Agata Cebera
Jagiellonian University in Kraków (Poland)

Aleksander Wróbel
Jagiellonian University in Kraków (Poland) & Uppsala University (Sweden)

**Compensation Liability for Damages Incurred while Exercising Public Authority:**
a Basic Pillar of Democratic State Ruled by Law

**Abstract:** The leading aim of this paper is to portray the constitutional institution of compensation liability for unlawful acts of public authorities in Polish law related to the development of general principle concerning democratic rule of law. Compensation for damages brought upon the citizens by civil servants constitutes a basic pillar of contemporary democratic state, because it guarantees acting by public authorities in compliances with law and deepen trustfulness. It is also said that the state of the above-mentioned institution indicates the development of democracy.

**Keywords:** democracy; state liability; investment arbitration.

**Introduction**

The main aim of this text is to present the constitutional institution of compensation liability for unlawful acts of public authorities in Polish law related to the development of general principle concerning democratic rule of law.

The conducted research pertaining to the issue of liability for damages inflicted while exercising the public authority in the legal systems of contemporary states give a basis to the thesis that at present nearly all democratic states provide for this liability. Particular legal systems differ only in its subjective and objective realms. From the conducted research it arises that, from the historical perspective, the ideas of democracy
and compensation for damages inflicted by the state developed independently. Not until the beginning of the 20th century could one observe their co-effectiveness in legal systems. As far as we are concerned, compensation for damages incurred to citizens by civil servants constitutes a basic pillar of contemporary democratic state, because it guarantees acting by public authorities in compliances with law and deepens trustfulness. It is also said that the state of the abovementioned institution indicates the level of development of democracy.

**Development of State Compensation Liability**

It is indispensable to start with indicating the early beginnings of liability of the State, which are dated back to the Roman law (Kosik, 1961). It needs to be stressed that in Polish legal system above-mentioned institution emerged in the art. 121 Act of 17 March 1921 – Constitution of Poland (Act of 17 March 1921 – Constitution of Poland; Journal of Laws of 1921, No. 44, item. 267; hereinafter referred to: “m.c.”). In accordance with this regulation, all citizens were entitled to demand redress damages sustained by the improper performance of official’s actions or while breaching other statuary duties by the State (or civil and military authorities). While analysing the wording of the art. 121 m.c. one should notice that on the one hand Poland was the first country in which the right to demand redress damages incurred by public authorities was stipulated in Constitution (Safjan, 2004). However, significant doubts occur, whether this regulation consisted of only a non-binding standard, or if it was directly applicable (Bagińska, 2010; Banaszczyk, 2012; Winiarz, 1956; Zylber, 1933, Stelmachowski & M. Wawilowa, 1956; Kosik, 1961). The aforementioned dispute had not only theoretical dimension, but also a practical one which takes its origins in these analyses. All in all, in the jurisdiction of the Supreme Court prevailed the paradigm based on the assumption of non-binding character of art. 121 m.c. (for example: Judgement of Supreme Court of 16 December 1927).

Adoption, on 27 October 1933, the Code of obligations (President’s ordinance from 27th October 1933 – Code of obligations; Journal of law No. 82, item 598 with further amendments) constituted the next step in the development of an institution of compensation liability of the state. The main aim of this codification was the unification of the general principles of obligation law. The Code came into force on the 1 July 1934, notwithstanding continued the lack of regulation related to the tort liability of the State for official acts (Bagińska, 2010). Ascertaining to that, one should bear in mind that there was a deficiency of the act regulating the liability of official activities, which State should have established on the basis of art. 121 m.c. In connection with presented circumstances, the State’s liability for official acts was
limited, because jurisdiction maintained the previous notion of non-binding character of art. 121 m.c. – it conveys that this provision still could not constitute a separate basis for compensation claim.

