bureaus in Poland. They conduct competitive activities, so it is highly recommended to send a query to all of them (if any). They offer information that may help entrepreneurs during the verification of their business partners' payment credibility and payment reliability. However, it is worth noting that the databases maintained by these institutions are not nationwide, i.e. – no records in a given database guarantee the absence of debts.

1.1.2. Does your jurisdiction have standard conditions for construction contracts? If yes, what type of clauses do they provide for employers in case of contractor's insolvency?

There are no standard conditions for construction contracts in Poland. The contracts used most frequently for large-scale construction projects are FIDIC contracts, often referred to as the international standard. However, domestic contracts based on FIDIC General Conditions of Contract require modification and partial adjustment to Polish law, for example in respect of the right to rescind from the contract. Other contracts concluded in practice transfer most of the risks to the contractor.

There are some provisions of law, which have a significant impact on the contracting parties. According to the most important one, i.e. Article 83 of the Bankruptcy and Reorganisation Law *'any provision in a contract stipulating that the legal relation, to*

¹ The person, company or organization who contracts the constructor to design (if applicable), execute and complete the construction works.

² The person, company or organization hired to execute the construction works.

which the bankrupt is a party, is to be changed or terminated in the case of a declaration of bankruptcy, shall be null and void. It is also worth noting that, after bankruptcy has been declared, any change or expiry of a legal relation, to which the bankrupt is a party, shall be possible only in accordance with the provisions of the Bankruptcy and Reorganisation Law under pain of ineffectiveness towards the bankruptcy estate. In order to circumvent these provisions, the right to withdraw from the contract due to the contractor's fault is associated with earlier occurrences. In accordance with the common practice, the employer is entitled to withdraw from the contract if: 1) the applicable governing body of the contractor adopts a resolution on filing for the contractor's bankruptcy, 2) a petition for declaration of the contractor's bankruptcy is filed by the contractor, the financing institution or any other party, or 3) the contractor becomes insolvent or ceases to timely satisfy its payment obligations (which is, in fact, a prerequisite for bankruptcy). The effectiveness of such reservations is valued differently, because the aforementioned solutions are controversial. This is why the Bankruptcy and Reorganisation Law is planned to be amended in the closest future.

1.1.3. What kind of securities does the employer usually demand from the contractor?

The security is usually granted in one of the following forms: 1) an insurance guarantee, 2) a bank guarantee, 3) a cash deposit. During the procedure for the award of a public contract (under the Public Procurement Law) the contractor may also choose to pay a performance bond in one or more of the following forms: 1) an endorsement from a bank or a cooperative savings and credit union 2) a promissory note endorsed by a bank or a cooperative savings and credit union, 3) a registered pledge.

1.1.4. In case of contractor's insolvency during the project, what alternatives does the employer have in order to carry it through?

If bankruptcy open to arrangements has been declared, the bankrupt may continue its business activity (under the administrator's supervision). In such case, the parties may continue performing the contract.

If bankruptcy by liquidation has been declared, the trustee may administer the bankrupt's enterprise if it is possible to make an arrangement with the creditors. In such case, the contract may be executed by the trustee acting as the contractor. It is possible also that the trustee sells the enterprise of the contractor as a whole or in organised parts together with all contracts which can be continued.

1.1.5. What kind of role do clauses regarding transfer of title play in construction contracts? Are clauses under which the contractor's materials, equipment and tools are deemed to be the property of the employer upon the moment the contractor brings these to the site valid in your jurisdiction and do they limit the powers of the bankruptcy estate?

The title and ownership of the materials and equipment may be transferred from the contractor to the employer when a part of materials or equipment is delivered to the construction site. This solution is valid under Polish law, which does not change the fact that the contractors often protest against the introducing such provision in the contract (especially if the contractor bears the risk of loss or damage to the materials or equipment after the transfer of ownership). Generally, the transfer of ownership before the declaration of bankruptcy is deemed valid.

1.1.6. In case of employer's insolvency or loan default of the employer, is it typical that construction contracts contain instruments (e.g. novation agreements) for the financier to take over the project and the construction contract?