A common reason of such state of matter emphasized by most authors was adverse and difficult political situation of the State. One should also notice that in both the jurisdiction and doctrine, distinction of two different areas of the State’s activity became troublesome in the new political and constitutional system (Szpunar, 1985; see also: Judgement of Supreme Court of 15 November 1945; Judgement of Supreme Court of 29 October 1945; Kosik, 1961). As Ewa Bagińska (2010) indicates, the state had a dominant position not only in the area of superior acts, but also in the area of economic activity and in proprietorship relations, consequently that dividing acts into one of those two specific types was not only difficult, but also impossible. The same notion is presented by Marek Safjan (2004), who has pointed out that in the reality of the communistic system with power, proprietorship and economical activities, condensed in one hand of the State, lack of division of official and economical acts was fully understandable.

The scholars had a common conviction that establishing a new constitution of Poland of 1952 did not bring any changes because the later just omit this issue (Haczkowska, 2007). It is worth pointing out, that up to the establishment of Act of 1956, there was no unitary legal regulation related to the liability for illegal acts in Poland. The characteristic feature of this act concerned progressive and innovative elimination of the exhaustive and disjoint division for official and economical acts (See also Judgement of Supreme Court of 31 October 1950, p. 802. See: Banaszczyk, 2010; Kosik, 1961; Winiarz, 1956). Ascertaining to the comments made above, one should be aware that the next level of development of tort liability of State was related to the connection of this liability with the person who performed an act, but no longer with the character of this act (official or economical). In the simplification act of 1956 had adopted subjective criterion, not the criterion of the character of an act. In other words, liability of the State was related to all acts performed by civil servants regardless of the legal form of this act or area of taken activity. In Bagińska’s (2010) opinion, it occurred with incorrect state of affairs commonly called as “stratification of liability”. It is based on the assumption that a legal regime of indemnification should not depend on the legal character of the entity performing an activity, conversely on the character of his activity.

Enactment on 2 of April 1997 the Constitution of the Republic of Poland was a quantum leap in the development of the institution of damages caused by illegal performance of public power not only due to the fact of raising to the rank of the constitutional principle of compensation liability of the country (Banaszczyk 2012),
Furthermore it made alternation to the form and character of the compensation liability.

In the Judgement of the Supreme Court of 4 of December 2001 (SK 18/00, OTK 2001, nr 8, poz. 256.) Court rules that art. 418 of the Civil Code is unconstitutional according to art. 77 part. 1 and art. 64 of the Constitution of the Republic of Poland. While decrypting the requirements of the compensation liability included in the art. 77 part. 1 of the Constitution, the Court called attention to the fact, that ground of liability is exclusively “illegal” act of the authority, as a result it is irrelevant whether act was culpable.

Aforementioned article is situated in the group of articles regulating measures of protection of rights and freedoms, thereby permissibility of formation by the law, additional requirement embodied in notion of guilt, would give a rise to confinement of constitutional frames of protection of those rights and freedoms. For this reason, Tribunal endorsed that:

a) Compensation liability provided in art. 77 part. 1 of the Constitution is attached to the activity of each public authority entity, which does not coincide with a scope included in the Civil Code. The latter locates above mentioned liability on the side of the Treasury (state legal entities) and local government entities (local community legal entities). Thereby one can notice the crossing relation: on one hand each state (local community) legal entity is categorized as public power, on the other hand one, can name non – state (non-local community) legal entities, which realize certain prerogatives of public power;

b) Compensation liability described in art. 77 part. 1 of the Constitution is not bridged with the activity of particular officials, but with the activity of the public entity. It implies that for emergence of liability the structural place in the entity is not pertinent;

c) According to established line of jurisprudence (Guidelines of the Supreme Court of 1971), an obligatory requirement of liability of the Treasury stemming from art. 417 of the Civil Code juxtaposed with art. 77 part. 1 of the Constitution is the cause of limitation of the liability of the Treasury. This opinion was interfered with a so called anonymous or organizational guilt, which sanctions compensation liability connected with the activity of an unidentified official.

In the ruling of 23 September 2003, Constitutional Tribunal stressed that art. 77 part. 1 of the Constitution is embodied in directly binding norm, not a program norm (K 20/02, OTK-A 2003, no. 7, item 76.). Consequently, up to that time regulations provided in Civil Code ought to be adjusted to the conditions and frames introduced by the new Constitution.
Amendments act of 17 June 2004 (Act of 17 June 2004 amendment of the Civil Code and additional act, Dz.U. 162, 1692.) vested the present day form to the institution of compensation liability for illegal activity of the public power entities. Due to the current legal regulation, the prerequisites of compensation liability of state are: 1) exercising public authority; 2) illegality; 3) causation. It is worth to allude that; tort liability of the State is related to the character of performed activities. All the entities executing official (imperial, superior etc.) activities are per se considerate as public authorities, regardless their position in the state system (as public authorities may be also qualified private entities while exercising official or superior activities). The fault of the civil servant is no longer required as a prerequisite of this liability.

Development of Democratic State Ruled by Law

In accordance with the definition of democracy established in Oxford Dictionary (see: https://en.oxforddictionaries.com/definition/democracy), it is a system of government by the whole population or all the eligible members of a state, typically through elected representatives. As Mariusz Krawczyk (2016) indicates, in our cultural area, it is commonly accepted that, in present times democracy does not constitute an unlimited power of people (nation), because this power is limited by the idea of state ruled by law. Zbigniew Kmieciak (2016) rightly stressed out that it is related to the “rule of law” defined by W. Petersen. One can only add that a democratic state is the state in which law reflects a social system which is accepted on natural law and on standards adopted in international law (Orłowski, 2004). W. Skrzydło (2013) emphasizes that, in a democratic state ruled by law, not only the rights of the majority should be assured, but also the rights of the minority. Due to “rule of law”, law is seen as a guarantee of personal freedoms and property of the entity (Kmieciak, 2016).

The first legal system which has adopted the principle of a democratic state ruled by law, was the German one (Constitution of 1949). In the Polish legal system this principle was established on 31 of December 1989 as a result of an amendment of art. 1 of Constitution of Polish Peoples Republic 1952. Currently, art. 2 of the Polish Constitution relates to this basic principle of contemporary state – the principle of a democratic state ruled by law (Rakoczy, 2013). As W. Skrzydło (2013) indicates, due to this principle the state should see to an influence of citizens on public authorities, their presence while making decisions in public matters.

Sokolewicz (1990) defines the democratic state ruled by law established on four basic standards: 1) predominance of law, 2) the requirement of legal basis for all
activities taken by public authorities, 3) the right to fair trial, 4) separation of powers. R. Tokarczyk (2016) observed that state and law remain in a mutual relation and a rival for predominance. When a public authority prevails, dictatorships formed. When law prevails, public authorities, democracy grow up (Tokarczyk, 2011).

At present the foundations of democracy encompass deepening the trust of citizens to the state authorities, which requires the establishment of legal institutions that will insure protection of the citizen from abuse of law by the authorities. Limiting this notion to the traditional legal aids and standards such as the right to be tried is not enough, hence an increase of the importance of the compensation liability of the State Treasury or other public entities. It is worth pointing out that Polish legislator was a “possibilist” – abuses and violations may occur, but one should establish a system of restoring imbalance in relation between public authorities and state caused by deviant behavior of civil servants. It means that the compensation liability of state constitutes a basic pillar of contemporary democratic state, because it is one of the guarantees acting by public authorities in compliances with law. Violations will be punished by the compensation liability of public entities, or even by the individual liability of civil servant. Such pecuniary and disciplinary sanctions reduce abuses of the power, and in fact constitutes a guarantee of democratic state ruled by law.