No, it is not typical at all. This kind of instruments are not popular in Polish contracts. Usually, no party (especially not the contractor) has the right to assign the contract without the consent of the employer. Non-assignment clauses are very frequent in the construction contracts.

The financing party may take over the project and the construction contract only if it was earlier agreed between the parties, i.e. not only the employer and the financing party, but also the contractor. The aforementioned situation is based on the idea of a contract for the benefit of a third party (*pactum in favorem tertii*). Also, if the project is externally financed, for example, by a bank, in practice you may find a sort of subordination deed between the employer and a bank, under which all contracts of the employer shall be transferred to the bank. In such case, the contractor is required to consent to the possible transfer of the construction contract. This is, however, a very rare case scenario.

1.2. Defending Contractor's interests

1.2.1. What kind of securities does the contractor usually demand from the employer? Are any of these securities mandatory in your jurisdiction?

Under Polish law, there are no mandatory securities in the construction contracts.

However, pursuant to the Polish Civil Code, the contractor has the right to demand that the employer provide a guarantee of payment for construction works to secure timely payment of the agreed remuneration for performing the construction works.

The acceptable security methods are: a bank or insurance guarantee, a bank letter of credit or bank suretyship granted upon the investor's request. The contractor may at any time demand a payment guarantee and this right cannot be excluded or limited. Failure to provide the demanded guarantee results in the emergence of the contractor's right to withdraw from the contract due to reasons attributable to the employer.

1.2.2. What other provisions (e.g. title retention, down-payment clauses etc.) are usually included in a construction contract to protect the contractor?

An advance payment (usually a maximum of 10%) is commonly accepted. The idea of milestones / separate stages of works, resulting in handing over and payment for the subsequent construction stages, is often applicable to the construction works contracts. In general, however, there is a problem with the balance of risk between the parties to the construction works contracts, which shifts to the detriment of the contractors.

1.2.3. Please describe the main effects on the contract in case of insolvency of the employer and focus on the following points:

- a) Does your jurisdiction have standard rules for termination of a contract in case of insolvency of the employer? If yes, can the parties deviate from these rules in their contract?
- b) If the contract does not end by law, who gets to decide whether the contract is terminated or not?
- c) If the contract is carried forward, is the employer still in charge or does the liquidator take over?

As mentioned above, Pursuant to the Bankruptcy and Reorganisation Law, any provision in a contract stipulating that the legal relation, to which the bankrupt is a party, is to be changed or terminated in the case of a declaration of bankruptcy, is ineffective.

On the date of declaring bankruptcy by liquidation, the bankrupt loses the right to administer and the possibility to use and dispose of the assets included in the

bankruptcy estate. Any legal acts of the bankrupt concerning the assets included in the bankruptcy estate are considered null and void. The insolvency trustee is the only contact person to deal with the bankrupt's business matters. There is a detailed regulation on the legal effects of an entrepreneur's bankruptcy on the contracts that he had concluded before the bankruptcy was declared. In practice, all further steps depend on the will of the insolvency trustee.

It is assumed that the construction works contract is a reciprocal agreement. Thus, the insolvency trustee may perform the obligations of the bankrupt arising under such contract that have not been performed in part or in full, and request that the other party render the reciprocal performance. The insolvency trustee may also withdraw from the agreement. It may be helpful that, upon the demand of the other party, the trustee shall, within three months, declare in writing whether or not he wants to terminate the agreement. The parties may not change the above-mentioned rules.

If bankruptcy open to arrangements has been declared, the bankrupt may continue its operations (under the administrator's supervision).

1.2.4. What happens to the claim for remuneration of the contractor towards the employer:

- a) In case of termination of the contract?
- b) In case the contract is carried forward?

First of all, it must be stated that, pursuant to the Polish Civil Code, the construction contract may not be terminated, but either party may rescind there from in very particular cases provided by the law or stipulated by the parties in the contract. As a rule, the effect of rescission is different to an ordinary termination of the agreement, as it puts the parties in the same position as if the contract had never existed (*ex tunc*), whereas termination usually takes effect at the moment of delivery of the termination letter to the other party (*ex nunc*). Therefore, the rescission of either party to the construction contract has the legal effect of erasing the contract as if it never happened. In such case, the remuneration of the contractor under the contract will not be due, unless the rescission was unjustified. Even if the rescission was justified, the contractor may claim remuneration for unjustified enrichment on the part of the employer.

The parties to the construction contract may explicitly stipulate therein that the rescission will be effective on delivery of the rescission letter (*ex nunc*). In such case, the contractor can claim remuneration for the works performed until the rescission. No remuneration is to be paid for any non-performed works.

If the contract is transferred partially, then the appropriate part of remuneration is to be transferred accordingly. The assignment agreement should specify the details of the

settlement of accounts between the assignee and the original employer. If the contract is transferred in whole, then the assignee assumes all duties of the employer. Therefore, the remuneration due on the assignment date should be paid by the new assignee, unless the assignment contract states otherwise.

1.2.5. During the project, who usually owns the parts of the building that have already been finished? Are there any rules in your jurisdiction that would allow the contractor to get a freehold of the construction site and continue the project with a different employer?

Polish law recognises the *superficies solo credit* rule taken from the Roman law. Therefore, regardless of what parties might agree on contractually, pursuant to the *superficies solo credit* rule, the owner of the land (employer or other investor) acquires the ownership right to what is located thereon. The contractor only possesses the land (is the factual holder of the land) and is contractually responsible for what happens thereon after the construction site handover (managing the site, implementations of safety rules etc.).

1.2.6. What kind of provisions should/can a contractor include in the contracts with his subcontractors to protect himself in case of the employer's insolvency?

Under certain conditions, the employer and the contractor bear joint and several liability for the payment of the remuneration for the construction works performed by a subcontractor. Any provisions contrary to the above-mentioned rule are invalid. The employer is liable for the remuneration of the subcontractor if the first consented to the agreement between the contractor and the subcontractor (or did not raise any objection to the contract between the contractor and subcontractor within 14 days).

In the contract with his subcontractors, the contractor usually tries to include clauses stipulating that the payment of the remuneration shall be contingent upon the consent of the employer (investor) to the conclusion of the contract with subcontractor, or upon the commissioning of the construction works. Since such provisions are not very favourable to the subcontractors, it is in practice very difficult to negotiate and include them in the subconstruction contracts.

2. Lease contracts

2.1. Is a lease affected by the foreclosure of a mortgage or other in rem guarantee over the leased property? May the new landlord terminate the lease?

The rights *in rem* that do not involve the right to use the land (e.g. mortgage) have no impact on the lease agreement for this land. The rights *in rem* authorising the entitled person to use the land may have an impact on the lease, unless the lease agreement has

been entered into the land and mortgage register of the property and enjoys priority over the rights that are not revealed in this register, or that were revealed at a later date.

In case of sale of the property, the acquirer becomes a party to the lease agreement in place of the previous landlord and may terminate the lease by serving notice within the statutory notice periods, unless the lease was concluded for a definite term in writing with a certain date (e.g. in writing and with signatures certified by a notary) and the property was handed over to the tenant. Therefore, if the tenant does not wish for the lease agreement to be terminated by the new landlord at any earlier time, the lease must be in writing with certain date and for a definite term. In such case, after the property is handed over to the tenant, the new landlord must continue the lease.

If the property is sold during enforcement or bankruptcy proceedings, the purchaser becomes a party to the lease as a new landlord as well. However, pursuant to a new provision in the Polish Civil Procedure Code (as of 3 May 2012) if the lease agreement is concluded for a definite period longer than 2 years, the purchaser of the property in enforcement or bankruptcy proceedings may terminate it upon one year's notice, even if the property was handed over to the tenant and the agreement was signed in writing with a certain date. No solution to prevent this termination may be recommended as this provision may not be modified or excluded by the parties to the lease agreement.