**Development of Compensation Liability and the Principle of Democratic State Ruled by Law**

It means that the development of compensation liability for illegal acts of public authorities is consisting of the following steps:

a) State was liable only for economical deeds. Only exceptionally State could bear liability for other activities, like e.g. official deeds;

b) State was liable for all acts performed by civil servants regardless the type or area of this activity;

c) State is liable for all action, but the scope of liability depends on the character of taken action. Stricter liability uninfluenced of fault perquisite is related to acts constituting “exercising public authority”, the rest is based on the general principles of tort law.

One should also notice that on the basis of another criterion we can distinguish:

a) period before 17th October 1997 – liability for illegal acts of public authorities was based on principle of guilt and the scope of compensation was limited to *damnum emergens*;

b) period after 17th October 1997 -- liability for illegal acts of public authorities was no longer based on principle of guilt and the scope of compensation was
no longer limited to *damnum emergens*, but contains also compensation for *lucrum cesans*.

To conclude the above discussion, it needs to be stressed out that one can observe a direct mutual influence between the development of institution of compensation liability of the State and development of democracy. The compensation liability of the State constitutes a basic pillar of contemporary democratic state, because it guarantees acting by public authorities in compliances with law. For the subject of these consideration, it is necessary to point out, that rapid development of democracy in Poland after 1989, caused a rapid development of institution of compensation liability of state, especially significant extension of this liability.

**State Compensation Liability– an Example of Improper Protection of Shareholders**

In this part of this study, the Authors will present an example of current legal aridness of compensation liability regulation, and later – on this basis predict the direction of its development in the future regarding to the development of the standards of a democratic state ruled by law.

According to art. 77(1) of the Constitution of Poland each person has a right to compensation of damages which were caused by the illegal action of the state entity. Article 417 § 1 of the Civil Code clarifies, that for the damage caused by illegal act or omission connected with performing the state power, is the State Treasury liable, local government unity or legal entity performing the state power on a legal basis. Even a cursory analysis of the art. 417 of Civil Code and art. 77 part 1 of the Constitution of Poland leads to the conclusion neither of them contains no provisions concerning an incurred person (Radwański, 2004; Banaszczyk, 2012). Aforesaid observation has a vast consequence on practice, because it means that according to general rules of civil law, incurred subject of civil law is entitled to claim a compensation (Radwański, 2004), also legal person i.e. stock company (Radwański, 2004).

That issue causes a dilemma, whether a shareholder is entitled, due to a decrease of the stock value of a stock company (S.C.), which is the consequence of a damage caused by the state entity? In the literature on the subject one can read that this is a liability for so-called indirect damages (Kaliński, 2014), so damages to directly damaged entity which is a result of an act or omission, and by that is direct to the interests of third persons (Kaliński, 2014).

The core issue of the problem can be reduced to furnish the answer on the question, whether shareholder can claim the redress for the damage caused as a result of actions directed against the company group. According to a first approach, presented by the
M. Kaliński (2013), above mentioned possibility is excluded. This author stressed that an action which can cause harm to the company can indirectly violate the right of a shareholder, by decreasing the value of his stock, but still the fact of indirect damage cannot grant the right for compensation. According to M. Kaliński, this stems out of the rule of limitation of the indemnity to the entities which were directly harmed by the abuse of power – the amount of harm parties cannot be indefinite. Cited author depicts proposed statement by giving the following example. The shareholder has received a compensation for the harm caused by the decreased value of the stock. Later on, company itself claims, damages, which does not take into consideration the court’s ruling issued as a result of proceedings between a shareholder and a debtor. There are no grounds to count previous damages paid to shareholder in lieu of the claim of the company.

M. Kaliński (2012) pointed out that each of the entities has its own assets, disparate from each other. This designates that according to the opinion of the cited author, shareholder by claiming damages, satisfies one’s damages, and as a result, succeeding satisfaction of the claim of the company can effect double indemnity, because shareholder would already receive the compensation. A. Opalski (2012) agrees with the latter position. He states that harmed entity in this category of cases is only company, thereby not a shareholder. A similar approach was presented by Błaszczyk (2011). He underlined that in described situation there would exist a causal link between shareholders claim and compensation and an action taken against the stock company.