2.2. Does your jurisdiction afford any protection for the tenant in this case, for example, by guaranteeing the continuity of the lease agreement or a right of first refusal for acquisition of the leased property? Are there any requirements that need to be fulfilled if the tenant wishes to oppose these rights (if applicable) against his new landlord.

As mentioned in the response to Clause 2.1., only contracts in writing with a certain date and for a definite term may be protected from early termination by the new landlord, unless the property was not handed over to the tenant yet. In case of a contract for a definite term but only in writing, the tenant may obtain the certain date by himself by requesting the administrative authorities or a notary to confirm the date on the tenant's copy of the contract. According to the jurisprudence of the Polish Supreme Court, such an action is effective and prevents the new landlord (who actually may not be aware that tenant obtained a certain date on his copy of the contract) from terminating the contract early.

2.3. In case of insolvency of the tenant, is the landlord entitled to terminate the lease? Are insolvency clauses common in lease agreements in your jurisdiction? Are they normally upheld in court?

As mentioned above, according to Article 83 of the Bankruptcy and Reorganisation Law *'any provision in a contract stipulating that the legal relation, to which the bankrupt is a party, is to be changed or terminated in the case of a declaration of bankruptcy, shall be null and void.'* No exception is made to the aforementioned rule in

respect of the lease agreement. In light of the fact that the termination of the lease in case of insolvency of any party to the lease is impossible, it happens frequently in practice that the contracts stipulate termination in the case of submission of a petition for declaration of bankruptcy, or if the tenant ceases to timely satisfy its payment obligations (which is actually a prerequisite for bankruptcy). However, such clauses are deemed controversial and may be interpreted as circumvention of the law.

Obviously, if the tenant goes bankrupt, the landlord may terminate the lease subject to the provisions of the lease agreement. Though, as stated above, the lease agreement may not state directly that the landlord shall be entitled to terminate the lease in case of bankruptcy of the tenant.

According to the provisions of the Bankruptcy and Reorganisation Law, in case of bankruptcy of the tenant, if the property was not handed over to him yet, the landlord may withdraw from the lease agreement within 2 months of the date of declaration of bankruptcy of the tenant. In such case, no indemnity for early termination is due to the landlord.

If the subject of the lease agreement has already been handed over to the tenant, in case of his bankruptcy, the trustee may terminate the lease, even if the termination by the bankrupt was inadmissible. If the agreement pertains to a real property where the bankrupt operated its enterprise, the termination shall be made with a six-month notice, whereas, in other cases, with the statutory termination notice, unless the agreement provides for a shorter termination notice. The agreement may not be terminated before the end of the period, for which the rent has been paid in advance. Under an order of the judge-commissioner, the trustee may terminate the lease before the end of that period, if the continuation of the agreement were to impede the conduct of the bankruptcy proceedings, and, in particular, when it increases the costs of bankruptcy. In such case, the landlord may claim compensation in bankruptcy proceedings for the termination of the lease before the date set forth in the agreement, for a period no longer than 2 years.

2.4. What kind of securities does the landlord usually demand from the tenant? How tenant's insolvency may affect the ability of the landlord to execute these guarantees and collect rent and other monies due to under the lease?

The typical security in lease contracts is a bank or insurance guarantee, a cash deposit (equal to several months' rent) and a notary deed on the submission to enforcement proceedings (usually in the case of rent and service charge payments), which significantly shortens the court proceedings.

The impact of the declaration of bankruptcy of the tenant on the bank or insurance guarantees depends on the wording of the guarantee letter. For this reason, the landlord should obtain a guarantee indicating directly that the right to use the guarantee is preserved in case of the tenant's insolvency.

As to the cash deposits, if the lease agreement is continued during the bankruptcy proceedings, the landlord is entitled to preserve the deposit. In case the lease is terminated (please see response to the Clause 2.3. above) the landlord should return the deposit.

The notary deed on submission to the enforcement proceedings does not secure the landlord against the insolvency of the tenant, since, in such case, in order to seek compensation from the tenant's assets, the landlord must claim compensation in bankruptcy proceedings in accordance with the general rules set forth in the Bankruptcy and Reorganisation Law.