A different approach was adopted by the Supreme Court of Poland in ruling from 22 of June 2012. It reasoned that a capacity to sue, basing on article 417 § 1 of the Civil Code, can be granted to the entities, which rights and interests were a subject of indirect breaches caused by abuse of the state’s power. In the grounds of the rulings The Court commented the relations between the company and the shareholder. A stock company is one of the types of capital companies, the core meaning of which is the separation of management and ownership functions.

The Supreme Court stressed out that the company and shareholder have separated assets. In an economic point of view shareholder may be classified as an owner, but due to the legal requirements until to the company’s liquidation complete he is not entitled like an ownership to a company's assets. The Court pointed out that stock (with some restrictions) may be offered on the trade market, and the sale price may be different than the market value. One should notice that deterioration of the company position results in impairment of the market value of stocks. As the Court pointed out, this mutual influence indicates that deviant behaviour incurring damages can indirectly violate shareholders rights and decrease market values of stocks. Due to
In this jurisdiction there are no reasons to limit liability, when this illegal behaviour constitutes exercising public authority.

In the next judgment of 26 March 2014 the Court confirmed that claims for redressing damages incurred to shareholder indirectly (as a result of the illegal decision addressed to the company) may be accepted but one should distinguish two different categories of those claims. First of all, claims subsidiary to a company can distinguished. Secondly, one can distinguish individual claims based on indirect violation of the rights of shareholders, which sparked off damages exceeding damages incurred to the company. This judgment seems to correspond with the Judgment of the Supreme Court of 22 June 2012. In other words, it can be indicated that in the first situation shareholder’s claim is not individual, because in the company’s balance sheet should be shown asset – receivable for payment of compensation. Pecuniary performance of this obligation cause increase in the value of stocks. Moreover, lack of the company’s activity in the execution of this receivable entitles a single shareholder to lodge a claim on behalf a company on the basis of art. 486 Polish Commercial Companies Code. Negligence of a shareholder cannot bring him additional benefits at the cost of the company and the creditor by increasing the scope of demanding compensation. To conclude the above discussion, it needs to be stressed that shareholder is entitled to lodge a claim for reduction of a stock’s value only when this claim has individual character (not a subsidiary).

Aforesaid should not confine only to the area of domestic law but should be elucidated from the perspective of alternative methods of dispute resolution on an international level, such as international investment arbitration. International investment arbitration law perspective will provide an invaluable comparison with its solutions adopted on international level, imperceptibly present in various ways in domestic legal systems, including Polish. The perfect example of its presence and the need of comparison is materialised in the way of protection of shareholders of the State companies on the domestic level with all its restrictions and international level, which is open only for foreigners, for example, shareholder with Ukrainian citizenship or legal entity registered in Ukraine. The parties of investment arbitration are quite unique, because one of them is country and the other is embodied by the person of an investor. The aim of this juxtaposing is to show the minuses of domestic solutions and harmfulness of certain doctrinal discussions, concomitantly it is to provide possible directions of development of polish in the realm of shareholder rights protection.

In this work, the authors analysed as an example Bilateral Investment Agreement for promotion and security of investment adopted on January 12, 1993 (**Bilateral Agreement Between Governments of Poland and Ukraine about mutual promotion and protection of investment, 1993;** “BIT”). In article 1 part 4 of the BIT states that each
party of the BIT will protect investments made by the investors from Poland on the
territory of Ukraine and at the same time investments made by Ukrainian investors
made in Poland are protected on the territory of Poland. Foregoing article 9 in part
2 provide, that in the case of a dispute which would not be solved in diplomatic
matters in 12 months, will be directed to arbitration committee with three arbitrators.
Mentioned BIT is giving a ground for investment arbitration under certain conditions.
First of all, there should be an investment and it should be made by an investor. At
the same time BIT is providing the definitions of both investor and investment.

The notion of investor is regulated in article 1 part 1. Enumeration of subjects
given by the article is quite wide and names, i.e. from physical person – citizen of
Poland or Ukraine, legal entities and are performing “real economic activity” on the
territories of one of the countries.

Under the word “investment” BIT name among others movable goods and related
rights, money demands and what is interesting from our perspective – shares, parts
of the companies, etc. Whereby, physical person or legal company, who purchased
the shares of a stock company, also partially state-owned company, can make a use of
protection on the way of international investment arbitration proceedings if her rights
were violated and it caused direct, and what is more interesting, indirect expropriation
of the investment. Under direct expropriation one should understand taking the
investment form the investor and by that deprive investors of his investment. When
indirect expropriation occurs, it “leaves the investor’s title untouched, but deprives him
of the possibility of utilizing the investment in a meaningful way” (Dolzer & Schreuer,
2008).

Going further BIT provides possibility for the investor e.g. from Ukraine, invest-
ing on the territory of Poland, to commence arbitration against Poland in case of
expropriation. Comparing to polish domestic regulations where Polish citizens cannot
go to the court to protect their shares independently, where Ukrainian citizens can
commence arbitration proceedings against Poland only by fulfilling the demands of
investment and investor on the basis of BIT. To paraphrase, Ukrainian investor can,
without the interruption of the organs of the company, also state company, go to an
arbitration committee and demand compensation for diminishing the price of a share
and by that – expropriation. This article does not explain the question whether this
arbitration will succeed, the most important is the possibility to assert the rights before
the arbitration committee.

This situation is placing polish shareholder in a much worse position comparing
to foreign investors and is an encouragement to go in the direction of treaty shopping
by registering fictional companies which can fulfil the demand of real economic
activity.
An example of BIT between Poland and Ukraine is one of the examples of protection of shareholders through international agreements. Investment in the form of shares is also protected by NAFTA in article 1139, which is stating that by the investment one should understand “equity or debt securities”, which defines them “includes voting and non-voting shares [bolded by A.W.], bonds, convertible debentures, stock options and warrants” (North American Free Trade Agreement, 1994). Another known Multilateral Investment Treaty protecting shares in stock market company in the area of the energy sector is the Energy Charter Treaty (ETC). In article 1 (6) (b) ETC enumerates as an investment “a company or business enterprise, or shares, stock [bolded by A.W.], or other forms of equity participation in a company or business enterprise, and bonds and other debt of a company or business enterprise…” (Energy Charter Treaty and Related Documents, 1998).

Conclusions

To sum up, given examples of alternative method of investment protection of a foreign investor and investment and by that putting polish investors in a worse position than foreign investor is counter the rule of the country’s liability for damages according to article 77 part 1 of Constitution of Poland, which is to secure the rule of law. Every deviation from the principle of legalism leads to an abuse of power by the state together with its entities and by that is violating the standards of the modern democratic state. The most accurate and relevant words summarizing this work are the following words of famous author H.C. Gutteridge (2015) “The boycotting of courts of law by men of business and the drifting away of commercial litigation into the hands of arbitrators is, to no small extent, the result of a marked disinclination to run the risk of becoming involved in the mesh of rules of conflict [scholar discussions – A.W] which are so complicated and obscure that neither merchant nor his legal advisers can foresee their effect on the rights of the parties with any reasonable degree of certainty.”

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Authors

Ms Agata Cebera LL.M.
Jagiellonian University in Kraków, Department of Administrative Procedure. Contact details: ul. Olszewskiego 2, 31–007 Kraków, Poland; e-mail: agata.cebera@doctoral.uj.edu.pl

Mr Aleksander Wróbel LL.M.
Jagiellonian University in Kraków, Department of Penal Law & Uppsala University. Contact details: ul. Olszewskiego 2, 31–007 Kraków, Poland; e-mail: awgp.wrobel@uj.edu.pl.